REVENUE ACT OF 1963

15-65-5

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-EIGHTH CONGRESS

FIRST SESSION

ON

H.R. 8363

AN ACT TO AMEND THE INTERNAL REVENUE CODE OF 1954 TO REDUCE INDIVIDUAL AND CORPORATE INCOME TAXES, TO MAKE CERTAIN STRUCTURAL CHANGES WITH RESPECT TO THE INCOME TAX, AND FOR OTHER PURPOSES

OCTOBER 21, 22, 23, 24, AND 25, 1963

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REVENUE ACT OF 1963

MONDAY, OCTOBER 21, 1963

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

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

Present: Senators Byrd, Smathers, Douglas, Gore, Talmadge, McCarthy, Ribicoff, Williams, Carlson, Bennett, Curtis, Morton, and Dirksen.

Also present: Hon. Herbert S. Walters, U.S. Senator from Tennessee.

Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. William Keel of the Democratic National Committee.

Mr. Keel, will you come forward and proceed with your statement?

You may proceed, sir.

STATEMENT OF WILLIAM KEEL, RESEARCH DIVISION, DEMOCRATIC NATIONAL COMMITTEE; ACCOMPANIED BY HAROLD LEVENTHAL, COUNSEL, DEMOCRATIC NATIONAL COMMITTEE

Mr. KEEL. I have here with me today Mr. Harold Leventhal, who is counsel of the Democratic National Committee.

I would like to read a statement if I may.

The CHAIRMAN. You go ahead, sir, and make any statement you care to make.

Mr. KEEL. My name is William Keel. I consider myself a permanent resident of Nashville, and am a registered voter in Tennessee.

Senator SMATHERS. Will you talk a little louder, Mr. Keel? I cannot hear.

Mr. KEEL. I think there is something the matter with this microphone.

Senator BENNETT. You are not talking into it.

Mr. KEEL. My name is William Keel. I consider myself a permanent resident of Nashville, and am a registered voter in Tennessee, although at present I am living in an apartment house at 1507 Parkwood Terrace, Falls Church, Va. Since May 1963, I have been head of the Research Division of the Democratic National Committee.

Mr. Chairman, you asked me to appear today with my records to enable me to answer questions relative to the sending and the subject matter of a telegram I sent October 11 to Sam R. Taylor III, Johnson City, Tenn., transmitting a suggested press release for Mr. Taylor to dispatch to news media.

I am, of course, willing and desirous of answering your questions. However, I would appreciate the privilege of making an introductory explanation to the committee, and particularly to my Senator, Senator Gore, because there has apparently been misunderstanding of the significance and purpose of my wire.

The idea of sending the wire came to me as an outgrowth of work I have been doing in developing information on the importance of the tax program which was sent by Chairman Bailey to Governors and key Democrats throughout the Nation.

But it was solely my own idea to reinforce this general information program with the specific release that I sent to Mr. Taylor concerning the importance of the tax bill for Tennessee. I wish to make it perfectly clear that I prepared and sent the wire to Mr. Taylor without consultation with anyone else, either in the Democratic National Committee or elsewhere.

This wire grew out of my strong personal conviction that the administration's tax reduction program was important for the Nation and for the State of Tennessee. The bill passed the House with the support of the entire Democratic delegation from Tennessee. Senator Walters has also indicated he is in favor of a tax reduction program.

The wire has been referred to in some newspaper stories as a "purge" wire. Such a possible interpretation never even crossed my mind.

I have always supported the candidacy of Senator Gore. As a reporter for the Nashville Tennessean I have assisted Senator Gore in some of his crusades. The one I recall particularly was his investigation of excessive mortgage money rates.

Neither I nor anyone else would want to impinge in any way on the right, and even duty, of Senator Gore to cast his vote on any measure according to the free exercise of his conscience.

However, I am confident that Senator Gore, like any other Senator or Congressman, is interested in the views of local party and community leaders on salient issues.

The wire I sent Mr. Taylor was based on the assumption that I had, after talking to him on the telephone, that he was in favor of the administration's tax reduction program and wished to have the benefit of the data I had available on the subject.

There may be some question of judgment as to the way in which this release was drawn up, and specifically the fact that Senator Gore was mentioned by name.

Although general material on tax reduction has been sent to all States, there has been no other instance in which a Senator was singled out by name. This particular instance was a happenstance arising out of the fact that I have my roots in Tennessee, and became particularly upset by the fact that Senator Gore's has been a militant voice against the tax cut bill.

Perhaps I acted out of an excess of zeal. It was my hope that Senator Gore would come to support the administration's tax cut program. But there was no doubt in my mind that he would do so only if he became convinced by public opinion that it was consistent with the best interests of his State and the Nation.

Thank you again for the privilege of making this explanation. I regret any confusion or misunderstanding I may have caused.

The CHAIRMAN. Thank you, Mr. Keel.

The Chair recognizes the Senator from Tennessee, Senator Gore, on a matter of personal privilege.

Senator GORE. Mr. Keel, first I want to thank you for your support of my candidacy in Tennessee. I am grateful for your friendship and support.

The matter under consideration now is not the action of an individual citizen but an action which you took as an official of the Democratic National Committee.

Are you one of the top officials of the Democratic National Committee, or rather, do you hold one of the top positions at the Democratic National Committee?

Mr. KEEL. That is a difficult question to answer. I would say an intermediate position.

Senator GORE. What is the salary in the position you hold?

Mr. KEEL. $15,000.

Senator GORE. Do you know how many division heads there are in the Democratic National Committee organization?

Mr. KEEL. It is difficult to explain the structure of the national committee because it varies. I cannot answer that question.

Senator GORE. At any rate, you do hold the position of head of the research division?

Mr. KEEL. That is true.

Senator GORE. And the telegram to which reference has been made was dispatched to Tennessee in that official capacity?

Mr. KEEL. I sent the telegram to Tennessee.

Senator GORE. Mr. Keel, on the motion by Senator Douglas to provide a hurried and unusual consideration of this bill, many Democratic Senators voted as I did. The chairman did not vote.

Senator LONG. No such telegrams were dispatched to Louisiana, as I understand it.

Mr. KEEL. There was no news release of this sort to Louisiana.

Senator GORE. The junior Senator from Florida, Senator Smathers, who is assistant Democratic leader, voted as I did. Were any such telegrams sent to Florida?

Mr. KEEL. There were not.

Senator GORE. Senator Talmadge of the neighboring State of Georgia, a State which has always gone Democratic throughout its history—as I understand it no such telegram was sent to this State.

Mr. KEEL. That is correct.

Senator GORE. Senator McCarthy—would you give the same answer there?

Mr. KEEL. I will say there were no telegrams sent to these States that named the Senators.

Senator GORE. Senator Ribicoff of Connecticut voted as I did, and since he comes from the same State as Chairman Bailey, one would think that if a campaign of political coercion was to be undertaken generally that the Chairman would not overlook the Senator from his own State.

Senator RIBICOFF. Will the gentleman yield?

Senator GORE. I yield.

Senator RIBICOFF. I would say that Chairman Bailey is too smart to have ever sent such a stupid telegram.

Senator GORE. Mr. Keel, you say in your statement that the action which you took was not the subject of discussion or conference between you and anyone else.

Mr. KEEL. That is correct.

Senator GORE. Either in or out of Government?

Mr. KEEL. That is correct.

Senator GORE. Either connected with or not connected with the Democratic National Committee?

Mr. KEEL. That is correct.

Senator GORE. So you take sole responsibility for it and say it was your act and yours alone?

Mr. KEEL. That is correct.

Senator GORE. Maybe that is the reason it was aimed at me alone. Now, as a citizen of Tennessee, Mr. Keel, please understand that I do not question in any way your right to criticize, to question, to urge a change of position, or to take such action as you wish to bring about the kind of representation in the Senate or in the House on a particular question, or in general, you think best. The complication arises here because you did not act just as a citizen of Tennessee, but as Chairman of the Research Division of the Democratic National Committee, and as you have testified here, such action was not taken with respect to any other members of this committee on the Democratic side.

I will leave our Republican friends out of it. They are fair game. But I call to your attention that the motion of Senator Douglas was defeated six to four by the votes of Demorcatic Senators. Even if the Republican members had not voted on the motion, it would have lost six to four.

Did you personally pay for the telegram or was it charged to the Democratic National Committee?

Mr. KEEL. It was charged to the Democratic National Committee.

Senator GORE. Now I wish to ask you some questions about the content of the telegram. This telegram conveyed a proposed press release about which you had previously talked to Mr. Taylor by long distance telephone. Was this long distance charge paid by you or the Demorcatic National Committee?

Mr. KEEL. By the Democratic National Committee.

Senator GORE. And in this press release which you urged Mr. Taylor to disseminate to all newspapers, radio and television stations, a direct quotation was suggested charging that I was misrepresnting the interests and the sentiments of the people of Tennessee.

I am sure you realize that all of us like to think and hope that we are representing the interests and the wishes of our constituents. It is a serious charge to say that one is misrepresenting them. It is difficult to arrive at a consensus of 4 million people on a difficult thing like the tax bill.

Have you ever seen this tax bill? Have you ever studied it or read it?

Mr. KEEL. I have studied fact sheets based on the tax bill. I do not recall that I have seen the actual bill.

Senator GORE. You have not actually seen the bill. As you can see, it is about the size of a Nashville, Tenn., telephone directory.

Mr. KEEL. Right.

Senator GORE. And this is not as easy to understand as the Nashville telephone directory. It has 310 pages, and this is a technical, legal draft, a revision of the tax program.

Mr. KEEL. Yes, sir.

Senator GORE. Containing 234 changes in the tax law.

Mr. KEEL. Yes, sir.

Senator GORE. Each of which affects some citizens, many of which affect many citizens. Some provisions affect many citizens adversely as well as affecting many citizens favorably.

Now, the question under consideration, when the motion of Senator Douglas was placed, was whether this committee would be briefed by its technical staff, and then follow the orderly procedure which has been traditionally followed by this committee of giving careful consideration to a bill of such great importance.

I only relate these things to you to illustrate why I thought, and why the majority of the Democrats on this committee thought, it necessary to follow the course of careful consideration.

Now, in this telegram, in this suggested press release which you wired to Mr. Taylor and others, you used certain statistics which I did not find to conform to the facts.

You said, for instance, that in 50 Tennessee counties, which is more than half, the unemployment rate was from 10 to 20 percent.

I, as you perhaps know, contacted the commissioner of employment security in Tennessee and found that this was highly inaccurate information.

Where did you get your statistics?

Mr. KEEL. I made a call to Dr. Eberling, the statistical expert with the Tennessee Employment Security Office of Nashville, and this information was then conveyed to the Research Department.

The CHAIRMAN. Mr. Keel, will you speak a little louder, please?

Mr. KEEL. This was information which, as we understand it, he conveyed to our office.

Senator GORE. There must have been some misunderstanding because your telegram also cited the fact that there were 57,000 people in Tennessee unemployed.

Well, Tennessee is now a State of almost 4 million people. I do not think you could find 50 counties in which there were as many as 10 to 20 percent presently unemployed, and come up with a figure of 57,000 unemployed. Incidentally, unemployment is the lowest that it has been in Tennessee for several years.

Mr. KEEL. May I respond to that?

Senator GORE. I beg your pardon?

Mr. KEEL. May I respond to that?

Senator GORE. Oh, yes, indeed.

Mr. KEEL. First, may I say that the reason that I placed a call to Dr. Eberling was that I received in my office a publication "Labor Market Trend, September 1963, U.S. Department of Labor" which lists 35 Tennessee counties as being in a substantial unemployment group, which means they have more than 6-percent unemployment, and on the basis of this, I made an effort then to find out just exactly what the facts were.

Dr. Eberling, as I understand it, did not have the total unemployment figure, so I used the latest, most reasonable figure I could get from the Bureau of Labor Statistics here in Washington.

Senator GORE. For your information, in case you are not aware of it, the term which you used, "substantial unemployment," which under the act would qualify a county for accelerated public works projects, is 6 percent, and if only 35 counties qualified for that, you see there is an inconsistency.

But I shall not persist, Mr. Keel. The facts as to what the unemployment situation is in Tennessee can be ascertained from the proper officials, both Federal and National. This is not a matter of great national import.

I thought it unusual that one member of this committee, and one member alone, would be singled out for this attack, and particularly coming in the form of suggested press releases to leading members of my own party in my State. For that reason you can understand I resented it and asked the chairman of the committee, with the approval of the committee, to invite you to testify.

Do you have any further statements you wish to make?

Mr. KEEL. No, sir; I do not.

Senator GORE. Mr. Chairman, I have no further questions. Mr. Keel has answered. In my judgment he has answered forthrightly. I have no reason to question his veracity. He says he has made a mistake. I, too, have made mistakes.

I have no further questions.

The CHAIRMAN. Mr. Keel, you referred in your statement to the letters or telegrams sent by Chairman Bailey to Governors and key Democrats throughout the Nation.

Mr. KEEL. Yes, sir.

The CHAIRMAN. Do you have a list of those persons who received such a telegram and a copy of it?

Mr. KEEL. Yes, sir.

The CHAIRMAN. Was it sent at the expense of the Democratic National Committee?

Mr. KEEL. Yes, sir.

The CHAIRMAN. Will you read it, please, sir.

Senator SMATHERS. Is this the list of the Governors?

The CHAIRMAN. The Governors and key Democrats, he said in his statement, throughout the Nation.

I assume you sent the same——

Senator SMATHERS. Mr. Chairman, may I ask a question at this point?

As I understand it, the chamber of commerce has sent out telegrams to various representatives of areas throughout the State and the Nation. I have no doubt but that the Business Advisory Council has also sent out telegrams and information with respect to their views on the tax bill throughout the various States of the Union.

Is it the chairman's intention to put into the record everybody who has sent out correspondence to individuals on this bill? Maybe the Republican National Committee has sent out some telegrams. I am curious to know as to whether or not we are going to put into the record just key Democrats in these various States who have received such material.

I am sure the chairman would agree that it is within the right of the Democratic Committee to contact key Democrats in various States just as it is for Republicans, just as it is for the chamber of commerce. I was just curious as to what you are aiming at, Mr. Chairman.

The CHAIRMAN. I assume that the telegrams are more or less uniform, and I think it has an entirely different situation whereby the U.S. Chamber of Commerce pays for telegrams, as compared to the Democratic National Committee, whose purpose is to support members of the Democratic Party.

Unless the committee chooses to rule to the contrary, the chair thinks the communication should be made a part of this record.

Have you got a copy of it that you could read?

Mr. KEEL. The telegram?

The CHAIRMAN. Have you got a copy of the telegram that you sent or Chairman Bailey sent?

Mr. KEEL. I have, sir.

The CHAIRMAN. You have?

Mr. KEEL. Yes, sir.

The CHAIRMAN. Will you please read it unless there is objection?

Mr. KEEL. Yes, sir. May I correct the record here?

There was an initial telegram sent to these Governors by the chairman saying the information would be sent, and this was not a telegram. This was an airmail suggested news release, to save money.

Shall I proceed?

The CHAIRMAN. Will you please read it?

Mr. KEEL (reading):

DEAR FELLOW DEMOCRAT: This is a suggested news release to detail effect of Republican votes in your State. Please copy and distribute to press, radio, and TV in your name. Clippings appreciated.

This is the release to be copied and distributed:

"Republican Congressmen in this State who voted against the tax reduction legislation proposed by President Kennedy took the position that residents of the State do not need the increase in personal income—roughly estimated at $---------- annually—the bill would trigger.

"The estimate of increase in personal income is based on calculations prepared by the Research Department of the Democratic National Committee keyed to population growth, income statistics and other economic factors.

"The Treasury Department has estimated that the reduction would mean an increase of $---------- million in State and local taxes in this State. This should bring substantial relief from the critical financing problems we are facing in our State. Yet the Repulbicans vote "No" regardless of this advantage.

"The legislation authorizing a $11 billion tax reduction was passed by the House Wednesday, September 25, by a vote of 271 to 155. A total of 72 percent of the Republican members voted against the measure and against the following things a tax reduction would bring about in our State.

"More jobs at a time when automation is going ahead with leaps and bounds and workers in ever-increasing numbers are entering the labor market.

"Protection against another tragic recession. Republican administrations have been noted for their recessions and depressions. Recession means high unemployment and high budget deficits.

"New markets for the business of this State. The added purchasing power will funnel new fuel into our economy to fire the engines of business and industrial expansion. More purchasing power will create more demand. That will create more markets which will trigger business expansion. An that means more jobs.

"Higher family incomes and a balanced Federal budget. Every taxpayer will have more money with which to buy the things he needs. Individuals and businesses will be cut from the shackles of World War II taxation that is a drag on our economy."

Senator GORE. Mr. Chairman, may I interrupt to say that I see now that the real cause of my problem was that I was put in the den of iniquity with the Republicans.

The CHAIRMAN. Proceed.

Mr. KEEL (reading):

"The Republicans, by voting against these things, are saying this: "We don't want the private sector of our economy to be stimulated to solve our unemployment, to guard against recession, to expand business. We want to drag along and get the Nation into a position that will mean another recession, lower Federal revenues, and bigger deficits."

"They dodge deliberately President Kennedy's statement—made many times—that the real way to balance the budget is to broaden the economy and increase Federal revenues.

"And I say that the Republican Congressmen of this State who voted against this tax reduction were guilty of playing partisan politics with the Nation's economy, with your paycheck.

"Fortunately, they failed after Wilbur Mills, chairman of the House Ways and Means Committee, pointed out that an amendment sponsored by the Republicans could result in a tax increase because it authorized tax reforms without a tax reduction."

Sincererly,

JOHN M. BAILEY,
Chairman, Democratic National Committee.

The CHAIRMAN. I assume that that was sent to Senator Walters, as a member at that time of the Democratic National Committee; is that correct?

Mr. KEEL. I am sorry.

The CHAIRMAN. I said I assume that was sent to Senator Walters, who is now in this room, as a member of the Democratic National Committee.

Mr. KEEL. No, it was not.

The CHAIRMAN. It was not sent to members of the Democratic National Committee?

Mr. KEEL. May I explain?

The CHAIRMAN. You did not send it then to the members of the Democratic National Committee?

Mr. KEEL. That is right.

The CHAIRMAN. But you did send them to the Governors and other key persons?

Mr. KEEL. I sent them to the Governors in the States where we have Democratic Governors.

The CHAIRMAN. Do you think it would have been a good idea to send them to a few Republican Governors too?

Mr. KEEL. And in the few States where we do not have Democratic Governors, I sent them to our State chairmen.

The CHAIRMAN. How many copies of that were sent out?

You said key Democrats. What do you mean by key Democrats?

Mr. KEEL. I mean generally—there may have been one or two exceptions—the State chairmen, where we do not have a Democratic Governor.

The CHAIRMAN. This communication, then, was sent to Governors and State chairmen; is that correct?

Mr. KEEL. Yes, sir.

This is a program to put the President's program in terms of people, and we are trying to do that at the grassroots level.

The CHAIRMAN. Was there any suggestion that copies of it had been sent by the State chairmen to the key Democrats of these particular States, as was done in Tennessee?

Mr. KEEL. No, sir. The only suggestion I made was in the preface here. As I said there was a telegram that preceded this release.

The CHAIRMAN. The only suggestion was what? I did not catch that.

Mr. KEEL. The general suggestion was to put out a news release, Mr. Chairman.

The CHAIRMAN. Was to do what with it?

Mr. KEEL. Put out a news release.

The CHAIRMAN. In other words, were you trying to convert the Democratic Governors and the State chairman or were you furnishing them propaganda to convert others?

Mr. KEEL. I was furnishing them material for their press conferences and for news releases.

The CHAIRMAN. In other words, it was assumed that if it came officially to chairmen of the Democratic State committees, I have been one myself, it would be passed on, because you could count on the support of the State chairmen of the Democratic committee?

You must have had an objective in having the statements contained in the letter passed on to the rank and file of the Democrats.

Mr. KEEL. Mr. Chairman, this was for public consumption. This was material for a news release to be given to television, radio and the press, to inform the public of the significance of the administration's tax reduction plan.

The CHAIRMAN. That is what I am trying to get at. You intended it to be made public in some way.

Mr. KEEL. Yes, sir.

The CHAIRMAN. And who paid for that publicity?

Suppose it had gone on the radio where equal time might be requested.

Mr. KEEL. I would hope it would be free.

The CHAIRMAN. Who would?

Mr. KEEL. I would hope it would be free, sir. This is not a campaign.

The CHAIRMAN. The local Democratic Party would pay for it, is that it?

Mr. KEEL. No, sir. It would be in the news columns. It would not be an advertising matter.

The CHAIRMAN. You would regard that letter as nonpolitical; is that correct?

Mr. KEEL. No, sir; this is a partisan Democrat telegram.

The CHAIRMAN. Why did you not send it to the Republicans if it is nonpolitical?

Mr. KEEL. I am not working for the Republicans, sir.

The CHAIRMAN. Was it published generally in any newspapers through the country?

Mr. KEEL. It was in Tennessee, sir.

The CHAIRMAN. Did the Democratic chairmen, so far as you know, have copies made of it and send it throughout their States?

Mr. KEEL. The only check I have on that, Mr. Chairman, are the clippings that are returned, and I do not recall just what the return was on these.

The CHAIRMAN. Did you have any newspaper clippings sent to you containing the contents of the communication you sent to the State Democratic chairmen or the national committeemen or the Governors, I mean.

Mr. KEEL. I recall some, but I do not recall the volume, sir.

The CHAIRMAN. You saw some of them?

Mr. KEEL. Yes, sir.

The CHAIRMAN. The purpose of it was to get publicity, was it not?

Mr. KEEL. Yes, sir.

The CHAIRMAN. For the Administration, through the Democratic Party organization with respect to legislation. Now, has that ever been done before?

Mr. KEEL. Yes, sir.

The CHAIRMAN. A national campaign for or against a bill conducted through the Democratic National Committee?

Mr. KEEL. Yes, sir.

The CHAIRMAN. Where is the Democratic Party in both the House and the Senate divided with respect to legislation? A number of Democrats voted against the tax bill in the House, as you know. They voted their convictions.

It does not seem to me that they should be paraded over the country with the imputations that you have in that communication when they are Democrats and not Republicans.

How many Democrats voted against this bill in the House? Has anybody got that information?

It was quite a number.

Mr. KEEL. Mr. Chairman, 29 Democrats voted against it, 223 Democrats for it.

Senator SMATHERS. How many for it?

Mr. KEEL. There were 223.

This is on passage of the bill, sir.

The CHAIRMAN. Any further questions?

Senator SMATHERS. May I ask a question, Mr. Chairman?

Mr. Keel, do you know whether the chamber of commerce supports this tax reduction bill?

Mr. KEEL. No, sir. I know there is a substantial group of businessmen on the committee——

Senator SMATHERS. You do not recall what action the chamber of commerce took at their meeting here in Washington? You do not know?

Do you know whether or not the Business Advisory Council supports the tax reduction bill?

May I say for the record that I spoke to them Friday night, and I never saw such an affluent group of men, and I doubt if very many of them voted for the Democratic Party, but they seemed to me to rather universally support the tax reduction bill.

Do you know whether or not they are sending out information with respect to this tax bill?

Mr. KEEL. The Business Advisory Council?

Senator SMATHERS. Yes.

Mr. KEEL. Not to my knowledge.

Senator SMATHERS. Have you heard that they are?

Mr. KEEL. No, sir.

Senator SMATHERS. Do you know of any law which prohibits any political organization or any civic organization from sending out information with respect to legislation which is pending before the Congress of the United States?

Mr. KEEL. It goes out in great volumes.

Senator SMATHERS. What?

Mr. KEEL. It goes out in great volumes.

Senator SMATHERS. So the answer is: you do not know of any law which prohibits it?

Mr. KEEL. I do not know of any law which prohibits it, no.

Senator SMATHERS. In other words, it is your right to express your views?

Mr. KEEL. That is right.

Senator SMATHERS. Whether you are a political organization, a business organization, a citizens organization, or a labor organization; is that not correct?

Mr. KEEL. That is correct.

Senator SMATHERS. That is all.

The CHAIRMAN. Before I ask if there are further questions, we are honored today by having the junior Senator from Tennessee, who is also a member of the National Democratic Committee. I was wondering if Senator Walters desired to make a statement.

Senator WALTERS. Thank you, Chairman Byrd.

I have no statement to make, but I think this was, as Senator Ribicoff said, a very stupid telegram to be sent, and when I got a copy of it I certainly protested it at the time it was brought to my attention.

The CHAIRMAN. I would like to make one further statement: I do not question the right of any organization to communicate with any group of people in this country, but I think that the communication with respect to Senator Gore was totally erroneous, and I think that it and the other communications sent to the Governors carried implications that were not warranted and were not truthful.

Any further questions?

Do you have any further statement?

Mr. KEEL. No, sir; thank you very much.

The CHAIRMAN. The next witness is Mr. Joel Barlow of the U.S. Chamber of Commerce.

Will you come forward, please?

STATEMENT OF JOEL BARLOW, DIRECTOR, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. BARLOW. Mr. Chairman, my name is Joel Barlow. I am a director of the Chamber of Commerce of the United States and chairman of its committee on taxation. I am also a member of the Washington law firm of Covington & Burling. Today I am speaking on behalf of the national chamber and expressing its views and recommendations on H.R. 8363 as approved by its board of directors.

My oral statement will be as brief as possible.

This paper I have may look at little formidable, but I shall, in my oral statement, cover only about 15 pages.

I am most anxious to conserve the committee's time, in view of the long list of waiting witnesses and the exigencies of passing a tax bill before the end of this session of Congress, which we consider most essential. A detailed explanation of our position on the rate and structural changes in H.R. 8363 and a review of the chamber's tax program are being filed for the record, marked "appendix A," and "appendix B," and they are attached to this statement.

The national chamber wishes to emphasize to begin with that we have had many misgivings about endorsing tax rate reduction at this time (particularly as set out in H.R. 8363) because of the prospect of an even greater imbalance in the budget next year and a continuing level of Federal expenditures which, to our mind, cannot be justified on any basis.

We have been greatly concerned about the charges of fiscal irresponsibility which have been leveled at the chamber and others who have sought tax rate reduction and tax reform.

As recently as September 28, the national chamber's board of directors recognized that "while tax rate reduction is imperative to the fiscal and economic welfare of the Nation, the reduction of Federal expenditures is of equal importance."

When we first urged immediate rate reduction, we were relying on the administration's assurance that there would be a reduction in spending and obligational authority.

Therefore, I want to state as emphatically as I can that we believe the primary value of H.R. 8363 will be greatly diluted unless the Congress at the same time makes substantial cuts in Federal expenditures.

The national chamber has identified 117 specific places where the budget can be cut. In statements and testimony to congressional committees we have spelled out these recommendations in detail.

Senator BENNETT. Mr. Chairman, may I interrupt to ask the witness if this list of 117 is included in the material he is presenting to this committee?

Mr. BARLOW. No, Senator Bennett, but we can give that to you and make it a part of the record.

Senator BENNETT. I would like to ask that this specific list of 117 be included in the record.

The CHAIRMAN. And at the same time, I would like to ask that you include the State chambers who are not in favor of this bill.

Mr. BARLOW. I did not hear you, Senator.

The CHAIRMAN. That you include a list of the State chambers of commerce that are not in favor of the pending bill.

Mr. BARLOW. Yes, sir, Senator, we will do that.

(The information referred to follows:)

CHAMBER OF COMMERCE OF THE UNITED STATES,
Washington, D.C., October 25, 1963.

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The urgent printing schedule of the Finance Committee does not permit the national chamber to circulate its testimony and statement on H.R. 8363 to the State chambers of commerce to ascertain their specific approval or disapproval of the position expressed to the committee by Mr. Barlow on October 21.

However, the testimony of Mr. John Connolly, on behalf of the Council of State Chambers, lists the 30 members of that group subscribing to that testimony, 3 of which do so with stated exceptions.

Careful study of that testimony leads us to the conclusion that, while there are some stated differences regarding the structural reforms, the basic positions on tax-rate reduction and reduction of Federal expenditures are so closely allied as to indicate an extremely high percentage of agreement and acceptance.

May I also attach to this letter some information requested by Senator Douglas, during his interrogation of Mr. Barlow, on the fixed capital expenditures in the major industrial nations as a percentage of gross national product. The percentage figures listed are for the most recent calendar year for which the information was available.

Sincerely yours,

THERON J. RICE.

Senator SMATHERS. Does that mean you would want him to put in there those that are for it, those that may be for it, too?

The CHAIRMAN. I have no objection to that at all. He is indicating that all the chambers of commerce—State chambers—are associated with the U.S. Chamber, are they not?

Mr. BARLOW. When I say that the national chamber is in favor of the enactment of H.R. 8363 with some revisions, Senator, I am not speaking for the State chambers. They make their own decisions and they are not necessarily members or a part of the U.S. Chamber of Commerce, but that information, if we have it, on the action of State chambers, I will be glad to submit.

Senator GORE. Mr. Chairman, if he has that information, could he read it now?

I would like to know the position of the Tennessee Chamber of Commerce.

Mr. BARLOW. Senator Gore, I do not have that information.

Senator GORE. Thank you.

Mr. BARLOW. Already the Congress has made significant reductions in appropriations for the coming fiscal year. There can and should be more.

Furthermore, we have identified numerous new or expanded spending programs which must be denied if we are to realize the maximum stimulant to economic growth. A good example of this is a proposal now before the House Public Works Committee to double the current $900 million authorization for accelerated public works. The national chamber testified in opposition to this measure on October 17.

To make up for the short-term loss of revenue from rate reduction, we also urged that the tax bill seek out additional tax sources as proposed by the chamber in 1962 and again before the Ways and Means Committee in March of this year.

But unfortunately, the unreasonably high level of expenditures continues and no new tax sources have been tapped. The revenue gap has been narrowed principally in H.R. 8363 by a new patchwork of revenue-raising provisions generally having the effect of putting back into the law a considerable part of the progressivity that rate reduction would take out.

FISCAL RESPONSIBILITY REQUIRES A LONGER RANGE VIEW

After many thoughtful appraisals and reappraisals of our tax position during recent weeks, we have once more come to the conclusion that this is as protitious a time for tax rate reduction as there is likely to be, and that we cannot take just a short-range view of revenue needs. We believe we have no alternative, by any meaningful test of fiscal responsibility, but to support tax rate reduction now, even as proposed in H.R. 8363, since this is our last best hope of a balanced budget, long range, and the resumption of a healthy rate of economic growth.

No one should be under any illusion that H.R. 8363 is a major tax reform bill. It is not, nor does it purport to be. But it does make a start on rate reduction of all kinds, and rate reduction, to our mind, is the most urgent tax reform. For this reason and because of the inclusion of some other long-overdue amendments to the code, such as the income averaging provision, we have given it our support.

THE ALTERNATIVE TO H.R. 8363 IS A NEW SURGE OF SPENDING

The alternative which is threatened, and in the political nature of things seems inevitable if H.R. 8363 fails, really leaves us with no choice. The new surge of spending which would almost certainly follow defeat of H.R. 8363 would very likely make the present level of expenditures and imbalance in the budget seem like conservative fiscal policy.

Simply on the basis of recent official statements it seems clear that such a spending surge is not just an imaginary horror as some are inclined to believe, but instead a practical, political certainty. The choice is between relying on the private sector or the public "pump." Too many wise and sensible leaders in the Congress have expressed this view to disregard it.

DEFEAT OF H.R. 8363 WOULD UNDERMINE BUSINESS CONFIDENCE

If H.R. 8363 is not enacted in this session of Congress, it is our considered opinion that public confidence, and particularly that of the business community, will be seriously undermined and shaken.

Whatever momentum the economy has received from the prospect of tax rate reduction may very well be lost, and 1964 may well then be the year of another downturn with all its tragic consequences, including greatly increased unemployment.

As the President has pointed out through Secretary Dillon this past week, we cannot be oblivious to the cyclical pattern of recent years which once again points to abortive recovery and the possibility of a recession in 1964.

The permanent revenue loss from a severe downturn in gross national product and national income could very well exceed the temporary transitional revenue loss attendant upon the modest tax rate reduction proposed.

Even a delay in the enactment of H.R. 8363 until the 1964 session of Congress, with all the resulting uncertainties at the beginning of the new year, could trigger a downturn and have the most serious economic consequences.

THERE IS TOO MUCH RELIANCE ON A HIGH RATE INCOME TAX

As I have already emphasized this morning and as we have repeatedly pointed out in 1962 and prior years, and again this March before the Ways and Means Committee, our basic tax position is that the Nation's only chance, long range, for a balanced budget and improved national growth and economic health lies in a substantial reduction in our steeply progressive and repressive surtax rates; and also in a more balanced tax structure which means more reliance on tax sources other than the income tax, such as a supplemental low-rate excise tax or possibly a value-added tax.

There is, of course, always the danger that tapping new tax sources may be considered an invitation to more spending and an expanding role for the Federal Government. Somehow or other this notion must be avoided, but there would seem to be no way to legislate against it in a tax law.

Our income tax rates are the highest in the world and our tax structure is incredibly unbalanced and inadequate as compared with those of other industrial nations. We place more reliance on the income tax structure and thus on unreasonably high rates than does any other nation. And by so doing we impose much harsher penalties on initiative and success.

Faced with a serious competitive disadvantage in world markets, we are finally waking up to the fact that these severe tax penalties are a mistake.

We have been greatly encouraged to find the President and now the Ways and Means Committee agreeing with us that unless these high rates are reduced, they will continue to slow our national growth and stifle initiative and job-making investment. Without this initiative and investment, we will ultimately lose out as we seem to be doing now in the strenuous competition for world markets.

POLITICAL RATEMAKING THREATENS THE TAX BASE

There are those who do not yet seem to understand the serious economic consequences of steeply progressive tax rates, but are concerned principally with the political arithmetic of ratemaking. This thinking has been all too influential over the years in setting the high levels of surtax rates and in eroding the tax base with so-called relief provisions at all levels. But fortunately, the public itself is beginning to understand the serious economic consequences of surtaxes running all the way to 91 percent and relief provisions that remove millions of taxpayers from the tax rolls and eliminate an essential part of the tax base.

Eighty-five percent of all income taxes are raised at the base rate of 20 percent. Only 15 percent come from all of the progression that is in the tax structure.

The thousands of businessmen, small and large, in the chamber of commerce have a great conviction that responsible government is achieved only through responsible taxpaying citizens who are aware of the tax burden no matter how little they pay.

There are, most certainly, tax hardships for the lower income groups, and the chamber has consistently urged reductions in the lowest rates. Our recommendation before the House Ways and Means Committee was for a rate of 15 percent as compared with the Treasury proposal of 14 percent. But to completely relieve the lower income groups for whatever reason will so seriously erode the income tax base where the bulk of the revenue is collected that we will almost certainly face greater deficits in the years ahead. When you are relying on the income tax structure for 85 percent of your revenue, and 85 percent of all of the income tax comes from the base rate, you cannot eliminate millions of taxpayers without seriously eroding that tax base.

The new minimum standard deduction of H.R. 8363 goes dangerously far in this direction. But even this device is better in avoiding the fatal erosion of the tax base than a flat increase in the personal exemption as some have proposed. Fortunately, both the Treasury and the Ways and Means Committee have very wisely rejected this latter proposal.

RATE REDUCTION AS A DETERRENT TO SPENDING

Over the years we have had great conviction also, even when tax rate reduction seemed a kind of forlorn hope, that just keeping the necessity for tax rate reduction before the public and the Congress would in itself be a deterrent to spending.

We had some reason to believe that it might be a means of committing the Congress and the President to meaningful assurances that more and more reliance would be placed on the private sector instead of on the public pump, and that the overworked doctrine of "tax and tax and spend and spend and elect and elect" has now been generally discredited and discarded.

Senator DOUGLAS. Mr. Chairman, the witness is quoting a statement which was originally given such election by Mr. Arthur Krock in the administration of President Roosevelt and was ascribed to Mr. Harry Hopkins. If the history of that is fully analyzed, I think it would be found that these statements of Mr. Hopkins were not sequential, that in connection with his conversation with Mr. Krock he mentioned public works and said we would spend to relieve unemployment, and then later, in connection with another subject, the tax, and then when it came to the question of election, he said, "We believe we will elect President Roosevelt."

But what Mr. Krock, I am afraid, did was to put them all together as though this was a concerted policy of the administration, both punitive and rewarding, for the purpose of electing, and since this reflects by implication upon the memory of Mr. Hopkins and the memory of President Roosevelt, and I think unjustly so, although I am sure Mr. Barlow did not do it for this purpose, I want to put the real history of this statement into the record.

The CHAIRMAN. Thank you, Senator.

Mr. BARLOW. Mr. Chairman, Senator Douglas, I would like to say I had no implication of that kind in my mind at all. This is a phrase that has grown up and is very popular.

Senator DOUGLAS. I understand.

Mr. BARLOW. And to my knowledge it describes a certain philosophy of taxes.

Senator DOUGLAS. I understand, but it was originally introduced by Mr. Krock as a campaign weapon against President Roosevelt and as an attack on Harry Hopkins, and the real history of this phrase is very different from what is commonly known, and I wanted to defend the memory both of the President and of Mr. Hopkins in this connection.

Senator GORE. Mr. Chairman, he says it is a very popular phrase. With whom is it popular?

Mr. BARLOW. It is popular enough so that you hear it quoted a great many times over the years, Senator Gore.

Senator GORE. Have you ever heard its authenticity, its accurateness, questioned?

Mr. BARLOW. I think so, yes. I think so.

Senator GORE. Do you question its accuracy?

Mr. BARLOW. No, I do not question the accuracy of the statement, but I am glad to have this explanation from Senator Douglas as to the source. But I do think there is a very definite philosophy of tax and tax and spend and spend and elect and elect, and that is what I mean about the political arithmetic of our rate structure.

Senator GORE. Did you say race problem?

Mr. BARLOW. No, rate. No, I am on another subject today, Senator. This is a rate problem.

Senator DOUGLAS. I think people ought to be very careful about putting this phrase into added circulation, because it was improperly used in the first place and it has been improperly circulated since then, though I know you did it unintentionally.

Senator BENNETT. Mr. Chairman, I am very much interested in having this comment from Senator Douglas, but I think if we look back at the thirties, we will see that the tax and tax part was real, the rates went up, and they are the ones in part that we are wrestling with today. Certainly the spend and spend is a very real thing and still is with us, and unfortunately, the elect and elect is equally real.

Senator DOUGLAS. We can refight the battle of the thirties.

I will simply say that with 18 million unemployed, it was necessary for the Federal Government to step in and try to relieve distress and try to create employment. And so, far from being ashamed or apologetic for that in the slightest, there are millions of us who favored it at the time and will defend it to the death now and we do not propose to have the memory of a great man traduced in this fashion.

Senator BENNETT. You defend what happened, but you come now 30 years later and reinterpret the language, which described what happened.

Senator DOUGLAS. No, I simply asked you, Senator Bennett, to go into the history of this phase which is fully covered, I believe, in "Roosevelt and Hopkins," which Robert Sherwood published, and I happen to know some of the work which went into that book, and I think I am correct in saying that three disconnected statements which were not connected with each other were joined together as though they were part of a concerted plan or plot.

Senator BENNETT. Maybe three disconnected parts of a plan were connected, but I think each statement describes a very important part of the plan, and whether you connect them or disconnect them, I think the general interpretation of this phrase is still pretty descriptive.

Mr. BARLOW. Recent events suggest that the crusade for tax rate reduction is beginning to bear fruit. H.R. 8363 might be called exhibit A. There is also the beginning of a public ground swell for reduced expenditures. Both the President and the Congress are now promising action.

H.R. 8363 GIVES SOME ASSURANCE OF REDUCED SPENDING

We would like to think that section 1 of H.R. 8363 gives real assurance of reduced expenditures now and a balanced budget in the near future, particularly since it has the full endorsement of the President. We wish the commitment could be more definite and measurable. But we doubt if a workable commitment provision can be evolved in the tax structure that will not do violence to the doctrine of separation of powers.

And in any event, why is more of a directive in a tax bill needed when the real spending power and controls are in the Congress and not the Executive?

We are unalterably opposed to any provision that would transfer from the Congress to the President the power to determine when tax rate reduction is to occur, particularly when, as recently proposed, that discretion and power can be exercised by the President to postpone tax reduction by the simple expedient of increasing expenditures.

HIGH TAX RATES HANDICAP US IN WORLD COMPETITION

We do not look upon tax rate reduction, as some seem to do, as a panacea for all our fiscal ills. But we do believe that unless we make a start on it now—even in the imperfect way H.R. 8363 goes about it—the national economic health will not improve.

Our national economic health is not bad today and, taking a short-term view, it might be described as good. But for some time there have been symptoms and indications that it may be deteriorating—the aborted recoveries, the regularly recurring recessions, the slowdown in growth rate, the increasing reliance on Government spending, the seemingly irreducible level of unemployment, the continuing unfavorable balance of payments, the loss of export markets due to high costs and high prices, and the prospect for continuing losses of these markets, and perhaps more of our own domestic market, to low-price foreign competition.

These changed circumstances, particularly our deteriorating position in world competition, require, we believe, the proposed departure from the tax policies of the past.

The United States today is handicapped principally in world competition by the highest wage rates and the highest tax rates in the world. No one in his right mind has any notion we can or should reduce wage rates or the American standard of living. It is clear, however, that we can and we must make ourselves more competitive through greater productivity of both men and machines.

REDUCED RATES MEAN MORE JOB-MAKING INVESTMENT

This can come about in significant measure only by increased after-tax investment in cost-reducing, productive machinery and equipment to provide jobs for the millions of additional youngsters who will be looking for employment next year and in all the years to come. This increased investment will be made in adequate mesaure only if we adopt lower tax rates and a tax structure as benevolent as those in the other industrial nations of the world. H.R. 8363 is a step in this direction.

We took a first step in this direction in 1962 with the 7-percent investment credit and the new depreciation guidelines which had the effect of removing some of the tax deterrent to investment. But this was only a step, and not nearly as significant a liberalization of capital recovery for tax purposes as that provided by the other leading industrial nations.

THE RESERVE RATIO TEST SHOULD BE ELIMINATED

As a matter of fact, there seems to be little doubt in the minds of most tax authorities that unless the reserve ratio test in the Treasury guidelines is eliminated, it will, beginning in 1965, largely nullify the intended benefits of the new guidelines and the investment credit.

Continued insistence on the reserve ratio test, which is found in no other tax system in the world and is a throwback to outmoded depreciation concepts of physical lives and taxpayer historical experience, will also give rise to even more wasteful and meaningless controversies over depreciation allowances than taxpayers were forced into under the old discredited Bulletin F.

The Treasury should be directed by the Congress to eliminate the reserve ratio test. The suspicion is that Treasury officials would be glad to do so to avoid untold administrative difficulties, but they are apprehensive of congressional criticism that they should be exceeding the bounds of section 167, the depreciation provision in the code.

Senator Hartke has had the foresight to introduce S. 2231 which would eliminate the reserve ratio test, and his amendment should be included in H.R. 8363.

Whether we like the tax theories and practices adopted by other nations in minimizing tax deterrents to investment and job-making facilities, we really have no choice but to match them on some comparable basis if we expect to compete successfully with these other nations and solve the unfavorable balance-of-payments problem.

BASIS ADJUSTMENT IN INVESTMENT CREDIT SHOULD NOT BE REQUIRED

This is the principal justification for liberalizing the 7-percent investment credit as proposed in H.R. 8363 by eliminating the provision for a basis adjustment equal to the credit. Then, too, as the Ways and Means Committee has pointed out, this adjustment to basis has created accounting, reporting, and auditing difficulties which require its elimination in the interest of simplified administration.

As this committee well knows, the chamber once again raised a question in its testimony in 1962 and 1963 as to the propriety of using tax credits at all to accomplish economic and social reforms. We do not like subsidies in the tax structure for business or anyone else. We favored measurable deductions, such as an initial allowance, which enter into the computation of cost and the established pattern of determining net income.

At that time we supported the basis adjustment only because it was the kind of provision that would fit the credit more nearly into the Revenue Code's existing concepts and pattern of capital recovery.

However, since the administration and the Congress have decided upon the credit instead of an increased deduction or initial allowance, as used in many other countries, as the best method to make our investment writeoffs more comparable to those allowed by other nations, it must stay in the law; and the basis adjustment should be eliminated as proposed so as not to diminish the already inadequate allowance by trying to fit it into the conventional depreciation pattern.

BURGEONING LABOR FORCE REQUIRES TREMENDOUSLY INCREASED PLANT INVESTMENT

For more than 30 years we have lived under a tax structure that encourages consumption and discourages investment. This discrimination has increased as the surtax rates became more steeply progressive. The result we now face is a low-investment, high-consumption economy.

Investment in productive facilities and investment in relation to gross national product is lower in the United States than in practically all of the other industrial nations.

We need more investment in existing jobs in order to make the current jobs better paying and more productive. We need to create an enormous number of new jobs because the labor force will grow at least 50 percent faster in the next 7 years than in the last 7.

By 1965 we will have 1.2 million more youngsters reaching working age in a single year than we had in the previous year, just as this year we have about a million more youngsters reaching age 16 than reached that age last year. This startling increase is due to the high marriage and birth rates at the end of World War II.

It takes some $15,000 to $20,000 of after-tax investment for each job. The arithmetic calls for tremendously increased saving and investment in the years ahead if we are to rely on the private sector for investment instead of on the public pump for relief.

Tax rates in the middle and upper brackets will have to be continually reduced below the levels of H.R. 8363 if we hope to remove the barriers to business growth.

TOO MUCH EMPHASIS ON CONSUMER SPENDING

Unfortunately, the effect of the revision of the rate structure in H.R. 8363 has been to continue the undue emphasis on consumer spending. The effect of nearly every structural change in H.R. 8363 has been to offset the benefit of rate reduction and create more progression for taxpayers in the middle and upper brackets.

The rates simply have not come off as they originally went on. There is not even the proportionate rate reduction that could have been expected. Considerably more of the tax burden has been shifted to those taxpayers who were assured by the President, the Secretary of the Treasury, and others in their speeches that they would be relieved of some of their tax burden as an encouragement to investment.

Treasury statistics included in the House Ways and Means Committee report (table 6, p. 21) show that the percentage production in the bottom bracket is nearly 30 percent, in the top brackets approximately 23 percent, with only a 15-percent reduction in the middle brackets.

RATE REDUCTION ACTUALLY FAVORS LOWEST INCOME GROUP 3 TO 1

These percentage reductions, though not at all proportional, would not be too inequitable, again having the political arithmetic of rate-making in mind, if they actually represented the true ratio of reduction. But when the full effect of the structural changes is taken into consideration, there is actually a reduction of nearly 39 percent in the bottom bracket as compared with about a 13-percent reduction for incomes above $50,000. Thus, the benefit to the incomes in the lowest bracket is three times that of the benefit in the higher brackets (House report, table 3, p. 17).

The effect of this, as I have pointed out, is to continue to shift the burden of taxation to the higher incomes and discourage the job-making investment we so badly need. Because of the much more favorable reduction given the lowest rate group in H.R. 8363, a 50-percent ceiling surtax rate schedule, which seems to be the ideal that most people find, would be entirely justifiable. The additional revenue loss would be very small, much less than a half billion dollars.

DIVIDEND CREDIT SHOULD BE RETAINED

Investment will be still further discouraged by the elimination of the 4-percent dividend credit which would have the effect of increasing the double tax on corporate earnings. There is not much tax benefit in the present law, but at least a sound principle of tax economics and fairness had been established by the credit. Such principles are important.

In addition, there was always the hope that while the principle stood, more of the double tax could be eliminated.

The explanation in the report on H.R. 8363 begs the whole question of the inequity in double taxation. Contrary to the committee report, reduction in the corporate rate does nothing at all to remove the double tax. It is still there.

The legislative history of the 1954 act shows that the credit against tax was chosen because it gives the same absolute amount of relief for a given amount of dividends and because it does not therefore discriminate against lower bracket shareholders.

As Senator Williams has pointed out, the elimination of the credit works a real injustice on individuals in the middle income group who depend entirely on dividend income. They may pay a higher tax even after the rate reduction in H.R. 8363.

The dividend exclusion gives complete relief from double taxation to those with very small amounts of dividends. For larger shareholders this relief from double taxation is so small as to be meaningless in encouraging investment.

The effect of the elimination of the credit in favor of a maximum exclusion of $200 for a married couple is simply one more instance of discrimination against the substantial investor and an unwarranted increase in the progressivity of the higher rates, the very thing we are trying to eliminate.

STRUCTURAL CHANGES UNFAIRLY SHIFT THE BURDEN

H.R. 8363 has too many provisions with this kind of discrimination offsetting rate reduction. Actually, though, the chamber has been willing to endorse many of these provisions in H.R. 8363 as the price of making a start on rate reduction.

Section 203, for example, places an arbitrary ceiling in group-term insurance for the purpose of imputing income to the employee. Some further liberalization of this provision is necessary not only to eliminate the discrimination but also to avoid the hardship involved in imputing income with no cash to pay the tax.

In the supplement to my statement I have covered our proposals on that provision in great detail.

Moving in the direction of imputation of income is a dangerous course at best when we consider the multiplicity of economic benefits at all income levels and the formidable problems of valuation and collection and withholding on imputed income.

The Ways and Means Committee wisely recognized this in rejecting the Treasury proposal to tax unrealized gains as income at the time of a taxpayer's death. In the supplement to my statement I have gone into that in considerable detail.

Section 206 is particularly vulnerable to the charge of discrimination because it goes so far on certain sales of residences as to actually impose a higher tax on an individual who has a smaller gain solely because he is dealing in a more expensive asset. This obvious inequity as well as the limited ceiling must be removed from an otherwise equitable provision.

The denial of deduction for certain State, local, and foreign taxes (sec. 207) is another instance of weighting the scales in favor of the lower brackets. There has been no reduction in the standard minimum deduction to offset this disallowance for those who take specific item deductions.

The chamber supports the proposal in the interest of administrative simplicity, but with the admonition that we must not at present rate levels move farther in the direction of grossing up income and "taxing taxes" such as real estate and State income taxes.

Section 211, in placing a ceiling on both the deduction for child care and the level of compensation where the deduction is allowable, about $5,100 is the ceiling, is preferential treatment, building more progression into the tax rates paid by the middle and upper income groups. Without such arbitrary ceilings there would be some justification for what is clearly a relief provision since the deduction can be considered a cost-of-earning income.

Despite these and other differentials, the chamber has concluded, as I have said, that it should support as many of these substantive changes as possible in the interest of making a start on tax rate reduction and in the hope of more meaningful rate revision yet to come.

FIFTY PERCENT SHOULD BE HIGHEST RATE

The House committee at page 27 of its report has recognized, in bringing the corporate rate below 50 percent, that the Government should be only a "junior" and not a "senior" partner in the sharing of income.

President Kennedy, Secretary Dillon, and many others share this conviction.

Senator Long has made a very thoughtful and provocative proposal in this direction.

The public is beginning to have great impatience with rates above 50 percent even when the public generally does not have to pay them. Conceivably, the political arithmetic of ratemaking may improve. We have not despaired of bringing individual rates below the 50-percent level in the not too distant future. Fairness, the improvement of taxpayer attitudes, the need to minimize avoidance and evasion and save our self-assessment system, and the small amount of revenue involved are all factors that give some assurance that this is not a politically unrealistic position.

SECTION 219 IS REQUIRED TO ENCOURAGE INVESTMENT

The change in the treatment of capital gains (sec. 219) moves in the right direction of "unlocking" the billions in capital investment to make them available for new ventures and new investments, and also to put money in the Treasury.

It comes as a great surprise that the Treasury, after making such a splendid case for section 219, has now abandoned it simply because the Ways and Means Committee refused to put a double tax on unrealized appreciation at death.

In the supplement to my statement I go into the reasons for our position on that in great detail.

We believe the Ways and Means Committee is right, and section 219 clearly should be retained if there is really a purpose back of this legislation to encourage investment. This is one of the few structural changes in the bill that encourages investment. Most of the others continue the overemphasis on consumer spending. Consumer spending, in our opinion, can be inflationary.

Also, lowering the capital gains tax rate will raise substantial additional revenue during the initial period when we need it the most.

In the interest of simple fairness and less progression, section 219 requires one important change. The reduction in the maximum rate under the alternative tax should be made proportionate to the reduction in the inclusion factor for capital gains. This would make the maximum tax on class A capital gains 20 percent instead of 21 percent, which introduces, as I say, an extra element of progression.

INCOME AVERAGING NECESSARY FOR TAX EQUITY

Section 221 providing for income averaging, although somewhat complicated, and that may be something of an understatement, may well be considered for the time being an exception to the simplicity rule. Averaging is so badly needed in the interest of fairness and encouraging initiative, and so long overdue, that we should be willing to put up with the complexities that have held back its enactment for many years. The problems of draftsmanship have been all too formidable, and the authors of this provision are to be commended for a job well done.

Experience to be gained in administration will undoubtedly make possible a somewhat simpler provision with a broader coverage. For example, the present inequitable treatment of progressively peaking income has not been solved at all.

STOCK OPTIONS SHOULD BE RETAINED WITH REVISIONS

The national chamber supports here as it did before the Ways and Means Committee more restrictive treatment of stock options. We are convinced, though, that the provision in section 214 reducing the maximum life of options from 10 to 5 years is unduly and unnecessarily restrictive.

In my supplement to the statement I have gone into that in considerable detail.

The other restrictions can be justified, although certain technical language changes should be made for clarification.

Five years is simply too short a stock option life. Often and even usually it takes more than 5 years before the efforts of an employee for his company are reflected in the market value of its stock. If stock options are to have a salutary effect on the economy as intended by encouraging employees to have an investment stake in the business, then the employees must have the assurance that the period of holding is long enough for them to translate their efforts into earnings for the corporation so as to significantly increase the value of the corporate stock.

There are those who would eliminate the incentive provided by stock options by repealing sections 421 to 425 of the code. The effective answer to them is given by the House Ways and Means Committee at page 64 of its report on H.R. 8363:

> Your committee, however, decided to continue the stock option provision because it believes that it is good for the economy for management of various businesses to have a stake in their successful operation. Your committee believes that this provides important incentives to expand and improve the profit positions of the companies involved. This is not only good for the specific businesses involved, but also for the economy as a whole.

CONCLUSION

We are not at all sanguine that H.R. 8363 will undergo any major revision. The limitations of time would seem to make this all but impossible, and with all its shortcomings the bill does have the support generally of nearly all groups of taxpayers. For these reasons we are not pressing for the adoption of the chamber program or a major rewrite of the bill. But we would urge that its most glaring weaknesses be corrected, and that its passage be regarded simply as a transitional step toward more significant tax revision.

In summary, then, we endorse H.R. 8363 with the reservations we have noted. To say that H.R. 8363 is imperfect is, perhaps, to praise it. Clearly, the Ways and Means Committee had no illusions about its limitations. But as the committee said under its "Reasons for bill":

(*a*) It does make a start on lowering rates;

(*b*) It should after a brief transitional period raise the revenues;

(*c*) It does categorically promise expenditure control;

(*d*) It should minimize the possibility of a downturn in the economy and more unemployment;

(*e*) It will tend to increase demand and investment in low-cost productive capacity to make us more competitive;

(*f*) It is not likely to be inflationary because of the minimum change in the rates; and (*g*) Although its structural changes are not major tax reform, they seek to do equity and, perhaps more significantly in the context of fiscal responsibility, they do raise $1.1 billion additional revenue to reduce the imbalance in the budget.

We would add that if H.R. 8363 is lost, tax rate reduction conceivably may not come again for years. If the bill is defeated, the new surge of deficit spending will then be called upon to prevent real or even imagined recessions will almost certainly make tax rate reduction a practical impossibility because of the insatiable demand that will be set up for additional revenue. We will have abandoned the tremendous potential of the private sector to go down the road to the public pump. This would seem to be the most compelling reason for supporting H.R. 8363.

(Attachments to statement of Mr. Barlow follow:)

(Appendix A to Testimony of Joel Barlow on Behalf of National Chamber)

ANALYSIS WITH RECOMMENDATIONS OF THE PRINCIPAL PROVISIONS OF H.R. 8363

RATE REDUCTION—SECTION 111

The chamber has long advocated a substantial reduction in the oppressive tax burden which stifles economic growth and warps business decisions.

Our economy is presently plagued with two particularly serious problems—a lack of new investment in capital goods and a growing class of unemployed. If sources of capital for investment can be stimulated, a major stride toward overcoming both these problems will have been taken. Business will expand if it is provided with the funds to do so; venture capital will flow freely into new enterprises; and the new jobs thus created will drain off depressing unemployment. One need not be an economist to realize that a major source of investment capital must be the savings of upper income individuals. For this reason, the chamber considers it imperative that the Revenue Act of 1963 eliminate the confiscatory rates in the upper brackets of our tax structure.

It is unfortunate that the proposals in the House bill actually increase the progression in tax rates and, by concentrating tax reduction in the lower income brackets, place more emphasis on stimulating consumer demand than on freeing investment capital. Tax benefits granted to stimulate consumer demand create an inordinate revenue loss for the Treasury, with little benefit to the individual taxpayers concerned.

Because H.R. 8363 does grant some relief from confiscatory rates, however, and because without this tax bill, the danger of recession with a new surge of spending is so immediate, the chamber accepts the present rate reduction proposals in the interest of expediting passage of the bill. It regards the rate structure as transitional only. Despite its substantial drawbacks, the provisions of H.R. 8363 should operate to the eventual benefit of the overall economy.

It has been suggested that the rate reductions and structural reforms in the House bill work a greater benefit for upper bracket taxpayers than they do for those in lower brackets. This suggestion of course stems from the fact that there are always larger dollar savings for the upper bracket taxpayers simply because they have larger incomes. They had comparably larger amounts of tax to pay when the rates went up. A single taxpayer with a $50,000 taxable income, for example, today pays a tax of $26,820 while a single taxpayer with a taxable income of $1,500 pays a $300 tax. It is, of course, not possible to give equal dollar benefits to both these taxpayers in any meaningful rate revision.

Percentage figures give a true picture of the relative relief afforded different taxpayers. Treasury statistics illustrate quite clearly that benefits are concentrated in lower income classes. Based on the rate changes alone, the $1,500 taxpayer mentioned before, would have his taxes reduced 25 percent while the $50,000 taxpayer would have his taxes reduced only 15.8 percent.

When the effect of the structural modifications in the House bill is considered along with that of the rate changes, the slant of the House bill toward favoring lower income groups is shown even more clearly. The total effect of the House bill will be to reduce the taxes of taxpayers in the lowest adjusted gross income class, zero to $3,000, by 38.3 percent. This percentage of tax savings drops as gross income rises until taxpayers in the highest adjusted gross income class, the over $50,000 class, are offered only a 12.6-percent reduction in taxes, less than one-third of the percentage saving given lower income taxpayers.

It is true that by ignoring the effect of the structural reforms and by computing percentage figures on a base of income remaining after taxes rather than on a base of taxes paid, some startling and distorted figures can be developed in an effort to show that upper bracket taxpayers receive a greater benefit from the House bill than do lower bracket taxpayers. But it is, of course, unreasonable to ignore the effect of structural reforms which save the lowest income taxpayers 10.7 percent of their tax bill while tacking an additional 4.4 percent onto the tax bills of taxpayers in the over $50,000 income class. And it is misleading to compute on a base of income after taxes. Taxes make up only a minor portion of the budgets of lower income taxpayers; thus even if their taxes were wholly forgiven, they would not find their spendable income much increased. Upper income taxpayers on the other hand, find taxes make up a massive portion of their budgets. Even a minimal reduction in this tremendous burden would loom large when compared to after tax income. The fact that relatively minor tax reductions may result in sizable increases in after tax income to upper bracket individuals is more indicative of the enormity of the burden now placed upon them, than it is of any inequity in the rate reduction proposal.

Although consideration of dollar figures rather than percentages is not meaningful when one is talking of particular individual taxpayers, these figures take on important significance when the tax effect on the population as a whole is considered. Here again, it is apparent the benefits of the House bill are overwhelmingly directed at those taxpayers with modest income. Taxpayers in the adjusted gross income class of $5,000 to $10,000 alone receive as much dollar benefit as all taxpayers whose incomes are in excess of $10,000. Specifically, tax savings of $3.65 billion are afforded taxpayers earning $5,000 to $10,000 while only $3.635 billion of savings go to all taxpayers earning over $10,000. When the $1.55 billion tax saving to those taxpayers earning less than $5,000 is added to this it is apparent that lower income taxpayers receive the bulk of the benefits under the House bill.

MINIMUM STANDARD DEDUCTION—SECTION 112

The proposed minimum standard deduction is another step away from the the principle of tax equality. It will seriously erode the tax base by removing more than 1½ million taxpayers from the tax rolls. These people will be denied a sense of responsible participation in the affairs of the National Government contrary to their own best interests and the national interest.

This is the most costly single structural proposal in the House bill and yet one of virtually no value to the economy. With only nominal benefit to any single taxpayer, the minimum standard deduction will cause a revenue loss of $320 million. Because the benefit from this proposal will go almost entirely to taxpayers who earn less than $5,000 per year, little if any of it will go into investment. For the same revenue cost it would be possible, for example, not only to retain the dividend credit but to increase it and thereby invigorate the flow of venture capital in the economy.

We believe that responsible government is achieved only through responsible taxpaying citizens who are aware of the tax burden no matter how small.

The proposal is unnecessary at this time in light of the substantial reductions in lower bracket tax rates contained in this bill. The chamber recognizes the hardship at the lower income levels and it has approved the proposed reduction to 14 percent for the low-income group. It believes that uniform rate reduction and not the granting of special "tax benefits" is the proper approach to tax reform, and it therefore opposes the adoption of a minimum standard deduction.

CORPORATE RATE REDUCTIONS—SECTION 121

The chamber supports both the proposed reduction of corporate tax rates and the proposed reversal of the normal and surtax rates contained in the House bill. These provisions should be effective in stimulating the economy to higher rates of growth. It is of vital importance that corporate rate reduction be enacted.

The chamber maintains that the corporate rates should eventually be reduced to levels substantially lower than those now proposed. Even with a 48-percent rate, tax considerations play far too important a role in corporate decision-making. The rate reductions in the House bill are, however, a significant step toward the goal of realistic corporate taxation.

CURRENT TAXPAYMENTS BY CORPORATIONS—SECTION 122

Under the present proposal, corporate taxpayments are accelerated by stages which, when considered with the rate reductions, do not increase the effective corporate rate for any one year above the current 52-percent level. To the extent this acceleration in payments postpones the benefits to a corporation from rate reduction, it works at cross-purposes with the intended thrust of the tax bill. The chamber recognizes, however, that some acceleration may be necessary to minimize the impact on revenues of rate reduction. For this reason, the chamber gives qualified support to the acceleration plan in the House bill.

If the scheduled rate reductions are modified in the future it will also be necessary to revise the stages of acceleration. If this is not done, effective corporate tax rates could actually rise in some years.

DIVIDEND CREDIT AND EXCLUSION—SECTION 201

The dividend credit, a reform enacted after the most careful consideration only 10 years ago, is a limited but very essential means of providing relief from the double tax on corporate earnings and dividends, and thus increasing sources of equity or venture capital. The basic aim of the 1963 tax legislation is to stimulate economic growth. It is inconsistent at this time even to consider a measure which would restrict sources of corporate equity capital by penalizing these sources with an additional tax.

There is little doubt that equity capital is far more desirable for corporate financing than is debt capital. Yet our present tax structure, by giving corporations a deduction for interest payments but not for dividend payments, forces them into debt financing. In other developed countries of the world the undesirability of pressuring corporations into debt financing is well recognized. Great Britain overcomes it by giving shareholders a form of credit for taxes paid by their corporations, Canada by giving shareholders a 20-percent dividends received credit. If, as the Treasury has suggested, equity financing has not taken on new importance in the United States since the passage of the dividend credit in 1954, then it is imperative that we consider further measures to equalize the tax results of equity and debt financing, not the repeal of the only equalizing device we now have. At the very least, the chamber would expect the Treasury to make a thorough study of alternative devices to stimulate venture capital and suggest some replacement for the dividend credit before proposing its repeal.

The House bill would repeal the dividend credit and then temper the harshness of this by doubling the dividend exclusion. But the net effect of such a change will only be to encourage modest investments in equity securities. The investors who are the greatest source of equity capital will receive no stimulus from an expansion of the exclusion.

The Treasury has adduced a series of figures which indicate that only taxpayers in high income brackets benefit from the repeal of the dividend credit. This is perhaps true to the extent that individuals with higher incomes are those more likely to do what the dividend credit was designed to encourage, i.e., make substantial investments in securities. It is certainly no criticism of the dividend credit to say it benefits most of those who react as the credit wishes them to.

Of all the measures that could be used to lift the burden of double taxation and to encourage investment in equity securities, the dividend credit is the fairest to lower income taxpayers. The credit gives all taxpayers, regardless of bracket, the same $4 tax relief for every $100 of dividends. By contrast the dividend exclusion, offers greater proportionate benefit to upper bracket taxpayers. For example, the present $50 exclusion gives only $10 tax relief to a bottom bracket taxpayer (20-percent rate) but gives as much as $45.50 tax relief to an upper bracket taxpayer (91-percent rate).

Because the increased exclusion which has been substituted for the dividend credit is of nominal value to low bracket taxpayers, many low or middle income taxpayers who are wholly or largely dependent on dividend income will be seriously harmed. For example, a retired person over age 65 receiving only $3.500 income all in the form of dividends could find that his or her tax bill would actually be increased a few dollars by H.R. 8363. Such an increase could occur on income up to $13,000. These increases would result even after the effects of rate reduction and the increased dividend exclusion were taken into account. A person with dividend income in these modest amounts might well be a widow or a disabled person who invested lump sum proceeds of life or disability insurance. Assuming that an individual in such a situation would take pains to choose high dividend yield securities, $3,500 could easily be earned on an investment of less than $70,000.

For all these reasons, the chamber strongly opposes repeal of the dividend credit.

INVESTMENT CREDIT—SECTION 202

As this committee knows, the chamber raised a question in its testimony in 1962 and 1963 as to the propriety of using tax credits to accomplish economic and social reforms. We do not like subsidies in the tax structure for business or anyone else. We favored measurable deductions such as an initial allowance which enter into the computation of cost and the established pattern determining net income. At that time we supported the basis adjustment only because it was the kind of provision that would fit the credit more nearly into the Revenue Code's existing concepts and pattern of capital recovery.

However, since the administration and the Congress have decided upon the credit instead of an increased deduction or initial allowance as the best method to make our investment writeoffs more comparable to those allowed by other nations it must stay in the law; and the basis adjustment should be eliminated so as not to diminish the already inadequate allowance by trying to fit it into the conventional depreciation pattern.

Increasing corporate rate reduction by an additional 1 percent would not justify repealing the credit. If a 1-percent rate reduction were substituted for the investment credit, corporations investing only a small portion of earnings in new plant and equipment would be benefited at the expense of those corporations making substantial new investments. The many small unincorporated businesses would be unfairly discriminated against.

The chamber believes that, despite its drawbacks, the investment credit has been a significant factor in encouraging investment in new plant and equipment. It will, of course, take several years before its incentive effect will fully be reflected in corporate investment policies. If it is repealed only 1 or 2 years after its enactment, the business community will be unwilling to pursue longrun investment programs for fear that another shift in tax policy 2 years hence will agains upset reasonably developed expectations. Moreover, the business community will begin to question whether the Government is genuinely interested in encouraging capital investment.

The major criticism of the investment credit, as I have said, is the complex basis adjustment provision. By providing for the repeal of the basis reduction requirement of the credit, the House bill removes one of the complex features and, at the same time, augments its incentive effect. For these reasons, the chamber actively supports the repeal of the basis reduction requirement. There is no doubt that many more businesses would avail themselves of the credit if this requirement were repealed.

The chamber also supports the other proposals for modifying the investment credit which are contained in the House bill. We would like to call particular attention to the provision declaring that it is Congress' intention that regulatory agencies shall not "flow through" the investment credit to a utility's customers. As written, this provision would not bar the Renegotiation Board or the Department of Defense from deeming corporations to have higher profit levels because of the investment credit. We believe that a "flow through" in Government contract negotiations would be as antagonistic to the purposes of the credit as it is in the area of public utilities. The statement of congressional intent as to the ban on "flow through" should be expanded to include Government procurement and renegotiation.

GROUP TERM INSURANCE—SECTION 203

The House committee recognized, as does the chamber, the benefits to the national economy that results from encouraging employers to provide group term insurance for their employees. We also recognize that some limitation on the amount of such insurance which may be provided without taxing the employee may be necessary to eliminate possible abuse. The House bill has attempted to balance these interests by imposing a fixed $30,000 limit on tax-free group term insurance. The chamber feels that this fixed dollar limit will hamper employers who wish to provide group term insurance for their employees on a rational and equitable economic basis.

As in the case of any employee benefit, employers will naturally and logically wish to base an employee's insurance protection on his value to the company. Since the value of an employee is best measured by his wages, the chamber recommends that an exclusion from tax based on a multiple of earnings be substituted for the fixed dollar limit contained in the House bill. This earnings multiple limit recommended by the chamber would be realistic, reasonable, and practical, and would adequately prevent abuse.

The provisions in the House bill with regard to the amount to be taxed to the employee if the term insurance limit is exceeded are unduly complex. To the extent employees receive protection in excess of the limit, the House bill requires several calculations, using complex formulas, to allocate the cost of insurance on the basis of age brackets. All of these calculations must be made for each employee of the company and must be made anew each year. With almost 50 million individuals now covered under group term insurance, if it costs only 25 cents per individual to make these computations the revenue loss from tax deductible computations expense would more than offset the nominal $5 million revenue gain expected to result from the House proposal.

This burdensome and expensive complexity could be dispensed with if insurance costs were computed on a level premium basis; that is, without regard to age groupings. This is the system of taxing employee group term insurance that has successfully be adopted in Canada. Since the premium charge to an employer for a group term policy is based on a single group rate, it is sensible to use only that rate in imputing a portion of the premium cost to an individual employee. There is no more reason for reapportioning cost on the basis of age than there is for reapportioning it on the basis of the health of the employees, some of whom might not be able to secure any life insurance outside the group. The chamber accordingly recommends that the use of age brackets in imputing insurance cost be dispensed with and that the imputed amount be determined by reference to the group rate paid by the employer.

REIMBURSED MEDICAL EXPENSES—SECTION 204

The chamber supports the provision in the House bill requiring inclusion in gross income of health insurance reimbursements to the extent they exceed actual expenses. The excess of reimbursement over cost represents income rather than a loss recovery and should be subject to tax.

SICK PAY EXCLUSION—SECTION 205

The chamber has consistently opposed the sick pay exclusion as an unjustified erosion of the tax base. It gives an unwarranted benefit to employees who often have only minor ailments and it may, in fact, encourage absenteeism. For these reasons the chamber supports the provision in the House bill limiting the sick pay exclusion to employees who are absent from work for more than 30 days. While it would be desirable to repeal the sick pay exclusion entirely, we believe that the House provision will eliminate much of the abuse in this area.

SALE OF RESIDENCE BY AGED TAXPAYER—SECTION 206

The House bill would permit the exclusion from income of part or all of the gain realized by a taxpayer over age 65 on sale of his personal residence. The chamber recognizes the aged taxpayers are often forced to sell their homes and move to new quarters either because of retirement or a changing family situation. If these taxpayers reinvest their sales gains in the purchase of new homes they are presently protected from tax by the residence sale rollover provision of the code. But, for a variety of reasons, older taxpayers often prefer to move to apartments or other nonowned housing. The chamber believes that there is merit in the proposal to allow aged taxpayers to keep intact the proceeds from the sale of their residences under these conditions.

The provision in the House bill, however, operates in a regressive fashion. The higher the sale price of a taxpayer's residence, the lower the percentage of his gain that is excludable from income. For example, a taxpayer selling a house for $20,000 excludes all his gain from income whether that gain is $5,000, $10,000, or even $20,000, while a taxpayer who sells a house for $30,000 is permitted to exclude only two-thirds of his gain from income even if that gain is only a few hundred dollars. Any provision imposing a higher tax on an individual with a lower gain, merely because he is dealing with a more expensive asset, has no place in the income tax laws. It is a form of capital penalty wholly unrelated to the purpose of the provision to relieve aged taxpayers of undue tax burdens.

It would be most appropriate to have no limitation on the amount of gain which can be excluded from income. If the Congress determines, however, that some limit is necessary, the chamber believes that a limitation based on a fixed percentage of gain would be most equitable.

ELIMINATION OF DEDUCTION FOR SOME STATE AND LOCAL TAXES—SECTION 207

The House bill proposes to eliminate the present deduction for State and local taxes other than property, income, and general sales taxes. The taxes which will be eliminated as deductions are generally small in amount and difficult to document. For this reason, we support the proposal. We would strenuously oppose, however, any further narrowing of the deduction for State and local taxes, since we feel strongly that the accommodation reached between the States and the Federal Government in this important area must be preserved.

Also, we feel strongly that further "grossing up" of the tax structure or the imposition of a tax upon a tax cannot be defended in a high-rate income tax structure.

CASUALTY LOSS DEDUCTION—SECTION 208

The proposed $100 floor on casualty loss deductions is a reasonable provision, and the chamber supports it. The policy considerations which support the deduction for casualties suffered by the taxpayer are not applicable when the casualty in question is merely a minor nuisance loss.

CHARITABLE CONTRIBUTION DEDUCTION—SECTION 209

It is desirable to extend the 30-percent charitable deduction limit now provided for certain charitable groups to all publicly supported and controlled charities, so as to assist these organizations in raising funds, and the chamber supports this provision in the House bill. There is no justification for the discrimination in the present law.

The chamber also supports the provision in the House bill which allows corporations a 5-year carryover for excess contribution deductions. This provision will encourage corporations to support substantial charitable projects in instances where they might otherwise be hesitant because the gift involved would be in excess of the present limit.

The provisions in the House bill limiting the deductibility of gifts of future interests in personal property are also a desirable reform, to prevent abuse in this area of charitable giving.

MEDICAL EXPENSE DEDUCTION—SECTION 210

The chamber supports the repeal of the 1-percent floor for drug expenses of taxpayers over 65. The 3-percent floor on medical expense deductions does not apply to taxpayers after age 65, and it is reasonable to make the same concession in the case of drug expenses.

The income of a taxpayer over age 65 is generally shrinking at the same time expenses for drugs and medical care are rising. Allowing such taxpayers to deduct all of their expenses for drugs and medicines will mitigate their burden to some extent, at a negligible revenue cost to the Treasury.

MOVING EXPENSE DEDUCTION—SECTION 212 (INTERNAL REVENUE CODE, SEC. 217)

The House bill fills a gap in the present law by authorizing a deduction for nonreimbursed employee moving expenses to complement the exclusion of reimbursed moving expenses under present law. In addition, the bill properly recognizes that the moving expense treatment should apply to new as well as old employees. One of the strengths of the American economy is the mobility of its labor force. We believe that no tax barriers should be placed in the way of this mobility. The chamber also recognizes the fact that an employee who moves for his job is incurring an expense that is closely related to the production of income. For these reasons, the provisions in the House bill allowing a deduction for moving expenses are most desirable.

But the House bill does not go far enough to bring about the mobility that the President has requested. There are many expenses of moving that are not covered by H.R. 8363. For example, a relocating employee often must make an advance trip to his new area to search for a home; he may have to put his family in temporary lodgings while awaiting occupancy of his new home; or he may be forced to move on to his new position in advance of his family and to take up temporary quarters while awaiting their arrival. Because the expenses in any of these cases would be directly related to a move for employment purposes, the chamber recommends that section 212 of H.R. 8363 be expanded to allow their deductibility. If this is not done the tax laws will continue, to some extent, to deter employee mobility.

In another respect the bill as passed by the House does not go far enough. Frequently an employee is forced to move on short notice and dispose of his residence at less than its full fair market value. If he is reimbursed by his employer for this loss of market value, the employee should be permitted to treat this reimbursement as part of the proceeds of sale. The payment in such a case is directly related to the sale of the residence and the tax treatment to the employee should recognize this fact.

"BANK LOAN" INSURANCE—SECTION 213

Under the terms of the House bill interest deductions would be disallowed in certain cases where borrowings are systematically made to purchase life insurance. There are unquestionably instances of excessive use of borrowed funds to purchase life insurance, and the chamber agrees that the law should be amended to prevent these abuses. Unfortunately, the provisions of the House bill contain a multitude of subjective tests and a mass of limitations and qualifications. The chamber questions whether it is necessary to introduce such complexity into the code to eliminate this minor tax advantage. The chamber also questions the use of subjective tests that will create much uncertainty for the taxpayer in planning his activities.

The chamber supports the purpose of the provision in the House bill, but strongly recommends that it be simplified and placed on a more objective basis.

STOCK OPTIONS—SECTION 214

The chamber concurs in the view expressed by the House Ways and Means Committee that the basic stock option tax provisions should be retained because of the benefits to the economy which are derived by encouraging corporate management to have an active stake in their corporations. The chamber also recognizes that the present provisions of the code regarding employee stock options have given rise to unintended tax benefits. For this reason the chamber supports most of the stock option reforms contained in the House bill. In general, these reforms should curb the occasional excesses without limiting the effectiveness of bona fide stock option plans.

The chamber opposes, however, the provision in the House bill which would reduce the maximum life of an option from 10 years to 5. It may take several years for the efforts of an employee to be reflected in the market price of stock covered by an option. A 5-year period may make it impracticable for companies to use stock options as incentive devices. For example, if an option is granted at the peak of a business cycle the 5-year period might not be enough to carry through the downturn and subsequent recovery that are likely to complete the cycle. To be of value stock options should extend over a period of time long enough to assure the employee the opportunity to benefit from the long-term growth of his company, unaffected by business cycles.

There is no need to force early purchase of stock to assure that stock options will work as incentive devices. As soon as an option is issued to him, an employee has the same incentive to improve his company's position as he does when he is the actual owner of stock. The only effect of a 5-year life rather than a 10-year one will be to encourage an employee to cause a quick, short-term improvement in his company's position at the expense of longrun growth. This will not be beneficial to the economy.

As now drafted the bill requires that a qualified stock option plan "by its terms" have no more than a 5-year life and be nonexercisable while a prior option is outstanding. Since it is contemplated that these provisions will be made retroactively effective on June 11, 1963, corporations which presently wish to issue option plans are in a difficult position. Because it is possible these restrictive provisions may be modified before the bill is passed, it may not be proper or necessary to meet these requirements in their present form. Yet if an option does not "by its terms" meet them it may be nonqualified Even if an option issued today does "by its terms" meet these requirements it may become nonqualified if the requirements are changed.

It is true that the phrase "by its terms" is used in the present stock options provisions of the code. However, its use there presented no problems because employers presumably did not issue stock options until they were accorded legal sanction by the enactment of the present code provisions.

The chamber accordingly recommends that the phrase "by its terms" be deleted or that employers be permitted, without penalty, to modify plans issued between June 11, 1963, and the date of passage of the bill, so as to comply with the requirements of the provision.

INTEREST ON CERTAIN DEFERRED PAYMENTS—SECTION 215

Under present law there is no requirement that persons selling property on an installment basis report any income from interest unless interest is separately stated in the contract. The chamber agrees that some reform in this area is appropriate. We are concerned, however, that the provisions in the present bill may give too broad an authority to the Treasury Department to determine a standard rate of interest.

The Treasury's power to allocate interest should be limited to those cases where no interest is stated in the agreement or where there is affirmative evidence that the stated interest was not arrived at in a bona fide manner. The rates of interest on fairly negotiated contracts may reasonably be as low as 2 or 3 percent. The seller should not be penalized merely because he cannot, in arms-length bargaining, secure a rate of interest on his funds that the Treasury deems satisfactory.

PERSONAL HOLDING COMPANY TAXATION—SECTION 216

The Treasury has pointed out that means have been developed to circumvent the effectiveness of the personal holding company provisions in present law, and the House bill contains measures to make these provisions more effective. The chamber favors the elimination of abuses in this area, but questions whether amendments requiring 43 pages in bill form are necessary to correct present deficiencies in the law. The chamber generally supports the House proposals regarding personal holding companies, but urges that every effort be made to simplify them.

The chamber also recommends that section 333, the provision of the code designed to encourage the liquidation of personal holding companies, be modified. At present stock and securities acquired by a corporation after December 31, 1953, are taxed the same as cash in a section 333 liquidation. This cutoff date was originally set at April 9, 1938, the date of enactment of the predecessor of section 333, to prevent liquidating corporations from avoiding tax by converting cash into securities immediately before liquidation. In line with this purpose, the cutoff date has been advanced several times throughout the history of section 333, most recently upon the enactment of the Internal Revenue Code of 1954. Consistent with prior legislative practice this date is again due for advancement. Unfortunately, H.R. 8363 advances it only with regard to corporations brought within the personal holding company provisions by the changes that H.R. 8363 effects in those provisions. Because established legislative practices have recognized the desirability of encouraging the liquidation of all personal holding companies, the advancement of the cutoff date should not be so narrowly limited.

As an alternative to the sporadic advancing of this cutoff date, the chamber recommends the adoption of a moving date, fixed for any corporation 2 to 3 years before its liquidation. This proposal, which has also been made by the Section of Taxation of the American Bar Association, would adequately prevent misuse of section 333 while solving, once and for all, the problem of the cutoff date.

The chamber also renews its request, made before the House committee, that section 341 be made inapplicable for a time to corporations newly brought within the definition of a personal holding company. If this is not done shareholders of many corporations which have accidentally become classified as personal holding companies may be burdened with a large tax liability through no fault of their own.

AGGREGATION OF OIL AND GAS PROPERTIES—SECTION 217

The taxation of mineral and extractive income should not be modified in a piecemeal fashion. The President has recommended comprehensive studies of the overall problems in this area and it is our understanding that such studies are going forward at the present time. The chamber recommends that any modification of the law in the area be deferred until the results of these studies have been carefully considered.

CAPITAL GAINS TAX REDUCTION—SECTION 219

The chamber has long advocated a reduction in the capital gains tax as a means of invigorating the investment capital flow in the economy. President Kennedy, in his 1963 tax message, expressed quite pointedly the importance of a capital gains rate reduction when he said:

"The present tax treatment of capital gains and losses is inequitable * * *. [It] affects investment decisions, mobility and flow of risk capital from static to more dynamic investments, the ease or difficulty experienced by new ventures in obtaining capital, and thereby *the strength and potential for growth of the economy*." [Emphasis added.]

At the time the President's proposals were first made, the Secretary of the Treasury also indicated that the capital gains reductions were of major importance. He said:

"The present provisions are both inequitable in essential respects and detrimental to the mobility of investment funds and liquidity in capital markets * * *.

"Independent outside surveys, our own studies, and letters and comments which are received daily from taxpayers throughout the country indicate clearly that these substantial reductions will increase taxpayer willingness to realize capital gains and stimulate a larger turnover of capital assets."

These arguments of the administration were accepted by the House, which included a capital gains tax reduction in H.R. 8363. In its report the House Committee on Ways and Means pointed out that the reduction would: " 'unlock' capital investment where the investor is willing to undertake new and riskier investments needed by the economy * * *. [It] should result in increased investments and will be particularly helpful in tapping new sources of risk capital." These comments leave no doubt that at a time when the free flow of investment capital is one of the primary concerns of both the administration and the Congress a reduction in the capital gains tax is a particularly appropriate and most desirable reform.

Since the tax bill was first introduced the administration has surprisingly reversed its position and now opposes a reduction in capital gains taxes. It is important to note, however, that the reasons for this about face have nothing whatsoever to do with the merits of a capital gains tax reduction. The Secretary of the Treasury has admitted that, even without a change in the tax treatment of assets at death, the capital gains reduction will still have a stimulating effect on the economy.

The sole reason advanced by the Secretary of the Treasury for opposing the reduction is the politically inspired argument that it will give too much benefit to wealthy taxpayers unless those taxpayers are at the same time penalized with an additional tax at death. The chamber strongly believes that a capital gains tax reduction should stand or fall on its own merits. If it will benefit the economy—and the chamber and the administration both believe that it will—then the country should not suffer from its loss merely because it is not politically attractive to reduce the enormous tax burden on upper bracket individuals.

Even assuming that the political implications of a capital gains reduction must be considered, it is not true that the benefits from this reduction flow only to wealthy individuals. In 1960, the last year for which detailed figures are available, 31 percent of the long-term capital gains were earned by taxpayers with adjusted gross incomes of less than $10,000. Forty percent of the long-term capital gains were earned by taxpayers with adjusted gross incomes under $15,000. A large portion of the benefit from this reduction would thus flow to taxpayers in the lower brackets.

This point is emphasized by the fact that, on a percentage basis, the reductions in capital gains rates are weighted heavily in favor of lower income taxpayers. These taxpayers receive the advantage of both a reduced inclusion factor for capital gains and reduced rates of tax on the gain included, while upper bracket taxpayers receive the benefit only of a reduced rate—and that less than proportionate with the reduction made in the inclusion factor. To put this in specific figures, the capital gains tax rate on bottom bracket taxpayers falls from the present rate of 10 to 5.6 percent under H.R. 8363, a reduction of 44 percent. For taxpayers in the $6,000 to $8,000 taxable income bracket, the rate reduction is from 15 percent down to 10 percent, a drop of 33⅓ percent. The percentage of reduction continues to decline as income rises, until all taxpayers with taxable income of over $26,000 are afforded a drop in rate from 25 percent down to 21 percent, only a 16-percent reduction. Thus middle bracket taxpayers get twice the percentage rate reduction and bottom bracket taxpayers almost three times the percentage rate reduction given upper bracket taxpayers.

Since taxpayers earning under $10,000 receive over 30 percent of all reported long-term capital gains and since taxpayers earning under $10,000 receive roughly two to three times as much percentage benefit as upper bracket taxpayers receive from H.R. 8363, it seems fair to say that at least on a percentage basis most of the benefit from capital gains reductions in the bill flows to taxpayers in the under $10,000 income class. The Secretary of the Treasury has conceded that percentage reductions in tax are the best indicators of the effect of the bill.

Even if the reduction in capital gains tax was to some extent related to a change in taxation of assets at death in the initial proposals of the administration, the reduction has been so watered since it was originally proposed that the administration has been adequately compensated for a failure to secure a change in taxation at death. The inclusion factor in H.R. 8363 is 40 percent rather than the 30 percent originally proposed by the Treasury; the maximum rate is now 21 percent rather than 19.5 percent; the holding period is now 2 years rather than 1 year, and the corporate capital gains rate has not been reduced at all, rather than being reduced 3 percent as proposed by the Treasury.

The benefit to the economy from the invigorated flow of capital which this reduction would cause is well recognized. The reduction is, however, tailored to our current economic needs for still another reason. A major drawback in the administration's tax program is the tremendous short term loss of revenue it will create until its accelerating effect on the economy is realized. The reduction in capital gains tax will provide a major source of additional revenue during this short run period because of the extra tax receipts produced by the unlocking of capital. The House committee estimated, in their report on H.R. 8363, that $350 million would be gained in calendar 1964 and $210 million in calendar 1965. The Treasury estimates are a bit lower, $210 million in 1964 and $80 million in 1965. But whichever figures are accepted, it is undeniably true that the capital gains reduction will contribute major amounts of short run revenue while at the same time stimulating the economy to higher productive levels. It is difficult to imagine a provision more custom designed to fit our present needs

For these substantial reasons, the chamber strongly supports the reduction in capital gain taxes contained in H.R. 8363. We urge, however, that the reduction in the maximum rate under the alternative tax should be made proportionate to the reduction in the inclusion factor for capital gains. This calls for a maximum tax on class A capital gains of 20 percent rather than 21 percent as in the House bill. By offering a greater proportionate capital gains tax reduction to lower and middle bracket taxpayers, the new capital gains rates disfavor the stimulation of new investment from its most significant source.

The chamber also recommends that this committee consider, in addition to the reductions in the House bill, a broader change in the capital gain provisions which would allow taxpayers to liquidate capital investments free from tax so long as the proceeds are immediately reinvested. A tax imposed on an individual merely for shifting from one capital asset to another is in fact a capital levy or a transfer tax, and is not properly a part of the income tax structure.

As an alternative to this "rollover" exemption or as a supplement to it, consideration should also be given to taxing capital gains on assets that have been held for 10 years or more at an extremely low rate. Much of the gain after so long a holding period is attributable only to inflation. Because of the long holding period requirement, this provision could not be used as a device to circumvent taxation.

SALE OF DEPRECIABLE REAL PROPERTY—SECTION 220

The present tax treatment of depreciable real property is not in harmony with the treatment of other depreciable property. Within the last 2 years two important reforms have been introduced in nonreal property depreciation. The code has been amended to prevent the use of depreciation to convert ordinary income into capital gains and the policies and regulations of the Treasury have been amended so as to provide for modern, realistic rates of depreciation.

The House bill provides for extending the first of these reforms to cover real property. The chamber agrees that such an extension is desirable. At the same time, however, we believe that the second of these reforms, realistic depreciation, should also be extended to include depreciable real property. The present depreciation of real property does not adequately provide for obsolescence, which is a major problem in a rapidly changing economy such as ours. This is particularly true in the case of "special purpose" buildings. A thoroughgoing review of the problems in this area and the enactment of a modern depreciation provision is long overdue.

AVERAGING OF INCOME—SECTION 221

Steeply progressive income tax rates work an unfairness to taxpayers with bunched income. The income averaging proposal contained in the House bill overcomes some of the grossest inequities in this area, and the chamber supports it.

This committee should recognize, however, that the present proposal does not offer any relief to individuals whose incomes gradually build up to a high peak. Many professional men, for example, slowly develop their earning power until it is maximized when they are 45 to 55 years old. During the relatively short period for which this level of earnings can be maintained, many a man must put his children through college and get them started in life, while at the same time saving enough to provide for his own retirement. The chamber recommends that consideration be given to a more general averaging provision which would provide for relief for these taxpayers.

REPEAL OF CONSOLIDATED RETURNS TAX—SECTION 222

The chamber strongly supports the provision in the House bill which would repeal the 2-percent tax on consolidated returns. A corporate group which files a consolidated return suffers a penalty in losing the benefit of multiple-surtax exemptions. There is no reason why it should be further burdened with a penalty in the form of an extra tax. The filing of consolidated returns is not necessarily tax motivated but follows naturally and logically from a business decision to prepare consolidated audit reports. The Commissioner is empowered to prevent corporations from gaining an unfair benefit from consolidation by frequently shifting from consolidated returns to separate returns.

MULTIPLE-SURTAX EXEMPTION—SECTION 223

The Ways and Means Committee has noted that some few medium and large enterprises have adopted multiple-corporate structures. In most instances this has been for valid business reasons.

While statutory and judicial principles have been developed which prohibit splitups for tax purposes, the interchange of normal and surtax rates proposed in the House bill would increase the incentive to organize new corporations on a multiple basis. For this reason the bill contains provisions which would penalize multiple exemptions in the case of corporations under common control. While the chamber does not oppose reasonable reforms in this area, it seems unfair to impose a penalty upon corporations engaging in entirely unrelated business enterprises or upon corporations in which there is a substantial minority interest merely because of an element of common control. In any case, a penalty as high as 6 percentage points of rate may be questioned.

BASIS CARRYOVER AT DEATH—(NOT IN PRESENT BILL)

The chamber is strongly opposed to any proposal which would carry over the decedent's basis in his property to his heirs at death.

The House Committee on Ways and Means recognized that it would require almost impossible feats of draftsmanship to produce a workable statutory provision accomplishing this result, and wisely decided not to include any such provision in the tax bill.

Any such carryover provision would impose an impossible burden on taxpayers. In order to be equitable it would necessarily have to apply not only to assets such as stocks and securities but also to homes, automobiles, and jewelry. Records are lacking in most cases as to the cost or other basis of much of the property. Records which are kept are often in such form as to be unpersuasive to the Commissioner or to the courts. Thus the recipient of property from a decedent would usually have an impossible burden of proof in trying to establish basis. He would be forced to accept a determination of the Commissioner of Internal Revenue in this regard, even though the Commissioner, who must construe all doubts in favor of the Government, would naturally fix basis as a very low level. Where evidence of heirs was lacking a zero basis would often be assigned to the assets.

The policy considerations underlying the gift basis provisions have no validity in the area of death transfers. If the gift basis provisions were not as strict as they are, a taxpayer who carefully regulated his gifts could avoid all capital gains taxation and could freely shift capital losses so as to gain maximum tax benefit from them. Since a decedent has no power to control the timing of his transfers or to pick and choose among the assets he wishes to transfer, this danger of tax avoidance is not present in the case of transfers at death.

There is at least one further serious objection to a carryover basis. Stepping up basis to market value when an asset passes through an estate is the only means of freeing "locked in" capital that the code now provides. The carryover proposal would not merely perpetuate "locked in" capital; it would actually magnify the problem because the process of valuation without complete evidence would tend to drive basis down. Now, when our economy needs added stimuli for expansion, is hardly the time to eliminate an important source of investment capital.

Not only would the elimination of stepped-up basis tend to freeze capital after it passed through an estate, it would also reduce incentive to build and develop economic enterprises. The greater the share of man's assets that the Government will take after he dies, the less is his incentive to increase the size of his estate. The proposal to carry over a decedent's basis is merely an indirect manner of increasing the already very substantial capital levy on estates. As such it will deter the development of capital just as effectively as would a rise in estate tax rates.

Amendment No. 225 to H.R. 8363, a proposal to provide a carryover basis which has recently been introduced before the Senate, indicates the correctness of the House decision to omit any such provision from H.R. 8363. This proposal is 17 intricate pages in length and yet does not even attempt to resolve a major problem which disturbed the House Committee. If asset bases were directly carried over, it would often happen that because of differentials in appreciation, the relative benefits which a testator desired to confer upon his heirs would be distorted. Moreover, recipients of particular assets for which a decedent had kept poor records would be harshly penalized merely because of the decedent's neglect. The House Committee rightly decided that, because these serious inequities might otherwise result, it was necessary to spread the burden for the appreciation of all a decedent's assets among his heirs according to the value of the property they receive rather than according to the appreciation directly attributable to that property. Unfortunately, Amendment No. 225 ignores this need for apportionment according to value.

In this same proposal, the problems of determining bases are met by providing that, in the absence of other information, the fair market value of property at the time the decedent acquired it will determine its basis. This would, naturally, be the course followed by the Commissioner and the courts even in the absence of such a provision. Without records of the decedent, however, it is likely that the date of his acquisition will not be determinable. Even if this data is ascertained, the problems of determining the fair market value of assets at dates years removed, are so great as to bring this entire proposal into question.

Amendment No. 225 also attempts to avoid many problems of ascertaining basis by exempting "property (not including property of extraordinary value) which is a personal or household effect" from its application. The use of such vague language only passes on to the courts a problem which the draftsmen were unable to solve.

For all these reasons, the chamber urges that Amendment No. 225 or any other similar proposal be defeated.

AMENDMENT TO IRC SECTION 274—(NOT IN PRESENT BILL)

The chamber urges the adoption of S. 2068, the proposal to modify the present treatment of deductions for business travel and entertainment. The provisions of current law on this subject are so complex and confusing that the average businessman finds it difficult to be reasonably certain of compliance. He may often forego activities which would benefit his business because of doubts as to their deductibility. If he makes an expenditure in an area where the statute and regulations are unclear, he often is dismayed to find that merely proving the expense was made for bona fide business purposes is not enough to assure deductibility.

S. 2068 will (1) simplify the rules governing travel and entertainment expenses so that the average businessman can understand them, and (2) modify the law so that bona fide business expenses are less likely to be denied a deduction. It guards against unjustified deductions by retaining the record-keeping requirements that were enacted into law last year. The enactment of S. 2068 would remove a major area of friction and misunderstanding between business and the Internal Revenue Service, and thus benefit tax administration in general.

PROPOSAL TO AMEND IRC SECTION 167—(NOT IN PRESENT BILL)

The chamber strongly supports the proposed amendment to H.R. 8363 which would extend the Treasury's depreciation guidelines to taxpayers as a matter of right. This proposal would make the computation of depreciation deductions simple and certain.

By eliminating the reserve ratio test this proposal would encourage many more businessmen to utilize the guidelines and thereby develop modern asset replacement practices. The reserve ratio test works at cross purposes with the guidelines. It will cause endless and unnecessary controversies upon audit of tax returns. Because it is developed on the ideal model of a large asset account with a steady flow of replacements, it effectively prevents businessmen, who for valid reasons do not happen to conform to this ideal model, from using the guidelines.

Appendix B to Testimony of Joel Barlow on Behalf of National Chamber

REVIEW OF NATIONAL CHAMBER'S TAX POSITION AND PROGRAM

In giving our qualified support to H.R. 8363, we have done so with the thought that if we are ultimately to realize our goal of meaningful tax rate reduction, we must not discourage the first step in that direction as inadequate as it would seem to be. To give the committee a better understanding of the National Chamber's conception of an adequate tax program for rate reduction, this paper is filed as a supplement to our oral statement today on H.R. 8363.

A BRIEF STATEMENT OF THE ECONOMICS OF TAX RATE REDUCTION

Our income tax structure is a graduated structure taking steadily higher and higher portions of income from the income earner as incomes rise. We penalize or punish success most severely. A growing number of people, therefore, have concluded that if we are to prevent the choking off of economic recoveries and if we are to stimulate more growth, we need to cut taxes across the board and, in addition, particularly cut those taxes which retard both saving and new risk-taking. Such cuts would enlarge the deficit in the short run, but the individual and the corporate cuts would reinforce one another to help generate larger incomes and, therefore, reduce the deficit in the longer run.

It was estimated by Government officials, for example, that in 1962 if we had been operating at reasonably full employment, total income and total output would have been $30 billion higher. But Federal tax receipts would have absorbed about one-third or roughly $9 billion in excess of the then current tax collections. Private saving would have been up $5 or $6 billion. Thus, taxes and savings would have drawn some $14 or $15 billion from the economy. This would have had to be concurrently offset by additional investment or other expenditures, if full employment were to be obtained and maintained. This meant, for example, that at the levels of Government expenditures of a year ago the tax system barred the way to full employment unless we were able to raise private investment about $14 or $15 billion above the then current levels. These matters were fully explored in an address by Mr. Walter W. Heller before the American Statistical Association in September 1962.

On June 7 of last year the President reinforced this idea in these words: "* * * our tax structure, as presently weighted, asserts too heavy a drain on a prospering economy."

Again in 1962 Secretary of the Treasury Douglas Dillon said: "The current tax structure siphons off so large a fraction of the increased income generated by business recovery that forward momentum is dissipated before full employment and full utilization of industrial capacity can be reached." [1]

There is a very broad consensus among economists that the foregoing analysis is valid. It is for this reason that a tax cut is particularly urgent at this time—that is, before the recovery from the last recession, which began in February or March of 1961, is aborted.

While the proposed tax changes in H.R. 8363 are heavily weighted in favor of reductions for individuals in the lowest income group, in terms of leverage and effective economic impact there is good reason to believe that cutting the middle and the upper income tax brackets and reducing the corporate rate would be most effective. In order to have our economy grow, everyone agrees we must have more investment. We need more investment in existing jobs in order to make the current jobs better paying and more productive jobs. We need to create an enormous number of new jobs because the labor force will grow at least 50 percent faster in the next 7 years than in the last 7. By 1965 we will have 1.2 million more youngsters reaching working age in a single year than we had in the previous year, just as this year we have about a million more youngsters reaching age 16 than reached this age last year. This rise is due to the high marriage and birth rates at the end of World War II. It takes some $15,000 to $20,000 of after-tax investment for each job. The arithmetic calls for much more saving and investment in the years ahead.

It is regrettable that the corporation income tax rate is not being subjected to more drastic surgery in H.R. 8363. Business taxes, including the corporation income tax, largely and inevitably find their way into the price and cost structure. In terms of balance-of-payments problems efforts should be made to reduce those taxes which almost inevitably raise the cost (and, therefore, the price) at which output can be produced.

We recognize that there is disagreement on the incidence of the corporation income tax, but most economists agree today that the bulk of the tax is shifted forward to consumers in higher prices. Some of it, of course, is shifted to shareholders, particularly in the case of marginal companies, thus giving rise to the problem of double taxation of corporate earnings.

The corporate income tax then is to a very considerable extent a cost which the producers take into account just as other costs are taken into account, when new plans are considered for enlarging capacity, for initiating new methods and products and in developing new lines.

Suppose, for example, that in the light of other uses for funds and the risks of failure being taken into account, a corporation's management defers new investment until a prospective return of 10 percent looks promising. At the current corporate income tax rate of 52 percent the tax is 10.8 percent of investment and the return plus the tax together equal 20.8 percent.

To put the matter another way: Under these conditions new investment and new ventures tend to be deferred until they hold out the prospect of earning 10 percent net; that is, after taxes. The tax defers new capacity. It defers new enterprises which would be promising were the corporate income tax substantially lower. Furthermore, older equipment tends to be used longer. This induces a rise in the average age and obsolescence of our capital equipment. It reduces the investment in tools per worker. Furthermore, to induce new investment, the pretax anticipated yield on proposed or contemplated new investment must be progressively higher (not just proportionately higher) as the tax rate rises.

For example, when the corporate income tax was as high as 75 percent for every dollar of net return to the investor, the corporation had to earn $4: $1 for the investor and $3 for the U.S. Treasury. With the corporation tax rate at 52 percent, for every dollar going to the investor, the corporation has to earn $2 plus: Approximately $1 for the investor and $1 for the U.S. Treasury. Thus, a reduction in the present 52-percent corporate rate would yield benefits to society substantially in excess of the proportion of the tax cut. For example,

[1] Testimony, Joint Economic Committee, Aug. 13, 1962.

a reducion of 12 percentage points from 52 percent would yield more than 40 percent of the benefit to be obtained by abolishing the corporate tax entirely. This demonstrates the highly favorable leverage of a substantial reduction in the corporation tax rate.

In short, the indictment against the corporation income tax is most compelling in terms of jobs, values to the consumer and in terms of faster economic growth.

Furthermore, since our income tax system is a graduated one, if we do not from time to time cut down on the rates, we will find that the Government sector will inevitably grow larger proportionately than the private sector. If, for example, average incomes in one or two generations should reach $25,000 per family, which is not unlikely, the present tax structure would absorb an enormous proportion of our national income simply because nearly every family would be lifted into very high tax brackets. Then we would be more than half socialized, without any deliberate congressional decision to move in this direction.

OUR TAX STRUCTURE IS THE PRINCIPAL BARRIER TO GROWTH

For many years the national chamber has been acutely aware of the problems involved in the economics of taxation. Accordingly, we have repeatedly emphasized the inadequacy, inequity, and repressive effect of our steeply progressive income tax structure.

Time and again in testimony before the Congress we have pointed out how our steeply progressive rates stifle capital formation and economic growth; how they handicap us in competing for world markets; how they discriminate against and discourage those who must be relied upon for investment in productive facilities, and for funds for research and development to create new industries, new products and new jobs.

We have tried to make it clear that a progressive rate structure that penalizes investment in jobmaking facilities, that discourages initiative, risk taking and extra effort makes all taxpayers losers—the poor as well as the rich, and labor as well as owners and management.

We have recognized the hardship and the deterrent to consumer spending at the bottom of the rate scale, and we have repeatedly recommended tax cuts from the bottom to the top.

THERE IS TOO MUCH RELIANCE ON THE INCOME TAX

We have stressed the need for a more balanced tax structure. This would have to include a significant alternative source of revenue such as a low-rate excise tax or value-added tax to obviate the need for what has come to be recognized as a misplaced reliance on the progressive and repressive income tax rates.

It has been apparent for many years that this unbalanced structure has become an increasingly heavy drag on the economy; that it cannot continue to produce some 80 percent of all Federal revenues, as at present; and that, as economic momentum is lost due to the tax drag, continuing deficits and annual imbalances are inevitable.

EXCESSIVE EXPENDITURES PREVENT A SOLUTION

We have not, of course, attributed all our fiscal troubles to our failure over the years to design a sound tax system. Much of our difficulty comes from a continuing and unwarranted high level of expenditures. These are our two basic fiscal problems and certainly the most critical problems at the moment. The solution of one will not come without the other.

OUR TAX STRUCTURE DISCOURAGES INVESTMENT

For more than 30 years we have lived under a tax structure that encourages consumption and discourages investment. The result is a low-investment high-consumption economy. Investment in productive facilities and investment in relation to gross national product is lower in the United States than in most of the other industrial nations. This is one reason we have been falling behind in the race for space and in the race for markets. The new European Economic Community with its vast resources and markets presents a real competitive threat.

As Walter Lippmann has pointed out, "the new reality" we now face is the failure of the United States under two Presidents to cope successfully with this chronic economic sluggishness "which contrasts so vividly with the exuberant expansion of Western Europe."

We have repeatedly pointed to our critical economic situation, to the slowdown in investment and growth, the unfavorable balance of payments, the failure fully to recover from recessions, the downward trend in profits, the unavoidable and increasing reliance on Government spending for research and development and production facilities, the gradual liquidation of companies caught in the squeeze between high tax rates and low depreciation rates, and those caught in the squeeze between unreasonably low profit allowances on Government contracts and the high levies of the income tax and renegotiation (which is essentially an additional tax without a rate).

Most of our excess capacity today is obsolete, high-cost capacity, and principally because of the tax and profit squeeze. It will take investors and not just consumers, to modernize it and put it back to work. It takes many thousands of dollars after taxes just to provide the facilities for one job.

HIGH TAX RATES ARE FORCING LIQUIDATIONS

We have watched at first hand company after company—small companies and medium-sized companies—liquidate, sell out, and merge because of the Government's unwise, archaic tax policies. The constant threat of income tax penalties for accumulating earnings, and the prospect of estate tax penalties, in the form of confiscatory capital levies on business investment, have all too frequently forced the small businessman to liquidate or merge.

This, of course, works in direct conflict with the antitrust laws, and too often the stifling tax effect is compounded by a court decree that the large company hold back production, research, and new product development so that it will not preempt too large a share of the market.

Small wonder then that the countries of Western Europe, with more benevolent tax policies and more realistic concepts of competition are "exuberantly expanding" and attracting American investment in new plants while we remain sluggish and less able to cope with their competition for world markets—or, perhaps, even for our own.

THE ENCOURAGING PROSPECT OF MEANINGFUL RATE REVISION

Thus the chamber and the business community were greatly encouraged in 1961 and 1962 when assurances came from the President and his Cabinet in their many messages and speeches that they recognized the urgent need for changes in the tax structure to encourage extra effort, investment and risk taking.

We were reassured to hear them emphasize our basic theme that "we can no longer be content merely with the level of capital formation that will result from a response to increased consumer demand"; and that "the most urgent need is a change in the tax structure to take away the deterrents to investment" in modern facilities and in research and development so as to make possible new and better products, more jobs, and an improved competitive position in world markets.

For the first time in years we had some assurance and hope that the steeply progressive tax rates might come off proportionately as they went on in the 1930's and we would have an end to the overemphasis on (1) the Keynesian theory of consumer spending, (2) progressive taxation as the panacea for fiscal ills, and (3) the political arithmetic in ratemaking.

THE DEPRECIATION GUIDELINES AS A FIRST STEP

We were encouraged when the Treasury initially moved in this direction by relegating the discredited bulletin F depreciation rates to the ash heap and adopting more realistic depreciation guidelines which put a new and long-overdue emphasis on obsolescence. Next to tax rate revision, depreciation rate revision has been for years the most important plank in the chamber's tax program. We had misgivings about the reserve ratio test and the day of reckoning in 1965 but so much had been accomplished by the Treasury that we were not disposed to be too critical at that time. A start toward solution of a vexing problem was required.

THE 7 PERCENT INVESTMENT CREDIT

We were also encouraged when the President proposed a statutory as well as an administrative change in the writeoff of productive machinery and equipment. Although we oppose the tax credit method because of its inadequacy, and also because it is a subsidy entirely out of place in a tax structure, we commended the President for his recognition of the urgent need for a realistic writeoff of facilities more comparable to that allowed by the other industrial nations of the world.

Again after the President's tax reform speech on December 14, 1962, we were encouraged to believe that the principal emphasis in tax reduction would not be on increasing consumer spending, but on "a direct approach to investment incentives," as Secretary Dillon had so well expressed it earlier.

THE TREASURY'S TAX PROPOSAL AND H.R. 8363

But, unfortunately, we were once again to be disappointed and discouraged. The Treasury proposal could not have been better designed to shift more and more of the burden to the investors and business and professional men of the middle and upper brackets. H.R. 8363 is only a mild improvement. The steep rates do not come off as they went on.

The serious failure of the rate revision proposals in H.R. 8363 to encourage capital formation has the unfortunate effect of undoing the intended benefit of some well-designed changes such as 5-year averaging and capital gain revisions. The rate reduction and the tax reforms work at cross purposes. There has been a lot of running just to stay in about the same place. But still the running toward rate revision is in itself significant and must be encouraged.

The long-overdue corporate rate reduction is largely offset short-term when it is needed most by acceleration of tax payments for the larger companies. Corporate tax payments will actually not be reduced until 1966.

The Treasury states that rate reduction for business has been minimized because the new depreciation guidelines and the 7-percent credit "reduced corporate liabilities" by substantial amounts in 1962 and 1963. Quite inexplicably reduction in liabilities has been confused with postponement of liabilities. Foreclosure from participating fully in permanent rate restructuring is too high a price to pay for depreciation reforms that do no more than permit the realistic writeoff of a cost. Here again the tax proposals are still working at cross purposes.

THERE IS NO PROPORTIONATE REDUCTION

The pattern of individual rate reduction is not entirely surprising considering the inevitable political implications—about 23 percent in the lowest bracket as compared with approximately 20 percent in the highest bracket. But when the so-called structural changes are taken into account, we find that 38 percent of the tax reduction and relief has gone to the low-income brackets and only 9 percent to the upper brackets. The tax structure will now be more progressive than before. There is more emphasis than ever on consumer spending. Considerably more of the tax burden has been shifted to those taxpayers who were assured they would be relieved of some of their burden as an encouragement to investment, risk-taking and extra effort.

NOT ENOUGH RATE REDUCTION FOR GROWTH

Not only did the original Treasury proposals fail to bring about really meaningful rate reduction to remove tax barriers to growth, but the "promised reform" to simplify the tax structure and make it more equitable was also missing. The "permament restructuring" would have made the tax structure even more complicated. The word "refrom" is a misnomer and H.R. 8363 drops any pretense of major reform. The principal reforms with two or three exceptions are not really reforms or correctives at all, but simply devices to offset the loss of revenue from rate reduction. Actually, the so-called reforms write more complications and preferences into an already overburdened law. They set up numerous arbitrary ceilings on deductions and allowances which have the effect of shifting more and more of the tax burden to the middle and upper brackets.

The best way for us to illustrate the deficiencies we find in the pending proposals is to compare them with the tax program the chamber recommended in 1962 and again this year.

THE NATIONAL CHAMBER'S PROGRAM

I. The chamber favors immediate and substantial tax rate reduction. We believe that until we have a tax structure with a top rate of 50 percent or less, we cannot expect to get rid of the many so-called loopholes. Most of them will continue to be nothing more than the tax equities and relief provisions necessarily adopted by this committee and the Congress just to make the high rate structure endurable and enforcible. Tax rate reduction then must be a condition precedent to substantive tax reform.

II. The chamber favors rate reduction in a single year, or at most in 2 years, with the resulting loss in revenue to be offset by (*a*) substantial reductions in Federal expenditures and new obligational authority, (*b*) tax revenues generated by the amount of additional funds left at taxpayers' disposal, and, if necessary, (*c*) enactment of a low-rate general excise tax exempting food, medicine, and shelter. Such a low-rate uniform excise tax would give balance to our tax structure by placing less reliance on the overextended and overworked income tax. The feasibility of a value-added tax and other possible tax sources should be studied for possible enactment later. The chamber is convinced that actual 1964 and 1965 spending can easily be held to 1963 levels and can even be further reduced.

III. The chamber would renew its proposal, originally made in June 1962, for a reduction, now to be effective January 1, 1964, from the present 91 percent rate to 65 percent with proportionate reductions in all brackets, splitting the 20-percent bracket and applying a 15-percent rate to the first $1,000 of the new bracket. This 65- to 15-percent rate structure will produce $5 billion more in annual revenue than the 65- to 14-percent rate structure proposed by the Treasury and $3 billion more than the 70- to 14-percent rates in H.R. 8363. This difference illustrates the basis weakness of H.R. 8363 and the Treasury rate proposal—the serious erosion of the rate base that produces the bulk of the revenue.

IV. The chamber would also renew its proposal made in June 1962 for a reduction, now to be effective January 1, 1964, in the corporation tax rate from 52 to 47 percent and we would accept the concurrent reversal of the corporate normal and surtax rates as provided in H.R. 8363. To minimize the short-term revenue loss, the chamber would support the acceleration of payments as proposed in H.R. 8363.

Even this corporate rate structure is still too high (although lower than that in H.R. 8363) and ultimately it must be lowered; but revenue needs and a priority on individual rate reduction dictate this very limited, transitional rate adjustment at the present time.

The chamber wishes to emphasize that its proposals for individual rate changes are also to be considered transitional only, and not in any sense desirable or reasonable rates for a permanent tax structure. We find no assurance in the report on H.R. 8363 that this is a transitional step and not a reasonably permanent restructuring of the tax rate.

The rates proposed by the chamber have been set at these high levels, in this initial stage, solely because of the exigencies of short-term revenue needs and the importance of minimizing the imbalance in the budget.

Ultimately, the top rate for individuals should be no more than 50 percent. There is now a belated recognition on the part of most taxpayers and the Government that a rate structure making Uncle Sam more than a 50–50 partner in extra effort and earnings is basically unfair and unsound.

The difference both in the concepts and provisions of the chamber's program, as compared with those of H.R. 8363 and the administration's proposals, will be immediately apparent.

Even if the reduction were to be spread over 2 years to minimize the revenue loss, and to be offset in part by a substantial reduction in spending or, if necessary, a low-rate excise tax, it is certainly more adequate than H.R. 8363 or the Treasury's proposal, under the President's own adequacy test, because the total impact is greater and comes at least 1 year earlier than the 3-year Treasury proposal.

Not even the 1962 school of economists have been heard to say that every spending control or reduction will nullify or necessarily have a significant effect on the momentum to be expected from tax reduction. If every effort is made to hold the spending line, most new spending programs can go by the board.

There is a growing recognition, too, among these economists that an excise tax does not have the deterrent and repressive effect of the income tax: that it will not defeat the purpose of income tax rate reduction; and that some kind of excise tax must be enacted ultimately if we hope to have a balanced and adequate tax structure.

With the safeguards which have been written into the chamber's proposal, the danger of excessive revenue loss has been minimized.

FISCAL RESPONSIBILITY

Questions have been raised as to the fiscal responsibility of a program that calls for a greater income tax reduction in 1 or 2 years than that proposed in H.R. 8363 or by the Treasury.

The fiscal responsibility can quickly be established.

Contrary to some mistaken notions, the chamber has not been advocating a deliberate increase in the very substantial deficit confronting us. We have explained then, as we do now, precisely how reduced spending and a new tax source will offset the revenue loss.

As we have already pointed out, the chamber is convinced, on the basis of studies completed and underway both in and out of the Congress, that actual 1964 and 1965 spending can readily be reduced to the 1963 spending level, and perhaps, to an even lower level if Congress and the President are really willing to go all out as they say they are for fiscal sanity to remove the barriers to economic growth.

The deliberate choice of deficits is anathema to the chamber. We are convinced, however, that immediate tax rate reduction is so vital that even if it means some short-term imbalance, this can be justified as the only way to get greater revenues over the longer term. Tax reduction should encourage expenditure reduction and it should stimulate an increase in gross national product of at least two times the amount of the reduction.

But to get a multiplier factor like this we must have the right kind of tax reduction—not just relief for consumers, as important as that is, but tax reduction that will principally encourage investment and risk-taking and extra effort. Unfortunately, we do not find that kind of tax reduction in H.R. 8363, but it is an improvement over the Treasury's earlier program.

We must also have tax reduction that will leave our tax structure stronger and with a potential to keep up with needs and growth. And we do not find that at all adequately provided in H.R. 8363, but, again, it is better than the structure of the Treasury's program.

Under our proposal, if revenues are not accelerated as expected or spending cuts are not made in an adequate amount, then a low-rate excise tax could be enacted to increase revenues substantially. These measures, when considered in toto, make a planned approach to a balanced budget a reality to be achieved rather than an ever-receding ideal, praised in policy and abandoned in practice.

If a further safety factor is needed, some further acceleration in corporate tax payments can be enacted.

One of the basic recommendations of the chamber for many years has been that our tax structure must be reconstituted with less progression, fewer deterrents, and more reliance on other tax sources. If this is not done, tax revenues will continue year in and year out to be insufficient to balance the budget no matter how rigorously expenditures are controlled.

THE 14- TO 17-PERCENT RATES SERIOUSLY ERODE THE BASE

The disproportionate reduction in the lower rates in H.R. 8363 may so drastically erode the tax base where the bulk of the revenue has to be collected as to make the income tax structure wholly inadequate even over the longer term to produce the revenue needed for even disciplined, conservative budgets. Tapping some alternate source of revenue will be a necessity in the next few years. The overly zealous desire to relieve the lower income group for whatever reasons is likely to so seriously erode the income tax base where the bulk of the revenue is collected that unless we find an alternate tax source, we will almost certainly face greater deficits in the years ahead. H.R. 8363 goes dangerously far in this direction with the new minimum standard deduction.

The Treasury has conceded that we will not get rid of our budget imbalance and the tax drag on the economy if we persist in relying on an income tax that produces 84 percent of all revenues as at present. The income tax in other industrial nations is relied upon for less than 50 percent of total revenues and in most instances considerably less than that—between 30 and 40 percent. Experience there has taught that a more balanced structure with an excise tax is not only less of a deterrent to growth, but diversity of tax sources provides an additional safety factor in revenue collection.

A low-rate Federal excise tax is the best insurance against the fiscal problems which are known and confront us now, and against those that are unknown in launching a tax reduction program in the face of a substantial current deficit.

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A low-rate uniform excise tax can be called on to yield as much as $3.5 billion in additional revenue and at the same time it will eliminate many of the discriminatory excises with their discriminatory war-induced rates. It would not unduly delay the enactment of tax rate reduction. Unlike the income tax, it is not a deterrent to investment and extra effort.

At one time the excise tax was regarded by some economists as a regressive and unjustifiable tax measure because of the burden it placed on consumption. Today that thinking has changed to a very considerable extent because it has proved to be no serious deterrent to spending, and there is an inevitability about it as an element in any balanced tax structure.

In the pattern of the disproportionate rate reduction proposed by the administration, an excise tax seems particularly justified to minimize the disparity in treatment of the middle and upper income groups.

Great apprehension must always go with the recommendation that a new revenue source be tapped. There is always the danger it may be considered an invitation to more spending and an expanding role for the Government. Somehow or other this notion must be avoided like the plague. But there would seem to be no way to legislate against it.

H.R. 8363 DOES NOT SUFFICIENTLY CONSIDER TAXPAYERS' ATTITUDES

The Treasury's original tax proposals overlooked entirely the importance of taxpayers' attitudes and confidence. H.R. 8363 represents some improvement but its disproportionate rate reduction will be greatly resented as will many of the discriminatory structural changes. The President's repeated assurances that encouragement would be given to investment and risktaking and the House committee's explanation of H.R. 8363 would not suggest to the middle and upper income groups that more of the tax burden would be shifted to them, that tax rates would be more progressive, and that the steeply graduated rates should not come off proportionately as they went on in earlier years.

Their confidence will be further undermined by the lack of any assurances that these rates are only temporary. They had thought the President, the Treasury, and the Congress had recognized that there is a basic inequity in a rate structure higher than 50 percent; that Uncle Sam should not be more than a 50–50 partner in the last dollars earned from extra effort and extra risk. The President has spoken many times of the taxpayers' right "to retain a reasonable share of the results" of his efforts. What is left after a 70-percent tax bite still does not seem like a reasonable share to the taxpayer. He still remembers, as a kind of symbol of tax inequity, the 1932 rate increase from 25 percent to 63 percent. He had reason to believe that the attitude of Government had changed since the 1930's when Government officials were obsessed with the notion that most fiscal problems, even deficits, could be solved by more progression in income tax rates.

The increased progression and burden shift in the 70-percent to 14-percent rate structure do not meet the President's own criticism of the Government's "majority interest in profits" or "the standard of fairness" outlined by Secretary Dillon in his testimony.

Entirely apart from the need for tax revision for economic growth, the chamber has continually pressed for tax rate revision just as a matter of simple equity and fair dealing between the Government and its citizens. The chamber has been well aware that attitudes and confidence are important factors in every endeavor, particularly the collection of taxes under a voluntary assessment system.

The statistics of the Internal Revenue Service show that tax avoidance and tax evasion are on the rise. The Commissioner announced the other day that there was a marked increase in indictments and convictions in 1962. Much of this avoidance and evasion stems from taxpayer resentment at rates which the Government itself has described as "unreasonably high," "punitive" and "confiscatory"; resentment at arbitrary and patently unfair rulings and proposals made by the Government.

The President's proposal last year to disallow all business expense for entertainment, no matter how essential to the production of income, is an illustration of the kind of arbitrary proposal that convinces the taxpayer the Government does not want to be fair. And section 274 which emerged after the President's proposal is something less than a fair and understandable proposal. In the earlier Treasury proposal the arbitrary floors, ceilings, and other exemptions nullified the tax rate reductions. Again, H.R. 8363 is an improvement but it still builds more progression into the structure, and continually shifts the burden to the middle and upper income groups. This serves only to undermine taxpayer confidence and trust.

The tax equity provided by the dividend credit is small indeed but it has been a symbol of fairness. The proposal to eliminate it is another sign to the investor that the cards are stacked against him.

The businessman in the small- and medium-sized company has been greatly worried for years about the liquidity of his estate and the continuation of his business in the event of his death. He was assured in numerous speeches that the proposed tax reduction and tax reform would help him. Then he discovered that the Treasury's plan included an additional capital levy on his estate solely by reason of his investment in his business. It is an understatement to say that this left him unconvinced about the good faith and fairness of the Government and its interest in encouraging capital formation and investment. Fortunately, the House committee rejected the Treasury's proposal for presumptive realization of gain at death and this provision should not be reinstated for all the reasons the Ways and Means Committee has given us.

We are not at all sanguine that H.R. 8363 will undergo any major revision. The limitations of time makes this all but impossible; and with all its infirmities it has the support generally of all groups of taxpayers. But we would hope that some of its serious weaknesses would be corrected, and that its passage would be regarded as simply a transitional step to more significant tax revision.

The CHAIRMAN. Thank you very much, Mr. Barlow. You have probably forgotten, but I once had the honor to be a member of the board of directors of the United States chamber.

Mr. BARLOW. Yes, sir.

The CHAIRMAN. To show that you keep politics out of the chamber, shortly after I was elected a director, I came to the U.S. Senate, and was told that I had to resign as a director of the United States Chamber of Commerce or resign as Senator, and I chose the senatorship.

Mr. BARLOW. Understandably so, Senator.

The CHAIRMAN. Senator Smathers.

Senator SMATHERS. I have no questions.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. Mr. Barlow, I listened to your statement and I have also read it.

Now, to condense it down very briefly, do you endorse the enactment of H.R. 8363 or do you oppose it unless it is modified in the manner in which you have made recommendations?

Mr. BARLOW. We endorse H.R. 8363, particularly with respect to the rate revision. We think that there are some changes, Senator, that will have to be made in the bill. There are mistakes that would be acknowledged.

We think there are some provisions that are objectionable, we would like to see changed, but nevertheless we would support the bill as the House Ways and Means Committee has reported it if the changes we have requested are not made.

Senator WILLIAMS. Then you do support the House bill as it passed the House if there are no changes made?

Mr. BARLOW. We would not like to be in that position because we think that this committee will have the wisdom to make some changes, but we would support the House bill, yes.

Senator WILLIAMS. You heard the Secretary, or I am sure you have read Secretary Dillon's remarks to this committee and recommendations.

Do you agree with his recommendations?

Mr. BARLOW. No, I do not agree with Secretary Dillon on many of his recommendations.

As a matter of fact, my instinct is to agree with Senator Byrd on these problems of expenditures and tax rate reduction. The Secretary's proposal to eliminate capital gains treatment, it seems to us, is insupportable. He made one of the finest cases for supporting the reduction of capital gains rate and now he takes the position that he is opposed to it, simply because there is not going to be a double tax on estates at death.

Senator WILLIAMS. I agree, his statement is just as confusing as yours. He did make a fine argument for it and then turned around and recommended its being deleted.

But I notice that in your statement, while you have endorsed the bill, you have made some excellent arguments in your opinion why many sections of this bill are not good.

Now, assume that the committee adopts the Secretary's recommendations and deletes section 219 dealing with the capital gains provision, which is the way the administration is recommending. Would you still support the bill?

Mr. BARLOW. We have not had a meeting of the board of directors of the U.S. Chamber since Secretary Dillon's testimony. I suspect that the chamber would, even with this proposal, support the bill because the tax rate reduction is so important, and for all the other reasons I have given.

My own view is, this morning, that we should support it, even if the capital gains rate reduction is eliminated from the bill.

Senator WILLIAMS. Now, one other recommendation that the Secretary made was that as an alternative to eliminating section 219 the committee include the administration's recommendations to impose at death, at capital gains rates, tax on all unrealized income.

Personally, I am not in favor of that provision, but nevertheless, suppose the committee does include that provision which is recommended by the Treasury Department and also retains the capital gains provision. Would you still support the bill with the inclusion of that provision?

Mr. BARLOW. Senator Williams, I think we would have a meeting of our taxation committee in a hurry if that were the prospect, and a meeting of the board of directors, and I think there is a chance that the chamber might not support the bill if the double taxation, presumptive realization of gains, approach is taken. But I cannot say this morning. We have to decide these policy questions outside.

Senator WILLIAMS. That is the administration's recommendations, as you well know.

Mr. BARLOW. Yes.

Senator WILLIAMS. The administration requests that either that proposal be included as a part of this bill, or section 219 be deleted, and, as I understand it, you would continue to support the bill with the deletion of section 219?

Mr. BARLOW. Yes.

Senator WILLIAMS. But you would not support the bill if section 219 was retained, and this additional section put in which would tax at capital gains rate all unrealized income upon death.

Mr. BARLOW. It is my judgment that the chamber of commerce would not support it.

As far as I am concerned, I would not support it if there was a tax on presumptive realization of gains.

Senator WILLIAMS. The bill contains a provision to repeal the 4-percent dividend credit. You endorse the bill with the inclusion of that section; is that correct?

Mr. BARLOW. Yes. We do not like to, but that is one of the prices we think we have to pay for a start on some meaningful tax rate reduction, but that does not mean that we are not standing on principle and we do not feel strongly about that provision. We are looking at the political realities here of getting a bill through.

Senator WILLIAMS. You are not letting your principles defer you from endorsing a tax cut financed on borrowed money; is that what you mean?

Mr. BARLOW. No; I am not saying that.

We think the principle is right. We think that there may be very little prospect of getting any change since the Senate has already once voted to eliminate the dividend credit, so that we are trying to be realistic here, but that does not mean we have any less conviction about the impropriety of the double taxation of corporate earnings.

Senator WILLIAMS. Even though you may be against it, then I understand that you are endorsing the bill which will include the elimination or the repeal of the 4-percent dividend credit; is that correct?

Mr. BARLOW. Yes.

We are endorsing this, Senator Williams, and I want to make this very clear, with a basic assumption that some changes are going to be made here in the provisions that are a little ridiculous.

Senator WILLIAMS. That is a hope?

Mr. BARLOW. That is a hope.

Senator WILLIAMS. But assuming that they are not made——

Mr. BARLOW. I have faith in this committee, Senator, to make some changes here.

Senator WILLIAMS. I wish you would back your faith up a little further than you appear to be. But, assuming that they are not made—I want to get the record clear—you are still endorsing the bill even assuming that your hopes do not materialize and the bill is not amended in the manner other than as it came to the House; do I understand that you would still endorse the bill even with the inclusion of the repeal of the 4-percent dividend credit and all the other factors?

Mr. BARLOW. We would not oppose it if no changes are made. We would endorse it for all the reasons that I have tried to explain, and on that basis it is plain that some changes have to be made in the bill.

Senator WILLIAMS. If this bill is approved, with section 214, which makes the recommended changes in the treatment of stock options, if we approve the bill as it came from the House, would it be safe to say that the Senate is approving this change in the treatment of stock options with the endorsement of the chamber of commerce?

Mr. BARLOW. Yes.

Senator WILLIAMS. You are endorsing the changes as recommended in the bill as it came from the House?

Mr. BARLOW. With the exception of the period of option life.

We think 5 years is too short. But I would say that even if that were not changed, we would not withdraw our support of tax rate reduction in this bill.

Senator WILLIAMS. But you would support that particular change as it came from the House.

Now, on the treatment of oil depletion as it came from the House, do you support that provision of the House bill?

Mr. BARLOW. Yes.

Senator WILLIAMS. Would you go further and perhaps make a change in the rates of oil depletion?

Mr. BARLOW. Senator Williams, just in terms of the time we have to get a tax bill through, I do not believe that there is any hope of looking at the depletion area.

I think Secretary Dillon made that statement the other day. And also, I think the President is sincere when he says we need to study this area and take some time and decide what is the proper method of treating income from mineral property.

Senator WILLIAMS. I have been here 17 years, and served under three Presidents, and they have been studying it ever since I have been here.

Mr. BARLOW. I know, Senator; I agree. There has been some delay.

Senator WILLIAMS. Now section 203 deals with the group term insurance. You endorse the House provisions of the bill, of section 203, as it treats group term insurance; is that correct?

Mr. BARLOW. No, we do not endorse that provision. We do not like that provision.

I have set out, in some detail, in the supplement to my statement, how we think it should be changed.

Senator WILLIAMS. I appreciate that. But again, assuming that there are no changes made, and the vote comes on the bill as it came from the House, you would still endorse the bill, including the House provision, including section 203 as it came from the House; is that correct?

Mr. BARLOW. Yes, we would say that is another price we have to pay to get a start on tax rate reduction.

Senator WILLIAMS. The section of the bill dealing with the deductions of State and local taxes, you would endorse that also; is that correct?

Mr. BARLOW. Yes, we have endorsed that.

We think that raises a problem of Federal and State relationship. We think, also, that there is a discrimination against those who claim the specific deductions as against the standard minimum deduction, but we are endorsing it as another price to get tax rate reductions started.

Senator WILLIAMS. And you have complete faith in the language of the bill which expresses, more or less, a hope that there will be a reduction in Federal expenditures? You have faith that that will really develop?

Mr. BARLOW. I think, Senator, I have the same faith you have in that provision, knowing your approach.

Senator WILLIAMS. Then I would not put very much dependence in it because I have no faith at all in that statement, and I have seen no indication that either the Congress or the executive branch intends to carry it out; have you?

Mr. BARLOW. I do not know about what their intentions are, but I would say——

Senator WILLIAMS. It is more or less a hope.

Mr. Barlow. I think that is true, certainly, and I would say this, Senator, that I do think, quite seriously, that it is significant though, that this became important enough to write it in as section 1 of this tax bill.

To my recollection, I do not remember any protestations being made by an administration in a tax bill that they were going to cut expenditures in order to get tax rate reduction.

Senator Williams. Oh, but we did cut the expenditures in 1954. However, I think we are all being realistic; this flimsy language was included as an effort to get enough votes to pass the bill. But it is not binding upon either the executive or the legislative; is that true?

Mr. Barlow. No, clearly not.

Senator Williams. Now, section 223 deals with an additional 6-percent tax, penalty tax, as it relates to corporations that file separate incomes. You endorse that provision as a part of this bill, is that correct?

Mr. Barlow. Yes, we endorse that because that is a matter of fairness because of the reversal of the normal and surtax rates on corporations. That is, that does not pose a problem.

Senator Williams. Do you feel that the enactment of this bill and reducing taxes by $11 billion will provide enough additional revenue or stimulate our economy enough to provide enough additional revenue to balance the budget at any time in the foreseeable future?

Mr. Barlow. We hope so.

Secretary Dillon said he thought the budget would be balanced by 1967 or 1968. We would like to see it sooner. We are worried that Arthur Burns says it will not be balanced until 1972. But we do believe that only by stimulating this economy, for all the reasons I have mentioned, do we have any hope of producing revenue out of this kind of a tax structure to meet the expenditures, even if they are reduced to get a balanced budget.

Senator Bennett. Will the gentleman yield to me?

Senator Williams. Sure.

Senator Bennett. On this same subject, do you remember the extent by which we stimulated the economy by the tax reduction in 1954, Mr. Barlow?

Mr. Barlow. I do not remember the figures, but there was some stimulation to the economy.

Senator Bennett. $7 billion.

Mr. Barlow. $7.4 billion or something like that.

Senator Bennett. Do you know how much increase we have had in the deficit since that last stimulation?

And do you realize we are running along here year after year with more deficits and getting farther and farther away from a balanced budget?

What right have we got to assume that what would not stimulate in 1954 will stimulate in 1963?

Mr. Barlow. Senator Bennett, I think that the reduction in 1954 did stimulate. I would hate to think of what might have happened if we had not had that tax rate reduction in 1954. I do not blame the failure to balance the budget on the tax rate reduction in 1954. I think it is blamed on this high level of Federal expenditure, and we are hoping to do something about that.

Senator WILLIAMS. Federal spending in 1954 was reduced by about $6 billion along with this $7 billion tax cut.

Now, this $11 billion tax cut today is being recommended along with a $6 billion increase in Federal spending by the same administration.

Mr. BARLOW. As I have said in my statement, we do not like that, but——

Senator WILLIAMS. So there is quite a contrast between the circumstances surrounding it.

In addition to that, we have an $11 billion deficit confronting us next year.

Senator BENNETT. May I just get one figure into the record?

Between the 1954 tax cut and the present time our budget deficits have totaled $26 billion, and yet we are told that within the next 3, or at most 4, years we are going to so stimulate the economy with an $11 billion tax cut, which is about the same percentage of the gross national product today that the $7 billion was in 1954, so we are going to balance the budget in 4 years. You tell me why the difference?

Mr. BARLOW. Senator Bennett, I do not know that we are going to do that, and I am not sure that we can put much confidence in the promise that we will have a balanced budget in 1967 or 1968. But I think reducing tax rates will help to accomplish that, and I think the alternative of going to large expenditures for relief to take care of the unemployed, instead of going to the private sector for the after tax income to make jobs for the unemployed, presents such a horrible alternative that, as I said in my statement, we do not have as much choice in getting a meaningful tax reduction or a start on it.

Senator BENNETT. When the Secretary was here Friday and I was questioning him, I reminded him that in order to cut down the unemployment to 4 percent, we have got to find 1.315 million new jobs in addition to those required to take care of the people coming into the labor force, and he smiled at me and said, "This tax cut cannot make any appreciable dent in that problem. We do not think it will."

So I hope the chamber does not think that this tax cut is going to put 1.315 million men to work in time so that the rate will stay down when we add the 1 million new people that are going to come into the labor force next year.

Mr. BARLOW. We think it will help to put them to work, Senator, but the point we are making is this: We think it is much better to reduce the rates and try to get additional after tax income to provide investment for those jobs than it is to go to the other alternative of just spending to give them relief when they are unemployed.

Senator BENNETT. I agree with you, but do you think that this is an alternative?

Do you think you are going to hold off in a political year a vast new spending program when and if this tax bill is passed?

Let me give you an example of the thing that worries me. I think I am correct in my assumption that the U.S. Chamber is opposed to the proposal to add $455 million to the fund for the area redevelopment. The current information is that this has been postponed until next year. It has not been dropped. This is new expenditure for which I do not think there is any really proven need, because the ARA still has substantial funds unspent.

But now we are being told this is not going to be dropped by the administration. They are simply going to postpone it until next year. Now to me, that is an example of the thing we are up against.

Let's get the tax bill passed first, and then we will go ahead with the expenditures.

Are you afraid of another thing that worries me, that no matter what happens, if the economy goes into a downturn, if this bill passes, and there should be a downturn, then the administration is putting itself into a heads-I-win, tails-you-lose position?

The private sector is going to be blamed for the downturn, and if there is none, the tax bill is going to be given credit for it.

Mr. BARLOW. I think, Senator, I would agree with that.

Senator BENNETT. These are the things that worry me when representatives of American commerce and industry come in and say, "We want the tax bill. We hope that there is an alternative and that this is going to stave off increased expenditures."

But you have no assurance.

Mr. BARLOW. Senator, we may be naive and we may be overly trusting, but we feel that the control of expenditures is here in the Congress, and we are sure that we have such an unbalanced impossible kind of tax structure that it is holding us back. So we are convinced we have to make a move in that direction.

Now, whether this is going to be a factor in reduced spending if the Government is going to police itself as it says, we are hoping that it will be. But we feel that we cannot lose by making a start on changing this unbalanced, inadequate tax structure we have.

Senator BENNETT. But you will not make a fight for a quid pro quo. We are being criticized in our dealings with Russia. We give them the quid and we do not ask for the quo. This is another phrase that we have heard the last few days. Now you are willing to give the quid without asking for the quo.

Mr. BARLOW. No, we are asking for the quo, excuse me, Senator, and we think it is terribly important. It is just as important that we reduce this high level of expenditures as it is that we get a reduction in tax rates, and we are down here asking for that, and we hope that this committee, the Appropriations Committee and the Congress will do something about the expenditure level.

But we have to believe—we have a kind of Hobson's choice—we have to believe that this tax rate reduction is going to accomplish something, and we have to believe that you people are going to do something about the unjustifiably high level of expenditures.

Senator BENNETT. Do you believe that the administration makes no recommendations to its overwhelming majority in Congress about levels of expenditures?

Do you believe that Congress has waited now until nearly the first of November without completing its normal appropriation bills because we have not the capacity or because the word has come down from the White House to go slow?

In other words, we have what is called a strong Executive and the Executive makes the recommendations on which Congress acts.

The ARA is a good example.

Congress did not think that one up. And yet that will add nearly $1 billion if this new bill passes, to our rate of expenditures or our authorizations in 2 years.

Now that is why I am amazed to have you take the position that the tax bill will bind the Executive, but as far as the expenditures are concerned, why the Executive has nothing to do with it, that is the Congress that has to do that.

Mr. BARLOW. Senator, I do not think this tax bill binds the Executive at all. We have some assurance and some promises from responsible people in Government, but there is nothing in this tax bill that binds either the Congress or the Executive on reducing spending.

We just hope that they are going to do what they say they will, and that we can rely on some of these promises.

I say that may be naive, but it is our Hobson's choice.

Senator BENNETT. May I ask one more question?

The Secretary in his testimony said that if this tax bill is adopted, it will put an end to the cyclical pattern in our economy.

Do you believe that?

Mr. BARLOW. No, and I did not understand the Secretary to say that in his testimony. I think he said that it would soften or minimize the impact of cyclical——

Senator BENNETT. He used the word "end."

Mr. BARLOW. Well, I certainly disagree with that.

Senator BENNETT. Do you believe that every time a recession threatens, you have got to have another tax reduction?

Mr. BARLOW. No. I think that we have unusual circumstances today that warrant a kind of unusual tax policy.

I think for the first time we are beginning to get caught up in some of the problems that have been created by these high tax rates that have existed since World War II, and that this unusual approach of reducing taxes when there is an imbalance in the budget is required because, for instance, our position in world trade is deteriorating—we no longer are the lowest-cost producer in the world. We no longer have the technological improvements that other countries do not have. We are in a buyer's market today and not a seller's market.

And so we have to, as I have said in my statement, produce cheaply with our high wage rates and high tax rates; we have to improve productive facilities and be able to compete.

That is the reason that I think this tax rate reduction, despite the imbalance in the budget and high level of expenditures, is going to help our posture in world competition. That is the chamber's position.

Senator BENNETT. Do you think that the tax reduction standing by itself will represent enough of a factor in the total cost of production to make us competitive abroad?

Mr. BARLOW. It will help.

Senator BENNETT. It will not solve the problem?

Mr. BARLOW. No, I do not see a complete solution for any problems in this tax bill, but it makes a start.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Mr. Barlow, I take it that one of the reasons why you favor the tax rate reduction is that you think it will be a net stimulant to business?

Mr. BARLOW. Yes, sir.

Senator DOUGLAS. By increasing the total monetary demand for goods?

Mr. BARLOW. That is just one aspect, the consumer aspect.

Senator DOUGLAS. And this is the aspect which you have more or less emphasized in your testimony?

Mr. BARLOW. I have emphasized, Senator, purposely the stimulus that will come to investment in low-cost productive facilities and not the emphasis on consumer spending because we are concerned about too much emphasis on consumer spending over the years and the inflationary factor we have today.

Senator DOUGLAS. But you do believe it would increase the total monetary demand for goods?

Mr. BARLOW. Yes; there would be more after-tax income.

Senator DOUGLAS. But you at the same time believe that governmental expenditures should be reduced by the amount of the tax cut?

Mr. BARLOW. We have not taken the position that there should be an equivalent reduction.

Senator DOUGLAS. May I ask, Is it your opinion that governmental expenditures should be reduced by the amount of the tax cut?

Mr. BARLOW. We think that governmental expenditures could be reduced in these 2 years by the amount of the tax cut, and more.

Senator DOUGLAS. Would you favor that?

Mr. BARLOW. Yes.

Senator DOUGLAS. Under those conditions, how is there any net stimulant if, on the one hand, you stimulate by a reduction in taxes which increases aggregate demand, as you say, but take away with the other by reducing governmental expenditures? Have you not canceled the net expansive effect?

Mr. BARLOW. No, Senator.

Our position is that the benefit of this tax bill does not come out of just increasing consumer purchasing power. The benefit of this bill comes in producing more goods more cheaply and producing more income for the country.

I agree with you that if you just rely entirely on the effect of consumer spending, if the Government takes out of the economy an amount equivalent to the loss in revenue, that you have not increased the purchasing power. But we do not think that the tax bill should be enacted simply to increase consumer spending to produce income.

Senator DOUGLAS. Not even at all to increase consumer spending, this should not be any purpose?

Mr. BARLOW. Actually, such a distinguished economist as Dan Throup Smith of Harvard University has pointed out that the best thing to do today would not be to reduce any rate below 20 percent, not erode our tax base, not have more consumer spending which would be inflationary, but emphasize jobmaking investment.

Senator DOUGLAS. In other words, you value this bill primarily because of the added funds which are put in the hands of people who would then invest?

Mr. BARLOW. Yes, corporations.

Senator DOUGLAS. That is in the upper income groups?

Mr. BARLOW. Yes, and the encouragement——

Senator DOUGLAS. And you favor a tax system therefore which would increase the amount of income in the upper income groups because they will invest a larger proportion?

Mr. BARLOW. Senator, let me say in response to that question that there will be money spent beyond the tax saving just because of the confidence, just because of the new thrust in our tax structure. You do not look just at the dollars of tax savings to the middle and upper brackets and to the corporations, there will be a stimulus to the economy beyond the actual dollars of after-tax savings under the bill.

Senator DOUGLAS. But so far as the dollar stimulus is concerned, you place more trust in the dollars put in the hands of the well-to-do or wealthy than the dollars put in the hands of the poor or lower income groups because the upper groups will save a larger proportion of their income.

Mr. BARLOW. Senator, the position is this: We have an economy today that has the lowest rate of investment in relation to gross national product of any industrial country in the world.

Senator DOUGLAS. Are you certain of that?

Mr. BARLOW. Yes, that is the statistics that have been——

Senator DOUGLAS. Will you submit figures on that?

Mr. BARLOW. Yes, we will.

(The following was later received for the record:)

Country	Percentage	Year	Country	Percentage	Year
1. Japan	31	1960	6. Sweden	22	1961
2. Germany	25	1961	7. Belgium	18	1960
3. Netherlands	24	1961	8. France	18	1961
4. Italy	23	1961	9. United Kingdom	17	1961
5. Canada	22	1961	10. United States	16	1961

Source: The "United Nations Yearbook of National Accounts Statistics, 1962."

Mr. BARLOW. Those are the figures that have been given to me by the economists of the Chamber and I think they are reliable figures.

The reason that we think the time has come for an increase in after-tax dollars for investment is this problem of not investing enough in productive facilities. We have adequate consumer demand at this particular time in terms of facilities, but we do not have the low-cost facilities. We have overcapacity, but we do not have low-cost capacity, and that is what we are trying to do with the after-tax dollars in this tax rate reduction bill.

But I want to emphasize again that it is not just the tax saved to the middle income brackets and the upper income brackets. It is the additional amount they will spend because they have confidence.

Senator DOUGLAS. Now this may explain your long-range position which seems to be hinted at in your testimony. You say that—

Economic health lies in a substantial reduction in our steeply progressive and repressive surtax rates and also in a more balanced tax structure, which means more reliance on tax sources other than the income tax such as a supplemental low-rate excise tax or possibly a value-added tax.

Mr. BARLOW. Yes.

Senator DOUGLAS. So you would favor decreasing still further the rates in the upper incomes and would develop these additional taxes.

Just what do you mean by a supplemental low-rate excise tax or a value-added tax?

Mr. BARLOW. First, just let me say that we favor reducing the surtax rates down to 50 percent. We believe that there is a general feeling that it is inequitable and unfair for Uncle Sam, as the President said, to——

Senator DOUGLAS. Is that an average rate or a marginal rate?

Mr. BARLOW. That would be the top bracket rate.

Senator DOUGLAS. Of course, a top of 50-percent marginal rate would be less than a 50-percent average rate, because 50 percent would simply be on the last increment of income and the preceding increments which would be taxed at lower rates would therefore lower the average.

My guess is that a 50-percent marginal rate would be not far from a 30- to 35-percent average rate.

Mr. BARLOW. I think that is right, Senator, but our position is and has been that on the last dollar you own, whether it is $1,000 or whether it is $30,000, Uncle Sam should not come and take 91 percent of it. He should take no more than 50 percent of it.

Senator DOUGLAS. I do not like the 91-percent rate either.

Mr. BARLOW. No.

Senator DOUGLAS. But I want to point out that your proposal means probably an average rate not far from 30 to 35 percent.

Mr. BARLOW. We would think that would be entirely fair.

Senator DOUGLAS. And you are opposed to that amendment which was opposed to the Constitution that the Federal income tax should not exceed 25 percent?

Mr. BARLOW. I gather we are not talking about the constitutional amendment this morning, but I would think if you had your surtax rates running from 15 to 50 percent, with gradations say of 2 percent, that if the average effective rate came out at 35 to 37 percent, that that is all that the income tax structure should bear.

Senator DOUGLAS. If this was not enough to meet the needs of national defense, pensions, various other features, you would have a supplemental low-rate excise tax.

Mr. BARLOW. The reason for that, Senator, is this: As I said in my statement, of the total revenues collected in the United States today, 85 percent, as you know, come from the income tax. That means we rely on the income tax to a greater extent than any other nation, and that causes a lot of problems which you, as an economist, understand.

My point is this: If you are going to eliminate the hardships in the bottom brackets by reducing rates in those brackets—and we agree that there are hardships there—you would reduce the base of the tax so much that you could not collect enough revenue while relying on an income tax for 85 percent of all revenue. So we say to you, we have to look around for other sources as other nations have.

One source would be an excise tax.

Senator DOUGLAS. That is really a sales tax, is it not?

Mr. BARLOW. That is a sales tax.

Now we recognize the problem in that. The States rely on that sort of tax, and if the Federal Government gets into it, a problem is raised for the States. But nevertheless, as you know, we have today a crazy quilt of excise taxes. There is no rhyme or reason. They were built up during the war, and the rates vary all over the map. And so we are saying that if you got rid of this patchwork of high and low rates and had a uniform low rate, you would raise a great deal of revenue to support the income tax structure, without any real harm to the States.

If you had a 2-percent value-added tax you would collect as much revenue as you do from a 10-percent income tax on corporations.

So the whole thrust of those pages is to get a broader tax base.

Senator DOUGLAS. These are to be passed on by the consumer and borne by the consumer?

Mr. BARLOW. I did not hear you.

Senator DOUGLAS. These are to be passed on to the consumer and borne by the consumer?

Mr. BARLOW. That is the nature of those taxes.

Senator DOUGLAS. That is right.

Mr. BARLOW. But let me say this: You have some justification for having these taxes passed on to the consumer if you reduce the low rate structure of the income tax law.

Senator DOUGLAS. We are already collecting Federal taxes over $10 billion in excise taxes, plus I believe the taxes on gasoline which are isolated and in a separate account for the highway system, so that the Federal tax structure already has approximately $14 billion of excise taxes.

Then of course you have the State and local sales taxes, and the State property taxes amount together to something over $30 billion a year, so that the total tax structure of the country is already heavily loaded with excise and other repressive taxes.

Is there not a great mistake in fastening your attention entirely on the Federal tax structure, on the income tax feature, and neglecting these other portions?

Mr. BARLOW. Senator, I am using comparable figures.

If you take France, Germany, and England and consider their tax patterns, you will find that they have a much lower reliance on income taxes.

Senator DOUGLAS. You think we should follow the German system?

Mr. BARLOW. I think we have to for the reason that we are talking about.

You recognize, as I do, that there are hardships in the lower rates, and the trust of this bill is to relieve them of 38 percent of their liability as against 12 percent for the higher brackets, and when you start doing that, you whittle away at the broad base where all the money is collected, and you wind up with a tax structure that becomes increasingly more inadequate to meet this high level of expenditures. You will have a continuing imbalance in the budget, we feel, unless you keep the income tax structure beefed up at the base rate where it produces the most money.

You could confiscate, as you know very well, all of the income over $50,000 and you would not have a drop in the bucket in meeting Federal expenditures. We have to keep the base strong; that is what we are talking about when we refer to supplemental tax sources in the pages of my statement which you mentioned.

The value added tax, as you know, Senator, has the great advantage also of putting a premium on efficiency. The lower your costs, the less tax you pay.

This income tax structure, particularly in the area of business income, puts a penalty on the low-cost efficient producer. He pays more taxes.

Germany has gone the value added tax route with great success both in terms of encouraging industry and getting an expansion of productive facilities, and also in raising revenue.

Senator DOUGLAS. Do I take it that you do not like the principle of progression in the tax system?

Mr. BARLOW. I think the principle of progression is with us. I do not think we have to have all of the steeply graduated progression that we have.

I think that is what takes the initiative away from people, and it also slows down the momentum in our economy. I would say to you that I think to be politically realistic, we are going to have progressive tax rates, but the whole thrust of my argument this morning is that they should not be so steeply progressive.

Senator DOUGLAS. If you could remodel the tax structure to your own desires, would you have progression in the Federal income tax or proportional income tax?

Mr. BARLOW. The Chamber's view is that if we had a rate structure that ran from 20 to 50 percent, we would produce——

Senator DOUGLAS. I thought you said 15.

Mr. BARLOW. Fifteen to fifty percent or the present base rate, our proposal was to divide the bottom bracket into two $1,000 classifications, and have 20 percent on one and 15 percent on the other. You lose much less revenue under this proposal than under H.R. 8363. Thus our proposal for a rate structure, not being just academic about it but being realistic, would be a rate structure from 15 to 50 percent.

We proposed last year a transitional rate structure of 15 to 65 percent, with the hope that the 65 percent rate would get down to 50.

Senator DOUGLAS. And make good any deficit with a——

Mr. BARLOW. I could not hear you.

Senator DOUGLAS. I say make good any deficit with a sales tax?

Mr. BARLOW. Well, with a sales tax and take a look at the value added tax.

Senator DOUGLAS. Which is a form of sales tax.

Mr. BARLOW. You and I could debate that perhaps, whether it is a form of sales tax, but it can be evolved so that it is not passed on fully to the consumer.

Senator DOUGLAS. When Secretary Dillon testified, I read to him some statistics which had been prepared inside his own Department, and which he agreed were accurate, which showed that in 1959 there were eight men with adjusted gross incomes from $1 million to $5 million who paid no taxes whatsoever, not one single cent, and five men with adjusted gross incomes of over $5 million, who paid absolutely no taxes.

Do you think that is a just state of affairs?

Mr. BARLOW. I should say not, Senator, but it comes not so much from the reasons that might be attributed to it as it does from what is wrong with our tax structure. I think it highlighs what is wrong with our tax structure, because, in order for those people to pay no tax, they had to give away their money or they had to lose it. They had to give it to charity or they had to lose it in some business venture like drilling for oil.

You still do not have a rate that exceeds 100 percent. The reason they paid no income tax is because they resent taxes and they would rather give their money to charity or to the churches or the schools or lose it in business ventures than pay it to Uncle Sam.

Senator DOUGLAS. That was the defense or justification which Secretary Dillon put up, but a closer analysis of the figures showed that the major portion, the major portion, was due first to the depletion allowance for oil and gas, which, as you know, frees from taxation 27½ percent of gross income up to 50 percent of net income, that it was also due to the capital gains tax under which income can frequently be disguised as a capital gain, and therefore taxed at only half the rate of income tax subject to a maximum of 25 percent, and due also to the various shields, corporate shields which an individual can throw around his income.

This leads to gross injustices in the tax system.

I am glad to see I think that you agree that there are injustices.

Mr. BARLOW. Senator, I agree that there are gross injustices in our tax structure. That is the reason we want it changed.

I do want to point out that these individuals, as I said a minute ago, either have to give away their money or take deductions for costs that the Congress of the United States has decided are costs of producing income.

I would say to you that if we could get our rate structure down to a reasonable level, we would come up here as we did in 1959 and as we have done before, before the committees of Congress, and recommend areas where these deductions——

Senator DOUGLAS. Let me say I favor that, too.

Mr. BARLOW. Could be eliminated.

Senator DOUGLAS. If we could correct these abuses I would be in favor of reducing the maximum rate below 91 percent, although not necessarily to as low a figure as 50 percent.

But what has happened has been that almost none of these abuses are being corrected. Yet the maximum rates are being reduced at the same time, and you endorse Senator Long's proposal which would reduce them still further, and therefore, what we have been having is very little correction in the tax system itself, yet reduction in the upper limits.

I wish you would put your great abilities, and they are great, into helping plug what used to be called loopholes, which I think more properly may be termed "truckholes," in correcting these depletion allowances.

The Senator from Delaware and I do not agree on many subjects, but we agree thoroughly on this depletion allowance, and I hope that you could reinforce our bipartisan alliance to reduce this gross inequity.

I have been disappointed in the chamber that it has not come forward as a supporter of the Senator from Delaware and the Senator from Illinois.

Mr. BARLOW. Senator, I do not want you to be disappointed in the chamber.

Let me say this: We have felt, and we urged in the 1959 hearings, that there should be real tax reform and revision of this tax structure from top to bottom. But we really are convinced that you are not going to do much with what you call loopholes or truckholes until the public generally has some assurance that the rate is going to be reasonable. You have a hen or the egg problem, which comes first, the rate reduction or the assurance of rates.

A lot of people would give up their built-in preferences if they had some assurance that the rate was going to be reasonable.

Senator DOUGLAS. You see, you come down from 91 to 70 now. That is quite a reduction.

I personally think 50 is too low. But we might meet at some point, if you would support the move on the depletion allowance, and if you would help us on capital gains, and if you would help us in removing these corporate shields which are thrown around income. I would be willing to go down below 70 percent and I think you ought to be willing to come up above 50 if that happened.

These reductions are urged, but there is no corresponding movement to effect a reform.

Mr. BARLOW. We have made proposals for reforms, and as I have said, we would make many more proposals if we could be sure of some kind of reasonable rate structure.

Senator DOUGLAS. I will agree to reduce the rate to 66 percent if you will remove the depletion allowance, remove the corporate shields, and reform capital gains.

Mr. BARLOW. On removing some of these things, I think, Senator, you understand as well as I do that there are different kinds of income that have to be taxed differently, and you cannot, overnight, revamp all areas of this tax structure without having serious economic dislocations. But I think we are making progress when you get down to 66 percent.

Senator DOUGLAS. I would only do that if you would help on the reforms.

Mr. BARLOW. We will assure you that we will help on reforms, but we might have disagreement as to the area of reform.

Senator WILLIAMS. Will the Senator yield?

Senator DOUGLAS. Yes.

Senator WILLIAMS. Under existing law, even though we have the 91-percent rate, we have a factor here which says that under no circumstances can they take over 87 percent?

Mr. BARLOW. Yes.

Senator WILLIAMS. Last year or the year before, at any rate in the last couple of years I offered a proposal to cut the depletion allowance for oil back to 20 percent and accompanied that with an automatic reduction in the ceiling to 50 percent on overall income, and the revenue of one was offset by the other.

Would you endorse such a proposal?

Mr. BARLOW. Senator, not this morning. I would want to think about that a great deal.

Senator WILLIAMS. I appreciate the Senator from Illinois yielding; the reason I asked that question was that it seemed to be in line with what you were suggesting, that they get this overall rate down to 50 percent, and that you may be willing to reduce this depletion allowance accordingly.

I did offer such a proposal and would again, and I just ——

Mr. BARLOW. You can be sure it will have the most careful study by the chamber of commerce.

Senator WILLIAMS. There has been a 17-year study. But would you be willing—if the Senator will excuse me just a moment—for this particular bill, H.R. 8363, to get the same kind of a study that perhaps this depletion change has been getting?

Mr. BARLOW. I do not think it requires as much, Senator.

Senator WILLIAMS. Thank you.

Senator DOUGLAS. That is all, Mr. Chairman.

The CHAIRMAN. Senator Gore.

Senator GORE. Mr. Chairman, this is a very important and, in the language of a lawyer, a very material witness.

I have a luncheon engagement in 3 minutes and I would like to ask this gentleman some questions. He has made some statements that are important for consideration. I am willing to come back this afternoon or night or whenever the chairman suggests, but I am hardly in a position to continue right now.

The CHAIRMAN. How long will your questions be?

Senator GORE. I think 30 minutes.

The CHAIRMAN. Mr. Barlow, could you come back at 2:30?

Mr. BARLOW. Yes, sir.

The CHAIRMAN. Senator Williams has one more question.

Senator WILLIAMS. I will ask you just one question at this time. You suggested, or the suggestion has been made, that by reducing taxes we could reduce the income of the Federal Government and that this reduction in the income may act as a brake on expenditures; is that your feeling?

Mr. BARLOW. No, Senator, not exactly. Let me explain.

Our feeling is that if we do have tax rate reduction and we know that we are going to have less revenue in 1964 and 1965 because of this tax reduction, it should serve as some stimulus to the Congress to try to hold down expenditures. But I do not mean to say that we are in favor of this tax bill or this tax rate reduction because it is going to shut off revenues for expenditures.

We think it may have that effect, and I hope it does, but that is not the reason we are endorsing the tax cut.

Senator WILLIAMS. That gets to the question that I want to ask you, because the only way it could have that effect would be to deprive the Government of its ability to borrow the money to finance this tax cut and their spending at the same time.

Now, what action would you recommend this committee take in connection with the Secretary's request, which is coming down here in the next couple of weeks, for an increase in the debt ceiling?

How high would you say we should go? Give him what he asks for, or do you think we should cut that back so that he would have to absorb some of this tax cut and reduce spending?

Mr. BARLOW. I think, to use a phrase, I would hold his feet to the fire.

I do not think I would let them think that——

Senator WILLIAMS. Would you suggest that we hold it around $309 to $310 billion?

Mr. BARLOW. Yes, I would.

Senator WILLIAMS. Do you think we should increase it to $315 or $318 which he is expected to ask, in order to finance this tax cut?

Mr. BARLOW. I think clearly that we ought to try to hold the ceiling on the debt at the lowest possible figure.

Senator WILLIAMS. The only way to hold it is to hold against the increase.

Would you recommend strongly—would the chamber recommend that the debt ceiling should be held at $309 billion, which is the present ceiling?

Mr. BARLOW. I think a practical problem is involved when the Secretary of the Treasury comes here. The credit of the United States is involved.

I am a tax lawyer. That is not the area of my expertise.

I would say that the chamber's position would certainly be to try to hold the debt ceiling at the lowest possible level consistent with keeping American credit good in the world.

Senator WILLIAMS. American credit—if you are going to spend the money you have to finance it certainly. But the question I am asking is, do you think we should put this brake on and as you say hold his feet to the fire.

You are not going to do it with talking. You are only going to do it by putting an effective ceiling on available cash.

Now, do you support holding that ceiling and compelling the administration to live within that ceiling, or do you suggest that we raise it?

We are going to have that decision to make.

Mr. BARLOW. Senator, I want to be helpful, but this is not a judgment that I can make very well as to dollar amounts or to what the ceiling should be. But I can say that the whole thrust of the chamber's argument and position is that we stop this deficit spending and we try to hold a ceiling on the public debt.

Senator WILLIAMS. I will not press that further.

I will just have one other question.

(Off the record.)

Mr. BARLOW. One of the programs of the chamber has been to try to educate the chambers of commerce throughout the United States that the only way we are going to get a reduction in expenditures is a little self-discipline in all the various areas of the United States. In that sense I understand what you mean by holding the chamber's feet to the fire. We want our feet held to fire if we are effectively to reduce the demands of local communities for pork barrel legislation and large appropriations.

Senator BENNETT. This has been the theme of your present president's messages?

Mr. BARLOW. That is right.

Senator WILLIAMS. One of the arguments that the administration is making in support of this tax cut, even in the face of a prospective deficit of around $11 billion, is that it will stimulate the economy and it will increase the revenue of the Government to the point where they can balance the budget with its increased revenue.

Is that not almost exactly the same suggestion that the administration made a year ago to the steel industry?

The steel industry was suggesting that they should raise their prices in order to finance their operations to cover their increased costs. The President took a strong position they should hold their costs down, thereby increasing the demand for steel, selling more steel, and making more money in the end.

Now how did it work out with the steel industry?

Mr. BARLOW. Senator Williams, the steel industry, as I understand, today is working at 61 percent of capacity, and one of the concerns

I have, and I am not an economist, about the need for after tax investment is to increase productive activity in the country and produce more income to produce more revenue.

I feel generally that it is the chamber's position that although you will not get the full benefit of this tax reduction immediately, there will be a factor of increased economic activity and increased income to tax to produce more revenue in this next 2-year period and you will not have this $11 billion loss in revenue when you consider the favorable effect of the tax rate reduction itself.

Senator WILLIAMS. You still have not answered my question.

How did that idea work out in the steel industry?

Did it accelerate their business to the point where they made more money?

Mr. BARLOW. I do not know enough about the steel business to answer that. I do not know how it worked out.

Senator WILLIAMS. It did not work. The answer is as I think you do know—I ask again—do you agree with the President's recommendation of a year ago for the steel industry?

I am sure you are familiar with his recommendation at the time they suggested they raise prices.

Mr. BARLOW. I think the chamber's position at that time was opposed to the President's position, but I am unfortunately in the position here only of talking about the chamber's position on taxes, and I do not know about the effect on the steel industry.

Senator WILLIAMS. The point that I am making is that if this tax cut of $11 billion can accelerate our economy to the extent that it can balance the budget, do you not think it would be advisable to cut taxes just about 50 percent more than this bill suggests and maybe make a couple payments on the debt?

Mr. BARLOW. Well, I do not believe that there is a direct relationship, Senator. I think if you went to zero and had no taxes it would not help you much with the debt.

We felt in the chamber a year ago that there could have been a larger tax cut in 1 year. One of the problems with this tax bill we feel is that it is a little late. It has been around here, as Senator Byrd mentioned in his opening statement, for quite some time, and if we had had this tax cut earlier the beneficial effects would have been felt earlier in the economy, and we perhaps would have been in a little better position in 1964.

Senator WILLIAMS. Of course your earlier recommendation, when this was first proposed, was that there first be a cut in expenditures of the Federal Government and then a tax cut, is that not true?

Mr. BARLOW. That is right.

Senator WILLIAMS. And you have now come around to the point where you are recommending a tax cut and are willing to settle on a pious hope of a reduction in expenditures?

Mr. BARLOW. Well, that is one way to put it.

I might say that our position has not changed.

Senator WILLIAMS. No.

Mr. BARLOW. We felt that there should be a reduction in the high-level expenditures in 1962 and we feel that way in 1963. We are only sponsoring this tax rate reduction proposal because we think there are going to be more expenditures in 1964 if we do not support it.

Senator WILLIAMS. But my point is that you are willing now to change what was an insistent request that there be a reduction in expenditures when this tax cut was first mentioned.

You are now willing to settle for a hope?

Mr. BARLOW. No, Senator. I want to be perfectly clear on the record.

Our position now is exactly the same as it was in 1962. We think that reduction in expenditures and tax rate reduction go hand in hand. They go together. We have not changed our position as to priorities at all.

Senator WILLIAMS. Now we are getting back—maybe you and I are going to agree.

Mr. BARLOW. I think we do generally.

Senator WILLIAMS. Yes. We should.

Would you be willing to endorse this tax bill only with a provision which says that the reduction in expenditures would be mandatory, we put in a proviso in this bill, a new section, placing an overall ceiling on expenditures?

Would you be willing to make your endorsement of this tax bill contingent upon the acceptance of such a ceiling?

Mr. BARLOW. Senator, I would like to agree with you.

As I say, my instinct is to agree with you, but I do not think you can write into a tax bill that kind of a provision. I do not think the Internal Revenue Code ought to be cluttered up with appropriational limitations.

Senator WILLIAMS. It could be.

Mr. BARLOW. I think what you ought to do in the Congress, if I may say so, is to write those kinds of restrictions into the appropriation bills.

Senator WILLIAMS. I will agree with you on that, but we also have the authority to place such a restriction in this tax bill. The hope is already expressed, and you have strongly endorsed that hope.

Now, if we change that first section from a hope and put some teeth in it, as you say, would you endorse modification of that first section making it mandatory that such a reduction be made?

Mr. BARLOW. I do not think you can write an effective provision for this purpose. If you write into this bill that the tax rate reduction will only go into effect if expenditures are reduced, the President can increase expenditures, and in that way defeat the purpose of tax rate reduction. He can go to the people and say, "This is not my fault. Expenditures had to be increased, but there goes your tax rate reduction because the Congress wrote in this prohibition." I think that is a very bad approach, as much sympathy as I have with trying to put some teeth into limitations.

I do not believe that is the right approach to expenditure control working through a tax bill.

Senator WILLIAMS. Would you support the postponement of action on this bill until after the budget has been submitted for the next fiscal year?

Mr. BARLOW. No. We have talked a great deal about that, and I think that we should not wait for the budget to be submitted because, as I have said, at the yearend, and from now on we are getting very close to the yearend, many business decisions have to be made about spending more money than the tax savings.

Senator Douglas was talking about the savings that would be spent. But so many decisions have to be made that it is most important that we have an early decision.

There is one aspect of your question that gives me great concern, and that is a proposal that has been made to eliminate the 7-percent investment credit entirely.

I think unless that is cleared up before the yearend that there will be a real deadening effect on expansion and on spending by business for investment in low-cost productive facilities.

The tragedy would be that, once having liberalized the depreciation provisions with the guidelines and with the 7-percent investment credit and in less than a year action is taken to eliminate it, there would be very little confidence in the business community now or in the future that there are going to be allowances for capital recovery anywhere at all comparable to those given in European countries.

Senator WILLIAMS. Without debating the merits or demerits of the investment credit or whether it should or should not be eliminated, my question is this: Just suppose the committee did eliminate that section, would you then recommend that the bill be defeated, or would you recommend that it be passed with that deletion?

Mr. BARLOW. Deleting the 7-percent investment credit?

Senator WILLIAMS. Yes, just suppose it was deleted?

Mr. BARLOW. My guess is that we would oppose the bill if the 7-percent investment credit were deleted, but we would have a meeting of the taxation committee and the board. That would be a very important question.

We meet very regularly. We try to keep our finger on the pulse of our membership and what the business community wants.

When you give me some of these questions, and understandably you do, I try to deal with them, but when it comes to a major policy decision on this tax bill like the deletion of the 7-percent investment credit, we might have to take a different position.

Senator WILLIAMS. I was not raising these questions to argue with you on the merits of it. I just want to get your position clear.

Mr. BARLOW. No.

Senator WILLIAMS. My only question was assuming that a motion was made to delete the investment credit provisions of this bill, when the final vote came on whether we took the bill or not, as I understand it, you think you would be against it?

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

(Whereupon, at 12:40 p.m., the committee recessed, to reconvene at 2:30 p.m. the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

Mr. BARLOW. Will you take a seat, please.

Senator GORE. I am sorry, Mr. Chairman, I have been on the floor, and the leadership was telling me every minute that they were going to have a vote. I apologize, Mr. Chairman. I started to come earlier. I did not mean to take your valuable time.

The CHAIRMAN. Yes, sir. Go ahead.

Senator GORE. I noticed this morning, in response to a question by Senator Douglas as to whether the enactment of the pending bill would provide more investment capital, that you said, "Yes," because there will be more after-tax income. Do I correctly state your answer?

STATEMENT OF JOEL BARLOW, U.S. CHAMBER OF COMMERCE—Resumed

Mr. BARLOW. Yes, Senator, that is one of the reasons.

Senator GORE. I wrote it down because I had observed that in your statement you say: "It is misleading to compute on the basis of income after taxes."

Will you explain the contradiction?

Mr. BARLOW. Misleading, you say?

Senator GORE. No, you said that.

Mr. BARLOW. Will you tell me the sentence that you are referring to or the paragraphs, so we get this in context?

Senator GORE. In answer to a question by Senator Douglas this morning you used the phrase, which is a well-known one, and I am not accusing you of anything, "more after-tax income," or "after-tax income." Yet in your prepared statement you say it is misleading to compete on the basis of income after taxes.

The point I am trying to make, and there is no need to belabor it, is that after-tax income is to individuals and to corporations the most important single result of the tax bill.

Mr. BARLOW. I agree with you on that, but there is nothing inconsistent on what I have said. Let me explain why.

I told Senator Douglas this morning when we were discussing this, that one of the reasons there will be incentive to investment in moneymaking and jobmaking investment is that there will be more after-tax income.

I also pointed out to him that not only would there be more after tax income to encourage investment, but the fact that the tax bill is passed with lower rates would also give rise to confidence in the business community so that more money would be spent than just the after-tax income. Now I know of nothing in the context of those comments that is inconsistent at all.

Senator GORE. You don't mind then if all of us consider the after-tax income result of the pending bill if enacted?

Mr. BARLOW. Yes; I think, Senator, the important thing is to consider the after-tax income when the rates go up, and to consider the after-tax income when they come down.

The difficulty is, and I think this may be the reason for your comment, that when tax rates go up, there are people who refer only to the percentage of increase. The rate goes from 4 to 8 percent, they said that is a 100-percent increase. They don't talk at that time about the total dollars of additional cost of taxes.

What I am explaining is that when the tax rate comes down, we have to look at the percentage reduction which in this case is 3 to 1 in favor of the lower brackets, and not talk about just the reduction in dollars that arise not out of the tax structure but arise out of the total amount that people earn. Now that is all that I am talking about.

Senator GORE. Then I take it you would agree with me that a correct analysis of the bill requires an examination from both viewpoints or standpoints.

Mr. BARLOW. You have to look at after-tax income in terms of dollars. You have to look at after-tax income in terms of percentages, but we have to be careful that we don't distort either and get into this business of the political arithmetic of tax rate making. Let's use the same test when we go up as when we come down.

Senator GORE. You and I are in agreement in that we need to examine it from all angles, as a matter of fact.

Mr. BARLOW. Yes; I agree.

Senator GORE. But I am not sure what you mean by the term "political arithmetic." I am not acquainted with that.

Mr. BARLOW. What I mean by the political arithmetic is just what I have been explaining: that when the rates go up, one bit of arithmetic is used, and that is the percentage increase at the lower level of the bracket. When the rates come down, people are inclined to use political arithmetic as to the dollars of saving.

In other words, the Republican minority report refers to cigarette money. I don't think that is a proper evaluation of the results of this tax bill, because those savings that are small result not from the tax bill but result from the fact that those people don't make a great deal of money, and when you have millions of taxpayers at this rate base, Senator, saving $100 or $200, that is where you lose the bulk of your revenue. It is not in those top brackets, if you will excuse me.

Senator GORE. Why is one political arithmetic and the other not?

Mr. BARLOW. They are both. They are both political arithmetic. That has been our problem for years.

Senator GORE. You say it is proper to examine after-tax income from the standpoint of both dollars and percentages.

Mr. BARLOW. Yes.

Senator GORE. Up or down.

Mr. BARLOW. Yes.

Senator GORE. You and I are getting along remarkably well.

Mr. BARLOW. I am sure we will.

Senator GORE. Have you seen the testimony of the Secretary of the Treasury?

Mr. BARLOW. Yes; I heard it, too, Senator.

Senator GORE. His table 4 shows that the tax reduction which those filing 9,700,000 returns will share will be $555 million, and those filing 200,000 returns, taxpayers with adjusted gross income of over $50,000, will share approximately the same amount, or $525 million.

Now, how would you characterize this in terms of after-tax income, increase in after-tax income or political arithmetic? How would you characterize this, the Secretary's statement?

Mr. BARLOW. I characterize it this way, Senator: that when the rates went up you had the same dollar problem. Those fewer taxpayers paid all that money when they went up. So when the rates go down, because they earn more money, they pay those fewer dollars.

That does not come from this rate structure. That is a misconception. This comes from the fact that those people make that much money, and they are taxed so highly at the top brackets that it is perfectly plain there is going to be more dollars of reduction because they make more money. But that does not have anything to do with the rate structure.

As I pointed out earlier this morning, Senator, the greatest percentage of reduction of tax liability comes in the lower brackets, not in the upper.

Senator GORE. I don't know on what basis you say that this does not result from a change in the rates, but rather results from the income that these taxpayers have. It seems to me that we are talking about the same income but a changed tax structure. I don't quite follow your logic there. You are saying that this is not the result of any change that is brought about.

Mr. BARLOW. No; I said the differential is not a result of the change in rates. What I am saying to you is that the reason they are dollars of saving is because there were comparable dollars of cost when the rate went up. Whenever they come down, they should come down reasonably proportionately.

Now they haven't come down. The benefit is weighted in favor of the low-income groups. But when you talk about dollars of saving when the rates come down, you have to keep in mind the dollars of cost when the rate went up.

This is something that you and I probably don't need to discuss, because this argument has been going on for years, and it is not very meaningful. But I am saying the rates do not affect the differential of saving. The saving differential arises from the income people make.

Senator GORE. You and I would not want to argue about how many angels could dance on the point of a needle, would we?

Mr. BARLOW. No; I think that is the problem. We don't want to do that.

Senator GORE. I have just given you the tax reduction in dollar amounts from the table presented by the Secretary of the Treasury, resulting from the changes that will be brought about by the proposed bill, if enacted.

I notice you use sometimes the term "tax equality." You used that term in your testimony before the Ways and Means Committee. What do you mean by tax equality?

Mr. BARLOW. I used probably tax equity, and I don't want this confused with the tax equality.

Senator GORE. No; I am sorry, you didn't. You used tax equality.

Mr. BARLOW. I am perfectly willing to use that term. I just don't want it confused.

Let me say this: What I mean by tax equality is that to the extent possible there should be equitable treatment of taxpayers under a progressive tax rate which we have acknowledged is here and which we probably are not going to get rid of.

Senator GORE. Would you consider tax equity, would you consider that the——

The CHAIRMAN. I am sorry to interrupt, but there is a vote on the final passage of a bill. We will recess and come back immediately.

(Short recess.)

The CHAIRMAN. The committee will come to order.

Were you just answering a question?

Mr. BARLOW. I think I had concluded answering the question. I was waiting for the Senator.

Senator GORE. Would you wish to substitute tax equity for tax equality wherever you have used it in your testimony before the Senate and the House?

Mr. BARLOW. No, Senator. I think names are only labels for our ignorance, and you can use tax equality, tax equity interchangeably if you wish. I am not trying to make any point about the difference in those terms.

Senator GORE. I know, but there is a difference in the terms, and I am interested in your views. I think the U.S. Chamber of Commerce has presented a surprising point of view in your testimony, and I am interested in your views.

Mr. BARLOW. I have tried to set out in the statement——

Senator GORE. How do you distinguish between the terms tax equity and tax equality?

Mr. BARLOW. I think some people mean by tax equality that the rates should be equal.

Senator GORE. I am not asking you what some people mean. What do you mean?

Mr. BARLOW. Generally tax equality and tax equity as I say can be used interchangeably, but I think there are misconceptions about those terms, and when I talk about tax equity I simply mean treating taxpayers equitably and fairly. When I talk about tax equality, I mean about the same thing except there is a connotation about tax equality that some people think that the rate should be the same for everybody.

Senator GORE. You held forth rather eloquently against progression.

Mr. BARLOW. No, I did not hold forth against progression. I held forth against too much progression or too much steeply graduated tax rates, and I think that is a mistake for all the reasons I gave this morning. I think we have learned generally that it is a mistake.

Senator GORE. You think that the less progression there is in tax rates, the less we hew to the principle of taxation according to the ability to pay, the closer we come to tax equality?

Mr. BARLOW. I am not sure, Senator, what any of us mean by "ability to pay." That is a kind of overworked, overused term, and I don't hear it very much any more, but I say this to you: that, within reason, eliminating progression from the tax structure works more equity. That is at least our view. I imagine some people disagree with that.

Senator GORE. I am interested. You say you no longer hear the term "taxation according to ability to pay" very much. Of course, you move in a rather rarified atmosphere. I can understand why you might not hear that, but out where the people work, skimp, and try to make ends meet, and to whom "take-home pay" is a very meaningful phrase, "taxation according to ability to pay" has a very real meaning, if not an emotional impact.

Mr. BARLOW. I think that is true. I think I agree with that. But I am interested in those people who work, sweat, and have hardship in the tax rates, and I would like to reduce those rates and limit them for schoolteachers and wageworkers, too.

Our point is, if you are going to raise enough revenue in this country, you can't eliminate the broad tax base. We recognize hardships, the chamber recommended in its own program a rate of 15 percent, and this bill goes to 14, so that I don't think any of us are interested in doing anything but minimizing hardships at the bottom brackets. But you can't eliminate that tax base and collect any revenue. That is our basic point.

Senator GORE. I was very interested in the sentiment you expressed this morning with respect to taxes coming off as they went on. I don't remember your exact words, and I am not attempting to quote them.

You undersood, I am sure, from my exchange with the Secretary of the Treasury a few days ago, that I would have difficulty supporting a reduction in governmental revenue of $11 billion as a permanent reduction of the revenue level of the Government, regardless of what form the tax bill may have taken from the standpoint of equity as I understand it, or from the standpoint of tax equality and/or tax equity as you understand it.

I have the very deep feeling that if we are to have, regardless of the standard of responsibility to which you made a passing reference this morning—and I am glad to see the chamber of commerce make a reference, even though passing. I feel that the most inequitable single provision of our tax law—well, among the most inequitable provisions of our tax law—is the personal exemption of only $600 for a dependent. Do you happen to have children or have you had children in school?

Mr. BARLOW. Three.

Senator GORE. Then as a parent you would be able to know from personal experience the adequacy of a $600 deduction for the rearing and the education of a child. Would you be willing to give the committee the benefit of your view? Would you measure this $600 exemption alongside your yardstick of tax equality or tax equity as you choose?

Mr. BARLOW. Senator, I think the reason that there is a $600 personal exemption in the tax structure is as a recognition of the problems of people in paying taxes who have a lot of children. But I don't think it has ever been intended so far as I know to make the personal exemption anything like the equivalent of cost of raising a child.

I don't think there has been a decision under our tax laws to subsidize each family to the extent of cost of raising a child.

There is another problem here that comes in which seems to me fortifies the position I am taking, and that is, that we can't eliminate the cost, the complete cost to a family of bringing up children, in our tax structure, or we would not have enough base left at 20 percent today to raise anything like the revenue we need.

As I tried to point out in my statement this morning, the problem here is having an adequate tax structure to just approximate the high level of the spending today, the expenditures of the Federal Government. Because we are relying on the income tax structure for 85 percent, approximately, of all of our revenue, we can't give deductions and personal exemption to everybody to take care of the cost of his family, even at the low income levels, because there would not be enough tax to support this level of Federal expenditures or even a lower level.

I want to say again that the chamber has been over the years, I think, very much aware of the importance, every time we can of reducing those lower rates to eliminate hardship. But you can only go so far without destroying or eroding the tax base.

Senator GORE. You have answered me interestingly in your views of why this cannot be done, but you did not measure it with the yardstick of equity, which I asked you to do as you understand tax equity to be.

Mr. BARLOW. I would say in reply to that, that the tax structure, certainly at the lower rate levels, has done the best it can to give tax equity in that area. Although I suppose there is no pure or true equity when you are levying taxes, it has gone a long way toward recognizing the equitable problem, because we have a tax structure, as I said this morning, that is weighted in favor of the lower income groups.

When you have the progressive kind of rate structure that we have, going all the way up to an overall 87-percent limitation on income, you are doing pretty much equity to the people in the lower brackets when you tax them at 20 percent.

Senator GORE. You said once again as you said several times this morning, that this bill is weighted in favor of those with low income measured in terms of after-taxes income. A single-income taxpayer with an income of $4,000 to $6,000 would have his after-taxes income, to use your phrase, or take-home pay, to use the workingman's phrase, increased by this bill by 5 percent, or to give it in exact dollars, which you say we should consider, $230 a year. But the same taxpayer, if he had a corporate salary of from, say, $200,000 to $300,000 would receive a 100-percent increase in his after-tax income, to use your phrase, take-home pay, to use the workingman's phrase, real income to use mine. Now, how would you measure that by the yardstick of tax equity?

Mr. BARLOW. I thought I explained that to you earlier, Senator.

Sentaor GORE. You explained it, but you did not explain it in terms of tax equity.

Mr. BARLOW. I am sorry that I did not.

Senator GORE. I mean you explained your viewpoint, but not in terms of tax equity, which you now wish to substitute for tax equality.

Mr. BARLOW. I don't want to substitute tax equity for tax equality at all.

Senator GORE. You said you wished to consider them interchangeably.

Mr. BARLOW. I don't think they mean exactly the same thing. That is all I said. But I don't think there is any reason to quibble about definition.

But I would say to you again, on the basis of the illustration you just gave me, that the reason that a taxpayer in the $4,000 to $6,000 bracket saves only *x* hundred dollars as compared with the man in the $200,000 or $300,000 bracket is because he does not make as much money and he does not pay tax at the same high rates. A 1-percent reduction up at the top means thousands of dollars, and sometimes 10 times as much as a 10-percent reduction or a 6-percent reduction down in the lower brackets.

Senator GORE. But you have the inverse treatment here. You have in this bill the higher percentage reductions on the large amounts, and the low percentage reductions on the small amounts.

Mr. BARLOW. No, Senator.

Senator GORE. How do you measure that by the yardstick of tax equity?

Mr. BARLOW. Senator, I am sorry, I think you are mistaken because the Treasury's own statistics show that the reduction in the high bracket is only something like 12 percent.

Senator GORE. Let's take the reductions.

Mr. BARLOW. And in the lower brackets——

Senator GORE. It is reduced from 91 to what?

Mr. BARLOW. I have forgotten. I think the interim rate is 77 percent on the first year.

Senator GORE. And the lower bracket is reduced to what?

Mr. BARLOW. From 20 to 14.

Senator GORE. Which is the larger percentage reduction.

Mr. BARLOW. My land, the one on the small. You have almost a one-third reduction.

Senator GORE. You mean——

Mr. BARLOW. I mean a——

Senator GORE. You mean the reduction from 91 to——

Mr. BARLOW. From 91 to 77 is a much smaller percentage than from 20 to 14; much smaller. That is the whole point that I have been making.

You are counting the number of percentage points, but it seems to me that you may be forgetting that when the percentage points went on, a great many more went on on the top brackets. For instance, in 1932 the tax rate of an individual paying 25 percent, as I recall, went all the way to 63 percent in one jump.

Senator GORE. And you think it should come off as it went on?

Mr. BARLOW. Well, reasonably proportionately, but I am politically realistic enough to know that it won't. This bill is the proof of that.

Senator GORE. I was in the Congress and voted for what I considered the most onerous wartime levy, the lowering of the personal exemption of the taxpayer and dependents. The cost of living is considerably more than twice what it was in 1940. Then a man and wife had an exemption of $2,000 of income before the heavy hand of the Federal income tax law was laid upon that income.

As I then understood it and as I now understand it, the personal exemption, the family exemption, the dependent exemption, had as its basic purpose the permission of a subsistence level of income for the taxpayer and his family before a Federal income tax was levied. Now do you disagree with that?

Mr. BARLOW. No. I think that was one of the factors certainly, consideration of a subsistence level.

Senator GORE. Now if in 1940 a $2,000 exemption was adequate for a family subsistence, man and wife, what would you say a comparable figure would be now?

Mr. BARLOW. I am not sure what it should be, but I would say that——

Senator GORE. I did not ask what it should be.

Mr. BARLOW. No.

Senator GORE. What would it of necessity be when measured by the cost of living?

Mr. BARLOW. Well, you must remember, Senator, that there have been built into the tax structure some relief provisions since 1940 that offset the differential that you are talking about.

For instance, even in last year's revenue bill provisions were included that shifted the burden more and more away from the lower income groups, and you must also keep in mind I think that since 1940 everybody has been paying more taxes.

I might say this, that in the current tax bill they are trying to offset the inequity that you are talking about with the standard minimum deduction. You can't, I think, compare the dollar amounts of personal exemption.

Senator GORE. I appreciate your views. I always find them interesting.

If you could be a little more explicit in response to my inquiries, the consideration of the bill would be expedited. I asked you a simple question. I will repeat.

If $2,000 per year was adequate for a minimum family subsistence before the levying of an income tax in 1940, what would a comparable amount for family subsistence be at this time?

Mr. BARLOW. I am not sure of the figures on the inflation factor, but I understand that since 1939 the value of the dollar has depreciated about half, so taking your assumption and answering your question categorically, I suppose that if that was the subsistence level in 1940, it would be twice as much in 1963. But I don't know quite what that has to do with the imposition of taxes, because we are not talking about comparables.

Senator GORE. Well, it has a great deal to do with the imposition of taxes. We are talking about the basic unit of our society.

Mr. BARLOW. Yes.

Senator GORE. That family unit. Why doesn't that have something to do with taxes?

Mr. BARLOW. That has something to do with it, but what I am pointing out to you is that the subsistence level test under the tax structure in 1940 is not necessarily the same test in 1963, because equitable provisions and relief provisions have been put into the tax structure that were not there in 1940, these offset what I would agree with you is an inequity perhaps in the treatment of low-income taxpayers.

Senator GORE. Why would you say perhaps?

Mr. BARLOW. Well, because there is a question at what level the progressive rate structure becomes inequitable.

Senator GORE. Let me give you the exact index of the cost of living. In 1940 the consumer index stood at 48.8. In July 1963 it was 107.1, so you see there is an increase in the cost of living of, according to rough mental arithmetic, 112 to 114 percent.

Mr. BARLOW. More than double.

Senator GORE. More than double. Now would you conclude from your understanding of tax equality or tax equity that at least a $4,000 subsistence level, exactly double that permitted in 1940, would be necessary to make up for the 112-percent increase in the cost of living?

Mr. BARLOW. I was trying to point out, Senator, that I don't think it is necessary to double it, because of the other relief provisions that have been built into the tax structure such as the one now proposed, the minimum standard deduction, which leaves——

Senator GORE. You are talking about something that is proposed, but you were trying to tell me about some tax benefits that this family with a $4,000 income has now that it did not have in 1940. Would you mind spelling those out?

Mr. BARLOW. There are provisions like child-care provisions, and old people with low incomes have been helped since the 1940 act. There has been a recognition by this committee and the House Ways and Means Committee of the hardships in this area and relief provisions have been built into the structure.

But I want to say to you that I would like, except for the problem of taxpaying citizens knowing the burden of taxes, to relieve some of these people from the hardships of the tax structure. But the basic problem is that you can't eliminate this base, this great number of taxpayers who pay small amounts, because you can't collect enough revenues. They all have to contribute a little. That is my point.

Senator GORE. Before I come to that, I will say that I am referring here to a family of wage earners, not retired people. There are some provisions in existing law for retired people that were not in the law in 1940.

But I would like to point out to you one other thing that was in the law in 1940 which I voted to strike with the greatest of reluctance. That was a preference for earned income. On top of the $2,000 exemption, the man and woman who obtained their income through the sweat of their brow, the toil of their hands or their brains, had an earned-income credit.

Mr. BARLOW. That is right.

Senator GORE. For earned income. Now this was stricken out during the war.

Mr. BARLOW. That is right.

Senator GORE. As a wartime measure. Instead of that, we now have a provision in the law that gives a preference to unearned income, dividends from corporate stock. So when you come before this committee pleading for this tax bill on the basis of tax equity, you raise many questions.

Now you say that we can't raise the personal exemption because it will cost the Government too much revenue. Yet you advocate the passage of a bill that would cost an $11 billion permanent loss in revenue.

Mr. BARLOW. No; I think not, Senator. The Secretary of the Treasury has made it very clear that this does not contemplate $11 billion net loss in revenue, because if the President's concept of this tax bill and the Secretary of the Treasury's concept is right, it is going to give some momentum to the economy, and we are going to make up some of that income or that loss of revenue with increased incomes. That is the whole thrust and intent of this bill. I don't think we are losing $11 billion.

Senator GORE. I understood you to say this morning that you did not agree with that part, you did not expect any balanced budget, but you wanted this anyway.

Mr. BARLOW. Oh, I did not say that we did not expect it. I said we are hoping to have it.

Senator GORE. All right, let's take your thesis.

Mr. BARLOW. Yes.

Senator GORE. You advocate the passage of a bill reducing governmental revenue by $11 billion.

Mr. BARLOW. Short term.

Senator GORE. On whatever term, you advocate that. Yet you say we can't afford to raise the personal exemption, we can't afford to give a parent a little more deduction for the cost of rearing and educating a child.

Mr. BARLOW. Senator, we are giving them——

Senator GORE. How can we afford it in the one instance and yet we could not afford in the other?

Mr. BARLOW. Senator, let me explain this. Under this bill, as you know, you are giving these parents a little more of a deduction. In the minimum standard deduction which the Ways and Means Committee chose instead of the personal exemption, you are increasing it, you are giving them something. You are giving a 38-percent reduction in tax in this lower income bracket. We don't have to proceed on the assumption we are not benefiting low-income taxpayers.

But, second, with respect to the $11 billion of revenue loss, the whole thought here, and this is where the business community and others agree with the Government, is that if we can take off the onerous effect of the high progressive rate structure, we will give ourselves some economic momentum so that we will produce more income and have a better base for levying the tax. That is the whole thought.

Senator GORE. So you are for a little tax equity but not much.

Mr. BARLOW. Well, I am for all that we can stand at all times. We have to look at the exigencies of the situation.

Senator GORE. Let's stop right there. You are for all we can stand.

Mr. BARLOW. That is right.

Senator GORE. And you think we can stand $11 billion short term.

Mr. BARLOW. We have decided that we can, short term; yes.

Senator GORE. And the Secretary of the Treasury testified as you heard him, that the real segment or portion or part of our economy that needed stimulation was demand.

Mr. BARLOW. I did not understand him to say that alone. I understand that they have a balanced tax proposal.

Senator GORE. He said that was the major element that needed stimulation. You recall that, do you not?

Mr. BARLOW. But I did not understand him to say that it was the major element, but he agrees that we need both consumer demand and we need the funds for investment.

Senator GORE. I assure you he did so state.

You said this morning, though, that you disagreed with that. You thought we had placed too much emphasis already upon consumer demand.

Mr. BARLOW. Senator, when we, as an industrial nation, have the lowest rate of investment in the whole world in relation to gross national product, there is something wrong with the stimulus or the incentive in this country to investment. This must come, and the Treasury seems to think so, from the deterrent effect of this tax structure.

Senator GORE. I know, but you are going to something else now.

Mr. BARLOW. No; I don't want to.

Senator GORE. You did say you disagreed with the Treasury. You disagreed with the thrust of the testimony and the bill, you criticized the bill because it placed too much emphasis on spurring the demand sector of our economy.

Mr. BARLOW. Yes; that is right. We think that there is too much of a shift to emphasis on consumer statement.

Senator GORE. Then I do remember your remarks correctly.

Mr. BARLOW. That is right.

Senator GORE. Then you disagree with the Secretary of the Treasury as to the reasons for this bill, the principal reason for this bill, the principal need for this bill.

Mr. BARLOW. No. I think on the principal reasons we probably agree. I think that what we disagree with is the emphasis that both the Treasury and the House Ways and Means Committee have had to put on consumer spending in order to get a tax bill. That always comes back to the problem of the——

Senator GORE. Is that what you call political arithmetic?

Mr. BARLOW. A little bit of that, Senator; yes.

Senator GORE. I really find you very—I started to say confusing, but I will really say confused. How are we to stimulate the economy by a tax reduction unless that tax reduction goes to that element of society which will either spend or invest?

Mr. BARLOW. It has to go to the element that will spend or invest. That is what I am talking about. Some of it goes to the consumer for spending, some of it goes to the investment element for spending.

Senator GORE. I have now located that part of the testimony of the Secretary of the Treasury relating to this particular point. I quote:

> Our persisting problem has been insufficient demand. The Federal Government has the capacity to meet this problem, and since the enactment of the Employment Act of 1946, it has had a clear responsibility to do so.

But you say you disagree. You think the bill, indeed you think that existing law as you said, places to much emphasis upon consumer demand.

Mr. BARLOW. Yes.

Senator GORE. You think the proposed bill still does?

Mr. BARLOW. Yes; I think so.

Senator GORE. So to that extent you disagree with the Secretary of the Treasury?

Mr. BARLOW. That is right.

Senator GORE. I will forgo further questions of this distinguished gentleman.

Senator CURTIS. Mr. Chairman, I have some questions I would like to ask, but I would hate to miss a rollcall vote.

The CHAIRMAN. We will come back.

(A short recess.)

The CHAIRMAN. The meeting will come to order.

Senator GORE. May I proceed?

The CHAIRMAN. Proceed, Senator.

Senator GORE. I do not want to do you an injustice, so therefore I will state my conclusion as to your position. If you disagree with it, then perhaps we can clarify it.

As I understand what you said, it is that we can afford an $11 billion tax cut if it goes to the people to whom you think it should go, but we cannot afford it if the ordinary taxpayers and taxpayers' dependents are to be the beneficiaries of it. It seems to me that is the position at which you have arrived.

Mr. BARLOW. I think not, Senator. That it seems to me is not a fair statement of our position.

Senator GORE. Then let me ask you again, Do you wish to go further?

Mr. BARLOW. I was just going to say that I am not sure at all that we can afford an $11 billion tax cut.

We have endorsed this bill very reluctantly on the assurances of the President, of the Secretary of the Treasury, and of the Congress that we are going to get some reduced expenditures. We are supporting this bill not because we are happy at all with the prospect of the loss of revenue short term, but with the thought that the alternative is very bad. That if the private sector does not produce this money, you are going to appropriate it and our level of expenditures is going to go up, and then we will never raise enough revenue with this limited income tax structure, no matter how we broaden the base to pay our bills. So that is the reason for our support.

Senator GORE. All right, suppose we leave the same assurances in the bill—the bill seeks to codify a stump speech in the tax law. You seem to attach some value to it. I attach none at all.

Mr. BARLOW. I feel that we—excuse me.

Senator GORE. Suppose we have the same assurances, are given the same assurances, the same anticipation or doubts which you may have as the case may be, but the same quality of consideration for reduced Federal expenditures.

Would you still say that we could not afford an $11 billion tax cut if it were utilized in raising the personal exemption for each taxpayer and each dependent?

Mr. BARLOW. Senator, I am saying that we don't like the two together just the way I think you are trying to do.

I am saying that, and I think this is the reason the House Ways and Means Committee did not go to the increased personal exemption route, I am saying that the loss of revenue would be so much greater, without getting the kind of result from this tax bill that we need if we went the personal exemption route, that we can't afford to do that. We can't lose any more revenue than we are losing now, and maybe this is too much.

Senator GORE. Please understand I think it is too much.

Mr. BARLOW. I agree with you, certainly.

Senator GORE. Whatever the formula.

Mr. BARLOW. Yes.

Senator GORE. But you advocate it.

Mr. BARLOW. We are supporting it as about the only hope we see for getting some reasonable level of expenditures, and a budget balance, the Secretary says, in 1967; Mr. Burns says 1972. We would like to have it next year if we can get it, but we don't think we will get it. But we think unless we take the wraps off of our economic system with some kind of a sensible tax structure, we may not get it ever, and that is our concern.

Senator GORE. Would it be correct to say then that you support it, barely, but with faint hope and little confidence?

Mr. BARLOW. Well, that would be one way to describe it. I think we have a little more enthusiasm than that, Senator.

The CHAIRMAN. What percent of enthusiasm have you?

Mr. BARLOW. As I said, Senator Byrd, we look upon it as a Hobson's choice to a very considerable extent, but it is awfully important to get a start on rate reduction.

Senator GORE. This is not a Hobson's choice. This is the choice of the Senate committee. We must choose.

You come here supporting, as you say, barely, reluctantly, a bill providing for an $11 billion reduction in governmental revenue, and you express great doubts as to the possibility of a balanced budget, as has been forecast.

Now the proposition I have put to you, in view of the fact that the Secretary of the Treasury has said that our persistent problem has been insufficient demand, is this: Would you think we could afford this tax cut if the tax reduction is measured by a true yardstick of tax equity, and goes to increase the personal exemption of each taxpayer and dependent?

In other words, I feel that the man who has the most children to rear and educate is in greater need of tax reduction, and that his expenditure of what tax reduction comes to him will be far more effective in the economy than is the case if we give the 100-percent increase in the take-home pay of the corporate executive.

Mr. BARLOW. You are not by any means, Senator, giving a 100-percent increase in the take-home pay of the corporate executive under this bill, and I think we have an area of agreement here which pleases me.

Senator GORE. I will not argue this point with you, because I have asked the technical staff of this committee to prepare a table.

I made my own calculations to begin with, but so there would be no question about it—you wouldn't question that Colin Stam is a competent tax technician?

Mr. BARLOW. He is one of the ablest tax men in the United States, and I don't think anyone knows more about taxes than Colin Stam.

Senator GORE. I will agree. Then I will go to another point. How much of this tax cut in your opinion goes to spur consumption, and how much to spur investment?

Mr. BARLOW. Well, I think the Treasury statistics show about a 12-percent reduction to encourage investment, and about a 38-percent reduction to stimulate consumption. Now those are not exact figures as I pointed out a little bit earlier.

The fact that there is a tax bill and there is a recognition on the part of the Government that we need a revision in tax rates to stimulate investment beyond just the after-tax benefit in 1964 and 1965. But I think it can be said reasonably on the basis of Treasury statistics that those are the relative benefits for investment and consumption.

Senator BENNETT. Will the Senator yield?

Senator GORE. Yes.

Senator BENNETT. The 12 and 38 percent add up to 50. Where is the other 50 percent?

Mr. BARLOW. I am talking about the percentage of reduction, Senator; 38 percent from existing taxing liabilities in the bottom low-income rates and 12-percent reduction in liabilities in the upper brackets. We are not talking about a 100-percent figure.

Senator GORE. You still have only 50 percent accounted for.

Mr. BARLOW. We are talking about percentage of reduction.

Senator BENNETT. May I say you are saying that the 38-percent reduction in the lower brackets goes for consumption, and the 12 percent reduction—where do you apply that 12-percent reduction, to all brackets?

Mr. BARLOW. No. Let me explain. This percentage reduction cannot be categorically allocated to either consumption or investment, because the people in the higher tax brackets consume, too.

Senator BENNETT. Are going to consume some, sure.

Mr. BARLOW. What I was saying to Senator Gore was that the reduction of 38 percent for the lower income group is the principal stimulus to consumer spending.

Senator BENNETT. And you are saying that the reduction to the investment group is only 12 percent.

Mr. BARLOW. Yes, and that is not necessarily all allocated to investment incentives. There is a consumer element in that.

Senator GORE. And there is also a saving element in that.

Mr. BARLOW. There is saving all the way through the line on taxes wherever you reduce the rates.

Senator GORE. You complained earlier about using percentages. I don't want to complain about it, but I think perhaps we can understand this problem better in dollar amounts. There is a $11 billion tax reduction. How many dollars approximately of this $11 billion will go to investment, and what portion of it will go to increased consumer demand?

Mr. BARLOW. Just for the moment I forget the dollar figures. They are in the committee report.

Senator GORE. Do you concur with the committee report?

Mr. BARLOW. Yes. On table 8, page 23, the figures are set out, Senator. The saving is about $1,500 million, for the over $20,000 bracket——

Senator GORE. That is not answering my question though. I am asking you what portion of this $11 billion is going to investment and what portion is going to consumer demand. You said it is too heavily weighted toward consumer demand.

Mr. BARLOW. It is not possible on the basis of these figures, Senator, to decide just which dollars encourage investment.

Senator GORE. I did not say just the dollar. I said approximately what portion. Will it be $5 billion or will it be 7 or will it be 2?

Mr. BARLOW. The difficulty is that you can't draw a line on the tax brackets between what are dollars going for investment and what are dollars going for consumption, because there are dollars going for consumer spending throughout the entire bracket.

But if you are talking about the portion of the reduction that goes to given groups of taxpayers, and you want to cut off at any given point in the tax bracket, you can ascertain the dollar reduction by looking at the table on page 23.

Senator GORE. Don't you think when this drastic reduction in Government revenue is proposed, when for the first time so far as I am aware it is seriously proposed to increase the national debt in order to give a mammoth tax reduction, and that this is advocated on the basis of stimulating the economy, that this committee ought to be able to obtain from some source, if not from the U.S. Chamber of

Commerce, from some source, an estimate of what part of this $11 billion is going into investment, what part is going into consumption, what part is going into mining, into manufacturing, into construction, transportation, public utilities, wholesale and retail trade, and perhaps most important of all, what portion is going into services and what will be the increase in the gross national product.

Now no one has given us these figures, and you have disclaimed ability to give it to us. And yet you advocate and support this bill.

Mr. BARLOW. I am not sure you could break down and project all of these figures in that detail, but I should think if anybody can do it the U.S. Government can do it.

Senator GORE. Please understand I am not asking you on an exact dollars and cents basis. We are dealing with enormous amounts here, and we ought to be able, at least someone ought to be able, to give to this committee some estimate of the portion of this mammoth reduction in governmental revenue which will go into these principal categories. Now surely since you can't give us that, you can tell us by how much this tax reduction will increase the gross national product?

Mr. BARLOW. I certainly can't give you those figures. But suppose we compare notes with the Treasury and see what information can be evolved.

Senator GORE. Are you going to endorse whatever the Treasury submits?

Mr. BARLOW. You mean the statistics they submit?

Senator GORE. Yes.

Mr. BARLOW. I am not sure. I would have to see the statistics first. But we are satisfied, Senator, and it seems to me this is the important point, we are satisfied that under this bill there will be some stimulus to investment.

We think also that there will be considerably more stimulus to consumer demand. One of the things that troubles us about the bill, you are concerned about it and we are, too, is that if we have too much stimulus to consumer demand at the present time, it will create a demand for capacity and call on the excess capacity of the country, which is high-cost capacity. We won't have the money then for investment or the incentive to investment in low-cost facilities, so that we can be more competitive abroad.

We will have a self-contained economy in which we may have an inflationary factor if we have too much demand, and we will have a demand for products made on high-cost facilities at high prices. That does not move the economy ahead, certainly in terms of our relative position in world trade.

So I think generally we have to say our feeling is that there is about all of the impetus to consumer spending in this bill that we should have at this time, without worrying about inflation, and there is some incentive to investment, and that is one of the reasons that we support the bill.

Senator GORE. If you have reached the firm conviction that there is about all the stimulus to demand in this bill that the country can afford, surely you ought to be able to tell us about how much consumer demand there is involved in the bill, and how much the gross national product will be stimulated thereby.

Mr. BARLOW. We know the area, the relative area of incentive to consumer demand and investment, because we know that most of the consumer spending will come from the low-income groups, because most dollars are there, in total.

Senator GORE. Then I will ask you about the stimulation of investment. About how much increase in the gross national product do you think will flow from the stimulation of investment as a result of the bill?

Mr. BARLOW. Senator Gore, I am not an economist, and I don't have any figures on any projection of the gross national product.

Senator GORE. So you just generally——

Mr. BARLOW. But we feel that it will be substantial. Just as a tax lawyer let me say, Senator, I think this tax bill will slow down the liquidation of small companies. I think they will feel they are going to get some tax relief, unless you tack on the imputed income at death which makes it practically necessary for companies to liquidate. I think you will find some impetus, some increase in investment that is substantial because of this bill.

Senator GORE. So you are, generally speaking, supporting this bill, though you are not exactly sure why.

Mr. BARLOW. No, I am sure why, and the chamber is sure why.

I am not sure that we can measure all of the assurances and be satisfied as to what the increase in the gross national product will be. I am not sure that we can get any real comfort out of section 1 as to reduction in expenditures.

But we do see already in current appropriations bills some tendency on the part of the Congress to discipline itself, and to cut down on expenditures. We take the position that we do know why we are suporting this bill, even though we don't think it is a perfect bill.

Senator GORE. Then you don't agree with many things the Treasury has said, and you don't place much confidence in section 1, and you don't know what portion of it will go to investment, what portion of it will go to consumption. Yet you support it.

Mr. BARLOW. We agree with the Treasury on many things. I think we can state this thing positively as well as negatively.

Senator GORE. I shall not engage you further. Thank you. You have given interesting testimony.

Senator BENNETT. Mr. Chairman.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. The Senator from Tennessee has been probing to try and find some kind of a division as between consumer consumption and investment.

Senator GORE. Excuse me?

Senator BENNETT. The Senator from Tennessee has been probing the witness to try and develop some kind of a figure representing the division between consumption and investment.

Senator GORE. I was not asking for exact dollars and cents but some estimate of it.

Senator BENNETT. The Senator from Utah would like to throw some round figures into the record. The tax bill will produce, after it is fully effective, $8.8 billion, roughly, of reduction in personal income taxes, all grades.

Senator GORE. All what?

Senator BENNETT. At all grades, all rates. I think these statistics show that out of our personal disposal income, the American people save somewhere between 6 and 8 percent. That is money they have for investment.

Assuming that that same pattern holds, we can expect—and I will increase it a little, roughly—out of the $8.8 billion that will represent a reduction in personal income tax, we can expect about $8 billion to be consumed and about eight-tenths of $1 billion to be invested.

And the corporations will, after the full bill becomes effective, have a reduction of $2.3 billion. So if you add the eight-tenths of $1 billion to the $2.3 billion, this is at least a figure to look at.

Consumption will increase, or the money out of the tax bill that will be consumed will be roughly about $8 billion, and the amount available for investment, including that which goes to the corporations and that which the individuals traditionally save and invest, will make a total of $3 billion of new investment.

Senator GORE. You mean available for new investment.

Senator BENNETT. Available. This is the pattern. We can't say whether they will invest it or whether they will consume it all.

Senator GORE. This, Mr. Chairman, is a valuable contribution. At least we have the estimate of a distinguished businessman and an able Senator, former chairman of the National Association of Manufacturers, whose opinion I respect. This is the first time we have had this.

Now if $3 of the $11 billion is available for investment, no assurance exists at all that even a major part of this will actually be invested because there is a surplus of investment capital now. There is no shortage of investment capital at all. We have the testimony of the Secretary of the Treasury to that effect.

As the distinguished Senator knows—and he is a very successful businessman in his private life, before he came to the Senate, and I congratulate him upon it—a businessman invests not because he has the money in the bank, because he can borrow the money from the bank. He invests because he thinks he can make a profit.

Senator BENNETT. Let me give you some parallel figures. These are percentages and not billions of dollars.

In 1950 corporate profits were big enough to represent 8 percent of the total gross national product. In 1962 they had shrunk to 4.7 percent, nearly cut in half. So this is another factor in the economy which is discouraging investment.

The rate of profit, not the dollars, but the rate, in comparison with the total output of the economy, has shrunk from 8 to 4.7 in 12 years, and this is something that has got to be corrected if you are going to have, in my opinion, an increase in the incentive to invest.

Senator GORE. I really think the Senator could make a very valuable contribution by testifying before the committee, and I speak most sincerely. I wonder if you have any information on cash flows and dividends and how that would be affected.

Senator BENNETT. Of course, we can get it.

Senator GORE. As a percentage of gross national product.

Senator BENNETT. We can get it, but the dividends have to come out of the 4.7 which represents the amount of money available to the corporation after taxes. So if you take the dividends out of there, the amount of retained earnings is probably half of that, somewhere around 2.3 percent.

Senator GORE. Of course, the cash flow and dividends are an important part of this picture.

Senator BENNETT. Yes, I haven't gone into that. I have just been looking at this same question you have been looking at, and speculating what will happen to the tax cut. The first level of speculation is how much is the corporation going to get, how much is the individual going to get, and what is the pattern of the individual in dividing his income beween consumption and savings.

When you put those three things together, you can get an approximate idea that after the whole tax cut is affective, it will be about $8 billion consumed and about $3 billion of the $11 billion which would be available for investment.

Senator GORE. On this availability, let me read this to you. The McGraw-Hill organization made an investment survey and they reported that business executives—

attribute $1,200 million or about 40 percent of the planned increase in outlays on plant and equipment this year to the 7-percent investment credit, and the liberalized depreciation privileges put into effect last year.

I call this up, Mr. Chairman, because we were told last year, as you will recall, by the Secretary of the Treasury, that the most effective way to stimulate investment in the tax law was to give investment credit.

The Congress passed this bill. Liberalized depreciations were given. We see here that the promise has greatly exceeded the performance.

Now after we have done the two things which the Treasury said was most effective and would be most effective in stimulating investment, we find only $1.2 billion attributed to the investment credit and depreciation changes. And we are asked then to give a general tax reduction of $11 billion on the same basis, even though we were told last year that the most effective way to stimulate investment was investment credit and depreciation liberalization.

Mr. BARLOW. Senator, might I comment on that?

Senator GORE. Sure.

Mr. BARLOW. The proposal of the Treasury last year on the 7-percent investment credit was to stimulate investment in machinery and equipment, facilities to reduce cost.

Senator GORE. Plant and equipment.

Mr. BARLOW. That is right, plant and equipment. When you are talking about that kind of investment you are talking about a little different kind of investment than overall investment from savings in stocks and bonds and that type of investment.

I think it is clear from the McGraw-Hill study to which you refer that the 7-percent credit has been a very effective stimulant to investment in plant and equipment. But I would say to you that one of the reasons that you don't have higher figures is because of the Long amendment, which is repealed in H.R. 8363, and also because the Treasury put a reserve ratio test, as I testified earlier, into the guidelines. There has been some drawback on the part of the business community in investing in plant and equipment because of those two provisions.

That is one of the reasons I think the Ways and Means Committee was very wise in eliminating the basis adjustment provision. But the figures on overall investment that Senator Bennett gave you are not the same kind of investment that is contemplated by the 7-percent investment-credit stimulus.

I might say that on the investment figures that Senator Bennett gave you, there will be undoubtedly an increase in investment beyond the percentage to which he referred.

Senator GORE. Well, we cut corporate taxes by $2,250 million, and the record shows, such records as we have here, the careful surveys that have been made, that it is only approximately 50 percent effective. Mind you, 50-percent effectiveness from a tax cut which is directly beneficial to investment in plant and equipment.

Now if Senator Bennett's estimate is correct, that $3 billion will be available for investment, and we calculate that a tax reduction all up and down the scale will not be as effective in stimulating investment in plant and equipment as depreciation liberalization and investment credit, and we cut that to 40 percent instead of 50, we have a little over $1 billion that might be reasonably considered as going into investment.

I think if these figures are true, Mr. Chairman, we have rather generally been sold a bill of goods on this bill.

Mr. BARLOW. May I comment on that, Senator. In the first place the depreciation guidelines and the 7-percent investment credit did not represent a tax saving last year or this year. To the extent of the adjustment in depreciation it is simply a tax deferral. You are going to pay taxes sometime anyway. The reason that you haven't realized the full benefit of the investment credit——

Senator GORE. Before you leave that, it is a reduction in corporate tax liability for the year which is involved.

Mr. BARLOW. I know, but it is only temporary. It is transitional. You will pay it later.

Senator GORE. That is true of whatever kind of depreciation schedule you have. That is generally true.

Mr. BARLOW. That is right; but that is the point I am making. When you talk about a tax saving, this has not been a tax saving for those corporations. You can only write off the cost of this equipment once. I would say that if you get rid of the basis adjustment provision in the 7-percent investment credit, and you take the reserve ratio test off the guidelines, you will get the projection of investment the chamber believes the Treasury has planned.

Senator GORE. I wish to conclude, Mr. Chairman, by recalling that you said that no public hearing had been held upon the pending bill. It was written after the public hearings were concluded in the House, and I have searched the debate in the House of Representatives, and find that the details of the bill were scarcely touched. It was sort of a theoretical debate.

Now that we are examining the actual details of this bill, and going into its effect and also examining the various changes in the law adverse to some people, advantageous to others, I think that enthusiasm for the bill is diminishing even by those who support it. Even you come with faint heart.

Mr. BARLOW. No, Senator. Could I say this: I would like to accept your invitation to discuss the specific provisions over a Coca-Cola.

Senator GORE. Thank you.

Senator CURTIS. I have one question. I understood you to express the belief that expenditures would be controlled, which I assume you mean would be reduced. In whom do you place your confidence to bring that about?

Mr. BARLOW. I expressed the hope rather than the belief that we are seeing some signs of reduced expenditure as you know in the action of the House. I guess we place our faith in gentlemen like you, Senator Curtis, in the Senate and in the House of Representatives, to reduce these expenditures.

Senator CURTIS. I have never been on the winning side of it yet. The first 6 months of this year the President sent 70 requests for spending to Congress. The Congress has passed about 24 of them. This is new programs.

I won't go into them in detail, but they are everything from area redevelopment to Federal recreation programs, to all manner of new activities in which the Federal Government has never been in before. I am in need of some faith and hope, and if you have somebody to point out to me by which this can be brought about, I would pledge my assistance.

Mr. BARLOW. Senator, all I can say is that we will be down testifying at the hearings the Appropriations Committee has, and try to point out areas where expenditures can be reduced.

Senator CURTIS. That is a good activity. The thing that creates additional expenditures is expansion of the Federal Government. Appropriations sometimes are cut, and then they come in for supplemental amounts but you can't go on forever expanding the Federal Government and not expanding greatly the cost of the Federal Government. That is all, Mr. Chairman.

The CHAIRMAN. I have a couple of questions that I want you to clear my mind on. The total tax reduction would be $11.1 billion: $8.8 billion of that goes to individuals and $2.3 billion goes to corporations.

The theory of increasing the taxable income as I gather it is you increase the consumer demand by the distribution of the $8.8 billion. Then when that consumer demand is increased, the investment will occur, is that correct?

Mr. BARLOW. The $8 billion will increase the consumer demand. We don't think we have to wait for that.

The CHAIRMAN. Isn't that the basis of the theory that to reduce taxes it will increase the income and thereby take us out of a deficit period?

Mr. BARLOW. The theory is that tax rate reduction will immediately encourage investment. You won't wait for the consumer spending. You plan ahead so that there will be an increase in productive facilities, and there will be additional consumer spending.

The CHAIRMAN. But you do assume that as a base $8.8 billion would go into the purchase of goods of some kind.

Mr. BARLOW. Yes; some of it will be saved, as Senator Bennett pointed out. Some of it will be spent immediately. I think the Treasury statistics show about 90 percent will be spent.

The CHAIRMAN. Have you given consideration to the individual taxpayer? Would the stimulation be determined somewhat by his tax reduction? The staff has given me a memorandum that on income up to $3,000 the taxpayer gets a $49 a year reduction.

Now nobody knows what he will do with that. He may pay off a debt, he may buy something, he may invest in the stock market, but whatever he does with it I would assume it is not going to have any material effect on the prosperity because of the small amount.

Now in the income area of $3,000 to $5,000, the average taxpayer gets $67. I understand that these figures of course are on the basis of joint returns. One-third of the returns are single and two-thirds joint.

On income $5,000 to $10,000 there is a reduction of taxes of $90 for each taxpayer. I call a taxpayer one who makes a joint return. On income from $10,000 to $20,000 it is $165. On income from $20,000 to $50,000 it is $560 average. On income from $50,000 and over it is $2,194, and the average reduction for all taxpayers is $110 tax reduction.

It is your idea that as soon as this is received it will immediately move into trade and commerce, and thereby stimulate the purchase of things that are manufactured, and thereby create a demand for increased investment in manufacturing, is that correct?

Mr. BARLOW. Although the individual amounts are very small, the sum total of all these little amounts runs into billions of dollars as you know. The stimulus is going to come from the sum total effect.

The CHAIRMAN. Don't you have to determine this on the basis of the average individual who gets these sums? The $49 man probably will be a man who has his wages deducted. That would be a very small amount of tax reduction.

I question very seriously whether he would put that money aside to buy something especially. As you know, I have faith in the U.S. Chamber of Commerce, and while I totally disagree with the theory by which you are backing this tax reduction as to the gain, you take no recognition of the evils that are going to come from it.

The reduction is going to be added to the public debt on which we have to pay interest, and there is uncertainty as to whether there will be a reduction of expenditures. I say very frankly, and I believe I speak for the majority of the committee, that if we had substantial reduction in expenditures, and knew that huge sums were not to be added to the public debt, I would be one that would gladly support a tax reduction.

My opposition to it now is because I think you are putting the cart before the horse. You are trying to reduce taxes before you reduce expenditures, and you are relying on something in the future.

I have been here 30 years, let me say, and I have heard every President that I have served under promise a reduction of expenditures, and you know what has happened.

Mr. BARLOW. Senator Byrd, as you know, we have the greatest respect for your opinion and judgment, and we are unhappy to find ourselves in disagreement in any area. But we still have that forlorn hope that expenditures may come down and ultimately we will get a balanced budget.

The CHAIRMAN. When you deal with $11 billion, when our debt is $308 or $309 billion, when we are in a deficit period, and Mr. Dillon admitted that we will have a big deficit next year and a deficit the next year and so forth, I don't think we ought to base such a serious matter as that on hope.

Mr. BARLOW. Our instinct is to agree with you, but the Government has made a very plausible case, and we don't see that we have much choice because the alternative seems to be a surge of spending in 1964, if we don't go to the private sector.

The CHAIRMAN. You don't think that the Government should first show that they intend to reduce expenses by performance instead of promises?

Mr. BARLOW. We would like to do it that way you can be sure, but we don't see quite how we can.

The CHAIRMAN. In other words, you question whether there will be a performance.

Mr. BARLOW. Yes, I would say I question it, certainly.

The CHAIRMAN. Yet you are willing to add this to the public debt. The debt is never going to be paid; that is, not for many many years if ever. Do you find hope that something is going to be paid on the debt, in that pious preamble to the bill? You don't think we are going to pay anything on the debt, do you?

Mr. BARLOW. As I say, I am inclined to agree with you.

The CHAIRMAN. Why is there this great hurry to cut taxes before expenditures are reduced?

Mr. BARLOW. I am not an economist, Senator, but there seems to be a very considerable view among economists that once we have launched on this tax rate reduction program, if we don't see it through, when the year end comes for business planning, and we go into 1964 without any assurance of tax rate reduction, and maybe some doubt as to whether we will get it at all, that it could effect a downturn in the economy——

The CHAIRMAN. You, as representing the U.S. Chamber of Commerce, do you see a recession in the future?

Mr. BARLOW. I am not an economist. I am really only a tax lawyer not qualified to look ahead and see whether we will have recessions.

But as I say, there seems to be a body of opinion among economists that our 30 months period, our cyclical period, the magic 33 months to 45 months, is coming due, and there is a possibility of a downturn and a recession. But I don't think——

The CHAIRMAN. Isn't the stock market constantly going up? It went up again today and has been going up——

Mr. BARLOW. I know, Senator. It went up in 1929, too. That does not mean that it will always go up.

The CHAIRMAN. Do you think then there may be a recession unless we pass this tax reduction program which takes 2 years to get into the public?

Mr. BARLOW. All I can say is that there is a respectable body of economists who think there may be a downturn if we let go of this bill once we have started it.

The CHAIRMAN. Well, there is a respectable body on the other side along with some practical thought. What about that?

Mr. BARLOW. We have been trying to balance those views.

The CHAIRMAN. But you won't give me your percentage. Are you 1 percent for this bill, 10 or 25 percent?

Mr. BARLOW. No, I think quite seriously that we feel that we are not likely to get tax rate reductions in our time if we don't pick it up now, because, frankly we may never have any better economic period in which to start tax rate reduction.

The CHAIRMAN. Suppose the administration reduces expenditures like it promises the administration is. Do you think there will not be tax reduction?

Mr. BARLOW. No. It seems to me that if they reduce expenditures, there will be a better chance for tax reduction.

The CHAIRMAN. Now you are admitting that there won't be any reduction of expenditures, aren't you?

Mr. BARLOW. No.

The CHAIRMAN. You say the only hope of getting it is now when you don't have to reduce expenditures. If you have to reduce expenditures, there isn't any hope.

Mr. BARLOW. What I am saying is that I think there is a hope of reducing expenditures, but I think the only hope of meeting those expenditures with revenue over the longer range is to reduce these tax rates.

The CHAIRMAN. Did you just say if we don't get this bill through, that you will never get a tax reduction?

Mr. BARLOW. I did not say that. I said there was a likelihood we might not.

The CHAIRMAN. I think, in all frankness and candor, and I know you are speaking with conscientious convictions, we are dealing with a very dangerous subject here.

If this tax reduction does not bring prosperity, and I am questioning seriously that it will, because it relies upon the individual situation, you can't say that all of this money is going to be spent that will aid business, and if it does not do it, then the same economists that are advocating this bill will say "Yes, it did not reduce taxes enough."

In other words, it is the first time in the history of the United States that any President has deliberately asked for a planned deficit in order to reduce taxes. Mr. Eisenhower came out against it the other day; Mr. Truman came out against it.

I have searched the record and no other President has ever advocated this. If this is a panacea for everything and all the troubles we have, we have had very able men as Presidents, as you know, and it is no one's thought that reducing taxes with a mounting public debt is a sound thing to do. Have you ever thought of that?

Mr. BARLOW. Yes.

The CHAIRMAN. This is not the only crisis—if we have a crisis—in our history.

Mr. BARLOW. We are very much concerned about the same things you are. We have concluded that we have a little different situation today than we had in the past.

We have a little different problem, internationally, with foreign competition, and perhaps we have to do something to stimulate our economy so we will be more competitive abroad.

In the past, when these proposals have come up, the United States has been in a preeminent position industrially. We had the lowest cost products. We had advanced technology. We had a seller's market.

That is not true today. We are having a difficult time, and we need to produce things at lower prices so we can maintain our position abroad. It is particularly in this changed situation that we think justifies a changed approach on tax policy.

The CHAIRMAN. You mentioned the loss of gold, did you?

Mr. BARLOW. Yes.

The CHAIRMAN. If you will permit me to state my opinion about that, the way to prevent the loss of the gold is to restore the confidence in the dollar. Having another big deficit and continuing to have deficits certainly does not build up the confidence in the American dollar.

How can you blame the people abroad in asking for gold at $35 an ounce when that is less than the cost of producing it? You are not going to increase confidence by having more deficits. Those foreign nations have been through this deficit business. You don't catch them having deficits except in some extraordinary situation, and they take very strong means to correct it.

I remember I was in England at a time when they prohibited an Englishman from taking money out of the country because they did not want to increase the deficit and the balance of payments.

We could argue for hours about this, but it is a very serious conviction that I have, and I told Secretary Dillon, when he came to see me at my home, last December that I could not support a plan that literally adds to the present deficit and creates more. There is no use in continuing this argument, but I just wanted to make clear to you how strong my feeling is.

I don't claim to have the kind of knowledge that the economists have. I have been a practical person all of my life.

I think we are taking a tremendous risk, and I think it is possible to reduce Federal expenditures and it is possible for the President to bring in a reduced expenditure budget in January. Those who are talking about reductions in appropriations must remember that the unexpended balances in funds already appropriated on July 1 totaled $87 billion. That money can be spent independent of the appropriations that are made this year.

Thank you very much. I haven't agreed with you, but you have been a frank witness, and I don't believe you speak for all the chambers of commerce in the country. Back when I started out trying to do a little something along the economic lines, the U.S. Chamber of Commerce was the best supporter that those of us making that effort had. They were opposed to deficits, bitterly opposed to them.

Mr. BARLOW. We are bitterly opposed today, Senator.

The CHAIRMAN. Now they are opposed to them but they want to reduce taxes and increase the deficit by $11 billion. I just don't understand.

Mr. BARLOW. We are just afraid there is going to be more if this bill is defeated.

The CHAIRMAN. That is just a surmise.

Mr. BARLOW. I know.

The CHAIRMAN. You don't know and nobody else does.

Mr. BARLOW. That is right.

The CHAIRMAN. That is up in the clouds.

Mr. BARLOW. That is right.

The CHAIRMAN. Thank you very much.

Mr. BARLOW. Thank you.

The CHAIRMAN. The next witness scheduled is the Honorable Kermit Gordon, Director of the Bureau of the Budget, whose prepared statement was inserted in the record of the hearings on Friday, October 18.

Mr. Gordon, I want to apologize to you, sir. This is the second time you have been here but due to additional questions being asked of the Secretary of the Treasury we have been unable to question you in regard to your statement which has already been made a part of the record. I doubt very much if there is sufficient time this afternoon for all of the members who may desire to question you. Would it be agreeable to you to return at some future date which can be arranged to meet your convenience?

STATEMENT OF KERMIT GORDON, DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. GORDON. That is perfectly all right.

The CHAIRMAN. I want you to know it is entirely unintentional, and I regret very much that you have been called up here twice.

Mr. GORDON. I understand that.

Senator BENNETT. Mr. Chairman, while he is here I have one question. He knows what the question is, and I would like to get it on the record. Would you mind my asking him the question?

The CHAIRMAN. Senator Williams has come in.

Senator BENNETT. Mr. Gordon, the Secretary of the Treasury when he was here in response to questioning by Senator Williams indicated that the Treasury was not supporting the proposed accelerated public works program now being studied in the House. Does this proposed program have the support of the Bureau of the Budget?

Mr. GORDON. The administration, Senator, is not recommending the extension of the accelerated public works program.

Senator BENNETT. So the program did not originate, it was not suggested by the administration.

Mr. GORDON. Well, the initial public works program which was enacted in the Congress last year grew out of some proposal which the administration has made which was substantially modified in the Congress. But the administration has not proposed and is not recommending the extension which is now being considered in the committee of the House of Representatives.

Senator BENNETT. As I understand it, the House proposals report somewhere between $800 and $900 million.

Mr. GORDON. I am not certain of the exact figure, Senator. The present program is just about of that magnitude.

The administration last year asked for an authorization of $600 million. The Congress voted an authorization of $900 million, and $850 million has been appropriated under that $900 million authorization. My understanding is that the proposal which the House committee is now considering is roughly of the same magnitude as the first program.

Senator BENNETT. But it does not have the sponsorship and support of the administration.

Mr. GORDON. It does not, Senator.

Senator BENNETT. That is my question. Thank you.

The CHAIRMAN. What is the pleasure of the committee?

Senator CURTIS. Mr. Chairman, I have some questions. I will move as fast as I can with them, but I do have a number of questions.

Senator GORE. I have a number of questions. I can come at 6:30 tomorrow morning.

Mr. GORDON. I will be happy to be here, Senator.

Senator GORE. We might not have a quorum. I am sorry I can't stay later this afternoon. I have been here since 10 this morning.

The CHAIRMAN. As I understand it we will have an opportunity to examine you on your statement at a later date.

Mr. GORDON. Yes, indeed, at your pleasure.

The CHAIRMAN. I regret what has happened, but it is just unavoidable. The committee will have an opportunity to interrogate you at some mutually suitable time.

Mr. GORDON. Thank you very much, Mr. Chairman.

The CHAIRMAN. The committee will be in recess until 10 o'clock tomorrow morning.

(By direction of the chairman, the following is made a part of the record:)

THE INDEPENDENT RETAIL FOOD DISTRIBUTORS OF MARYLAND,
Baltimore, Md., January 17, 1963.

Hon. J. GLENN BEALL,
U.S. Senator,
Senate Office Building, Washington, D.C.

DEAR SENATOR BEALL: Since we so strongly believe that any tax cut passed by the Congress should contain provisions to generate full employment and increase sales volume, we have written to the President urging certain studies be made in an effort to accomplish that purpose.

We are aware that time is of the essence, since the tax bill has been submitted to Congress. However, in the committee hearings and discussions we hope the suggestions we have made will be given consideration. If opportunity is afforded, we plan to attend any sessions in Washington we believe will be helpful to the committee studying this matter.

In writing directly to the President, we have no intention of bypassing our duly elected Senators and Members of the House of Representatives. We felt, however, that it was urgent to have our views placed before the President as early as possible. All of our elected representatives will receive a copy of this letter which is enclosed.

I would appreciate deeply your reaction to this suggestion and ask your advice and help in stimulating and generating this suggested proposal. Won't you please let me hear from you as soon as you possibly can, since I intend to publish this letter in the February edition of the Maryland grocers' food trade magazine, the Skirmisher.

Best wishes for a happy and healthful New Year.

Sincerely yours,

JOSEPH L. MANNING, *Managing Director.*

THE INDEPENDENT RETAIL FOOD DISTRIBUTORS OF MARYLAND,
Baltimore, Md., January 17, 1963.

President JOHN F. KENNEDY,
The White House,
Washington, D.C.

MY DEAR MR. PRESIDENT: We are sure any income tax cut proposed by the administration will have for one of its purposes the stimulation of our economy in the form of increased employment with resultant increments to general income to Federal, State, and local governments.

If there is any reasonable device which would encourage improvements to dwelling properties where part of the costs of such improvements could be deducted from the individual homeowner's income tax, it would put many hundreds of people to work and encourage property improvements, thus reducing the cost of urban renewal programs. Prevention is cheaper than demolition but our present laws offer little or no incentive for improvements.

I am sure you are aware that in most jurisdictions properties which have been well maintained are assessed for more than similar properties in the same block but which have been allowed to fall into disrepair.

A considerable number of plumbers, electricians, carpenters, bricklayers, etc., were employed for a fairly simple neighborhood rehabilitation project such as we conducted here in Baltimore several years ago. In addition, building materials, fixtures, etc., are required for each individual improvement. We cannot help but believe that if some tax incentive were offered, thousands of properties would be improved and in the long run, less money would be required for urban renewal.

We also learned that providing new and modern kitchens, bathrooms, family rooms, etc., creates an incentive to purchase new furniture, rugs, and other items, and to generally refurbish the entire property.

In another field, domestic help could be employed if some relaxation on withholding taxes and a simplified form of reporting were adopted. Part-time help around the home could result in considerable employment if the property owner had less bookkeeping to do. Also, as soon as you tell a part-time gardener, maid or handyman you will have to withhold certain taxes and pay social security, he or she is not interested in the job.

Perhaps these are oversimplifications. However, we sincerely believe they merit study in any new tax revision.

In our judgment, what is needed is tax revision designed to stimulate business and promote employment, and we believe the items we suggest will generate considerable business activity.

Sincerely yours,

JOSEPH L. MANNING, *Managing Director.*

STATEMENT SUBMITTED BY SENATOR BYRD OF WEST VIRGINIA, ON BEHALF OF SENATOR HANS MCCOURT RE OPINIONS ON PROPOSED CHANGES TO EXISTING TAX STRUCTURE RELATED TO TIMBER CAPITAL GAINS

Basically, the President's proposed tax reforms in relation to timber sales is that such sales would be considered as income rather than capital gain. As a "sop" to the small timber holder, the first $5,000 of annual sales could be considered capital gains. This tax change would be a complete reversal from the existing section 631 of the Internal Revenue Code which has been in successful operation since 1944.

Wood industries in general operate on a smaller margin of profit than do other industries. The main attraction to investors is the capital gain treatment on the timber cut. Without this here would not be the incentive to selective cut and to reforest; instead, the days of the "robber barons" would reappear with forests ruthlessly cut down and land left to erode. It is the opinion of the writer as well as that of most people in the wood industry that modern forestry practices would be set back 50 years. With the population in the United States steadily increasing, the demand for wood and wood products will also increase. By the time this tax law could be changed back, disastrous results would have already occurred that would affect future generations.

To give concrete examples of the problem, let us consider the case of timber growers in the Virginias:

1. *Pulpwood.*—It is figured that land, properly planted, can grow a cord per acre per year. Wood of pulpwood size is worth about $6 per cord as standing timber. The cost of land planted in seedlings will be about $100 per acre. Thus a 6-percent return is realized. However, at least 20 years must go by before any of this timber can be harvested. During this period, the forest is subject to the ravages of fire as well as disease. Also, during this period the landowner is paying real estate taxes. So, even now, the growing of pulpwood is only a marginal proposition. Taking away the tax advantage would absolutely kill the tree farm program.

2. *Sawtimber.*—It will take about 50 years to grow timber of a size that is marketable. Based on average growth statistics, about 9,000 board feet per acre can be grown during this period. At stumpage prices of about $40 per thousand feet, this would mean a return of $360 per acre. Using a planted land value of $100 per acre, this shows a 7.2-percent return on investment.

Against this goes the even more danger of fire and disease as well as the longer period of paying real estate taxes before a return can be obtained on the investment. Again, just a marginal proposition even under existing tax laws.

Many of the proponents of this tax change will state that the bulk of the timber resource is held by the small landowner who will not be hurt because of the $5,000 exemption. Possibly this is right, but unfortunately it is not the small landowner who practices scientific forestry; the small man just cannot afford to enter into the long-term investment required to grow timber. Thus, it is the corporations and the large individual landowners who we must depend upon for large-scale reforestation.

Our State of West Virginia is one of the largest producers of hardwood timber. Direct employment as a result of this is over 10,000 with prospects of even more in the years to come. Consequently, it is of vital importance to our State's economic welfare for nothing to interfere with the growth of this segment of our economy.

Most of our logging is done on hilly terrain with costs consequently higher than areas of lowland logging. Also, our road system is still not to the extent where our timber is readily available to transportation; thus the timber exploiter must build roads into the area. Those are costly and must be looked at as a long-term investment. If the timberman ceases to regard timber as a worthwhile long-term investment, he will also feel the same about logging roads and expensive equipment. This could only lead to a decline of our wood industry.

Speaking for the welfare of our State as well as for our wood-using industries, we feel that this proposed tax change would be harmful to our particular State as well as to national interests.

TIMBER—THE NECESSITY FOR CONTINUING PRESENT TAX TREATMENT

Administration Proposals for Denial of Capital Gains Treatment of Timber Income Jeopardize Sound Forest Practices

(Submitted by Forest Industries Committee on Timber Valuation and Taxation, Washington, D.C.)

Part I—The Affirmative Case

Contents

SECTION 631. POSITION OF THE FOREST INDUSTRY

1. The threat

Section 631 of the Internal Revenue Code, which accords capital gains treatment to timber income of tree farmers and other private timberland owners, is in serious jeopardy as a result of recent Government proposals drastically to revise it. Briefly, these proposals would terminate capital gain treatment of gain realized on the cutting or disposal of timber:

(1) In the case of corporations—entirely.

(2) In the case of individuals—to the extent they realize gains over $5,000 in any year.

For almost 20 years, the capital gain treatment in section 631 has provided effective incentives to grow timber on a sustained-yield basis. The elimination of these incentives for a major segment of private timberland owners threatens the economic livelihood of these conservation-minded private landowners, the jobs of their employees, and the security of timber-dependent communities throughout the United States.

The products of our forests touch every one of us in our everyday lives, and the myriad of tree-derived products has substantially contributed to our standard of living.

To help maintain the growth and progress of this industry, which is a major factor in our Nation's economy, it is necessary to continue the capital gain treatment of timber as a means of maintaining our forward economic movement. Such continuance would assure permanent free enterprise operation of the timber industry for the benefit of employees and shareholders, consumers, and residents of timber-dependent communities.

Equally important, the retention of section 631 will assure continuance of the tremendous advances made in the science of forestry since the enactment of this law. These have occurred in the fields of genetics, reforestation, soil productivity, insect and disease control, and utilization. The resultant good forest management has materially increased multiple-use values of timberlands such as watershed protection, forest recreation, and wildlife habitat.

The proposed emasculation of section 631 would upset the existing pattern of constructive conservation practices over the last 20 years and would create almost insuperable economic barriers to the growing of timber on a sustained-yield basis. The present law, on the other hand, stabilizes forest land ownership and assures the continuance of the high standards of forest management on private lands.

It is imperative that every effort be made to hold section 631 intact so that tree farmers and other private timberland owners will pursue their conservation efforts. These efforts have, for the first time in recent history, brought timber growth well ahead of timber removal, thereby guaranteeing to our mushrooming population a continuous supply of more than 5,000 products made of pulp, paper, lumber, plywood, and wood-based synthetics, cellulose products, plastics, and chemicals.

2. Section 631 and forestry—Before and after

Before.—A dominant purpose of section 631 at the time of its enactment was to promote good forestry on private lands.[1] To achieve this purpose, it held out the promise of a rate of return upon investment that would induce the expenditures necessary to plant and seed trees and to manage them over the required 20- to 80- or 100-year growing period. The history of private forestry over the last 20 years shows that section 631 has accomplished its objectives.

Before section 631 was enacted in 1944, forest practices on private lands were generally unsatisfactory. Without the prospect of a reasonable rate of return, capital was flowing out of the forest industry into more promising alternatives. Landowners had little incentive to plant or seed new trees, and even less incentive to defer the cutting of their mature timber over the period required to permit the growth of a second harvest.

U.S. Forest Service officials frequently were critical. Pre-1944 annual reports of the Chief of the Forest Service contained such statements as the following:

1933: "Out of nearly 400 million acres of commercial timber growing land in private ownership, of which 270 million acres is in industrial holdings, less than 25 million is under some degree of forest management." (F. A. Silcox.)

1940: "In short, we are still liquidating forests on privately owned land. We are still creating ghost towns and rural slums. And the public still pays in human misery, in destruction of a basic resource, in loss of taxable wealth, in more and more public funds spent for such things as forest restoration. * * *" (Earle H. Clapp.)

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[1] Congressional Record, Senate, Feb. 22, 1944:

"Mr. TAFT. Would the Senator from Georgia comment on the statement 'This would encourage reforestation'? Is it not true that the more profitable the lumber industry is the more reforestation would be encouraged? Is not the amendment designed to encourage reforestation?

"Mr. GEORGE. Unquestionably it is so designed. It was recommended to us by a vast majority of the reforestation offices in the several States. They recommended the amendment on the ground that it represented a conservation program. This is what it would permit: If one owns a thousand acres of timbered land, with hardwood and softwood, and timber of all sizes and ages scattered throughout the thousand acres, he may take his mill onto the land, and he may by selective cutting continue his timber operations or lumbering operations with respect to that land through a long period of time; indeed, he can do it perpetually. It is the only basis on which the timber owner can really become a true conservator of timber."

1942: "About 80 percent of all cutting on private forest lands of the United States is stil without conscious regard to perpetuation of timber growth." (Earle H. Clapp.)

Alternate solutions for the problem were suggested. The first was Government policing of forestry activities on private lands. The second was to create, through the tax structure, the economic climate without which private forestry could not exist. In 1944, Congress chose the second alternative and enacted section 117(k)—now section 631.

The forest products industry now has operated for almost 20 years in the economic environment provided by section 631. How well has it responded to this stimulus?

Findings of the timber resources review.—Perhaps the most persuasive evidence of the striking improvement in private forestry under section 631 is the tribute paid to the forest products industry by the U.S. Forest Service in its 1958 publication, "Timber Resources for America's Future" (T.R.R.)—the official report of a nationwide timber resources review which it had conducted. This report was well summarized by Life magazine which said:

"A 1,000-page report issued last week by the U.S. Forest Service marked a historic turning point for one of the country's greatest natural resources, its woodlands. Plundered and threatened for decades by careless or greedy cutting, commercial forests—which still mantle a full quarter of the United States—are now no longer shrinking but growing wood faster than it is harvested. Although a staggering 10.8 billion cubic feet is being felled annually, 14.2 billion cubic feet of new timber is being raised every year.

"Happiest at the news were the big timber firms, for it measures the success of a 20-year program which has transformed the industry. Mass attacks on insects, mechaniszed firefighting, and new disease-resistant hybrids produce and guard spreading stands of sturdier timber. Machines replace much musclework of oldtime loggers and increased efficiency rescues mountains of wood formerly wasted.

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"The Forest Service report warns, however, that the most useful grades of timber are still being cut faster than grown, and that as demand keeps growing the overall supply may have to double in the next 50 years. The well-managed domains of the big timber firms and the Government comprise only 40 percent of all commercial forests. The rest is split up among 4.5 million private owners who, for the most part, manage their lands poorly. They will have to learn from their bigger brethren, if the United States is to satisfy its future wood needs."

In its nationwide survey, the Forest Service found, in comparing the effectiveness of reforestation and management by landowner groups, that:

"There was little difference between public ownerships as a group and forest industries as a group * * * The pulp industry with 84 percent of its recently cut lands qualifying for the upper productivity class exceeded the national forests with 81 percent and the lumber industry with 73 percent.

"These findings show that there is little distinction between productivity of recently cut lands in public ownership and those owned by forest industry" (p. 106).

Recent State reports.—The continuing improvement of industrial forestry which has occurred under section 631 has been noted at various local levels by the U.S. Forest Service. Its recent State forest resources reports contain statements such as the following:

"Recent forestry gains in Arkansas have largely taken place on public and industrially owned tracts" (Arkansas, 1960, p. 1).

"Long-term returns from forests are closely related to the skill and intensity of the management these forests receive. Most of the large landowners in Maine employ professional foresters to plan the overall management of their forests and to supervise harvest cuttings and related treatments. As a result, most of the large industrial forests are being managed under long-term management plans. Management of these forests is becoming more intensive year by year" (Maine, 1960, p. 33).

"Much of this surplus growth is on land owned by public agencies, pulp companies, and forest industries that are attempting to increase productivity by building up the growing stock" (Florida, 1960 Highlights).

Effectiveness of private forestry.—More specifically, in its study of the effectiveness of reforestation and forestry maangement, the Forest Service found, in the T.R.R., that 96 percent of recently cut forest industry lands are in the medium or upper productivity classes, and only 4 percent are in the lower class.[2] In contrast, shortly before section 631 was enacted, only 45 percent of such lands had fair or satisfactory stocking, and 55 percent was stocked poorly or not at all.[3]

The contribution of section 631 to this about-face in industrial forestry has been acknowledged by the Forest Service.[4] In the T.R.R. it stated:

"Capital gains provisions, adopted in 1943, of the Internal Revenue Code have made timber growing more attractive and have provided an important incentive for more aggressive forestry programs" (p. 304).

Section 631's contribution to the dramatic increase in the growth and conservation of timber has by no means been limited to the encouragement of reforestation. Section 631 also has permitted the orderly cutting of mature timber, which is necessary for sustained yield management of our forests. This necessity arises from the fact that trees planted today will not be harvested as sawlogs until after the year 2013 in the South, or after the year 2043 in the West. Unless the cutting of presently standing timber is spread out over decades, there will be a gap of many years between the exhaustion of present supplies of mature timber and the maturing of timber stands planted or seeded in recent years. Without capital gain treatment of timber cutting, this orderly cutting is an economic impossibility because of the inadequate return on investment.

3. *Who will meet tomorrow's timber requirements?*

Requirements.—No extended discussion is necessary to demonstrate that the population upsurge of this country, coupled with the anticipated growth in the Nation's economy, will vastly increase the Nation's need for timber products. The President of the United States himself, in his 1962 state of the Union message on conservation, testified to the urgent need for more timber growth to meet our future needs:

"Timber growth, particularly in softwoods, must be increased significantly if we are to meet the Nation's projected future requirements for wood products. The growing of timber is a long-term project, requiring concerted public and private efforts and considerable advance planning."

The U.S. Forest Service expressed a parallel thought in the T.R.R.:

"Forestry is not a short-time proposition. Where this Nation stands in timber supply in the year 2000 will depend largely on actions taken during the next two decades. Recent encouraging forestry trends must continue. But this is not enough. Acceleration of these trends is vital, and to a degree that will startle many of us. There are no grounds for complacency. If the timber resources of the Nation are to be reasonably abundant at the end of the century, and if our children and their children are to enjoy the same timber abundance that we ourselves know, standards and sights must be raised. The potential of the land is adequate. The opportunity is there."

The Forest Service predicted in the T.R.R. that, based upon median levels of timber demand, sawtimber growth by 1975 will be 14 percent less than demand, and by the year 2000 the deficit will have increased to 76 percent.

Thus, it is obvious that forest growth must be accelerated. An essential element of any nationwide effort toward this objective must be the continuance of those incentives whose proven success in the last 20 years augurs their continuing success in the future.

Industry and other private timberland.—Forest industries own 18 percent of privately owned commercial forest land. That they have responded not only well but uniquely well to the stimulus of section 631 has been testified to by the Forest Service in the TRR:

"It is apparent that forest industry ownerships are a more important factor in timber supply than would be indicated by the relative number of ownerships or the acreage owned" (summary, p. 83).

"The above comparisons show that the greatest advancements in forestry, the best conditions on recently cut lands and the largest timber volumes occur on lands of the forest industries and public agencies" (summary, p. 88).

Notwithstanding the remarkable response of the forest industry to the stimulus of section 631, it is now proposed to deprive members of the industry of the benefits of the very tax treatment that has produced these phenomenal results.

[2] T.R.R. summary, p. 75.
[3] H. Rept. No. 323, 1941, p. 37.
[4] See also the statistics indicating effect of timber capital gains shown in exhibit A.

The President and the Forest Service have expressly recognized the need for not merely continuing recent gains, but also for improving our present state of forestry. It is clear that the proposals with respect to section 631 will not only prevent the affected timber owners from improving present practices, but will forfeit many of our recent gains. As will be shown hereinafter, section 631 is an economic necessity. The proposals clearly will further depress the already low rate of return and cause a flight of capital from the forest industries companies into more rewarding alternatives. The superior attractiveness of these alternative investments will be the same whether the basic corporate tax is 52 percent or 47 percent.

The impact of the proposed changes in section 631 would not be limited to the forest industries. It will affect many owners of very small timber properties for the very simple reason that it is uneconomic to cut timber on small ownerships at frequent intervals. Every owner of 500 acres or more certainly expects his periodic sales to produce gains over $5,000—or he will quickly get out of the wood growing business. Ownerships of 500 acres or more (including forest industries ownership) represent 40 percent of all private commercial forest land—and in the light of the TRR comments, represent a significantly greater proportion of the Nation's private timber growing potential.

What will happen to this 40 percent segment of our private timber growing potential if the present section 631 tax treatment of timber income is denied to these owners? The Forest Service says that "it is vital to accelerate recent improvements in forestry to a degree that will startle many of us." Will anyone assert that the repeal of section 631 as to this class of owners will contribute to this acceleration? Obviously, it would have only the opposite effect.

In addition, repeal of section 631 as to this class of owners unquestionably would dilute its effectiveness as an incentive even for the class of owner who will continue to be entitled to its benefits—the very small landowners. Such an owner could not ignore the fact that Congress had repealed section 631 as to others who, in reliance upon section 631, had spent tens of millions of dollars to bring their standards of forest practices up to their present high levels, hence the same thing might happen to him. Certainly no prudent small landowner would invest time, money, and effort on reforestation of his lands, based upon current calculations of financial returns, without some guarantee that Congress will not repeal section 631 as to him (or reduce the $5,000 limitation) before he cuts the trees he is currently planting.

4. *The proposed discrimination between timber owners*

A major purpose of the 1944 law was to eliminate the discrimination between timber owners who used alternate methods of realizing gain from timber. Those who were following the best and also the most costly reforestation practices—continuous cutting under sustained yield management—were required to treat their income as ordinary income. Those who sold their timber outright received capital gain. In 1944, Congress removed this discrimination by extending capital gains treatment to this group of timber owners.

The current proposal would create a new discrimination in the tax treatment of different timber owners. Very small timber operators would continue to receive capital gains treatment. All others—including all corporate timber owners and operators—would again, as before 1944, be required to treat their timber income as ordinary income. Thus some timber owners would be discriminated against solely because of the size of their operations, and others would be discriminated against solely because they do business in corporate form.

5. *The proposed discrimination against timber owners*

When section 631 was enacted, the capital gain treatment it accorded was viewed "as an act of justice to those who grow timber over a period of a generation, or half a century, and who are entitled to just treatment, no matter in what manner they dispose of the timber."[5] This "just treatment" now would be eliminated, and all substantial timber owners and all corporate timber owners would be subjected to a new, unjust discrimination, vis-a-vis all owners of innumerable other kinds of assets. Other taxpayers would continue to receive capital gain treatment—and at a 40 percent reduced inclusion—on all their gain on sale of capital assets, whether the amount of their gain is $5,000 or $5 million. But gain on the sale of timber would be taxed as ordinary income to the extent it exceeds $5,000 in the case of individuals, and entirely in the case of corporations. This would be not only unjust treatment; it would be a rank, un-American discrimination.

6. Section 631 is an economic necessity

Importance of forest products industry.—Forest products companies play a significant basic role in the Nation's economy, entering into almost every phase of construction and housing, the production and utilization of paper products, and an ever growing variety of nonpaper products, particularly chemicals. The magnitude of the forest products industry and its contribution to our economy is dramatically shown by the fact that it employs more than 1,100,000 people, representing 7.1 percent of all employees engaged in manufacturing in the United States. Their aggregate payroll, $4.8 billion, comprises 6.1 percent of the total payroll of all manufacturing facilities. The continuation of a strong and virile forest products industry obviously is vital to the continued economic growth of the United States.

The industry has widespread local impact. In 31 States, 5 percent or more of the manufacturing employees are engaged in the forest products industry; in 19 of these States, 10 percent or more of the manufacturing employment is engaged in the forest products industry. The industry employs more than 10,000 people in 31 States, and in 17 of these States it employs more than 30,000 people.

The industry's capital expenditures for new plant and equipment have averaged $825 million per year in recent years. This not only has improved the end products consumed by the American public and added to the job security of employees, but, obviously, has contributed substantially to employment and profits in other segments of the economy.

Section 631 has a direct relationship to the health and vitality of the forest products industry. Specifically, and of utmost importance, it has a direct cause and effect relationship to the reforestation which is essential to its future. We now explain this fundamental economic fact.

Net after-tax rate of return.—The most significant criteria used by knowledgeable investors in deciding where and when they will invest is the anticipated net after-tax rate of return on their investment dollar. Likewise, corporate management has, as its most significant criteria in deciding where it will invest retained corporate earnings, the anticipated net after-tax rate of return. This is the heart of the reforestation problem—because forestry activities compete with the entire gamut of private enterprise activities for investment of dollars.

The effect of this competition is highlighted by the contrasting experience of the forest products industry in two recent periods. During the period from 1929 to 1943, the net after-tax rate of return of the lumber industry was only about one-third of the average net after-tax rate of return of all manufacturing industries, and the net after-tax rate of return of the paper industry was only about two-thirds of the overall average. As we have seen, there was very little reforestation during this period.

[5] Congressional Record, Senate, Feb. 23, 1944. Statement of Senator Barkley:

"I voted for this timber amendment as a member of the Finance Committee. I voted for it on the floor of the U.S. Senate. As one of the conferees on the part of the Senate, I signed the conference report containing it. For that vote I make no apology to any human being. I did not vote for it in order to create a fantastic or imaginary loophole to allow someone to escape taxes. I voted for it as an act of justice to those who grow timber over a period of a generation, or half a century, and who are entitled to just treatment, no matter in what manner they dispose of the timber."

In contrast, under section 631 during the years from 1944 to 1960, the net after-tax rate of return of the lumber industry and paper industry was approximately equal to the average for all manufacturing industries, being higher in 5 years and lower in 12 years.[6] As has been pointed out, it was during this period that for the first time in our history—under the stimulus of section 631—industrial forest owners matched even the Federal Government in the intensity and success of their forestry activities. This is clear proof of the importance of the net after-tax rate of return in the decisions of investors and corporate management as to the amounts of money to be spent on forestry. In recent years the Forest Service has indicated that productivity on private lands has even exceeded that on Federal lands.

Effect of proposals on rate of return.—The progress of the past 19 years in reforestation will overnight become uneconomical and financially unsound for the forest products industry if the new tax proposal, as espoused by the Treasury Department, becomes law. Your attention is directed to the attached chart, exhibit B, which clearly demonstrates the economics of growing a typical forest under both the present tax law and the Treasury's proposal. In arriving at the factors graphically presented, average land values, planting costs, and annual management costs have been used to determine the net after-tax rate of return—which varies between 3 and 4 percent, compounded annually. The dollar return is based on statistics compiled by the U.S. Department of Agriculture.

It will be noted from the chart, exhibit B, that the net after-tax rate of return on forest reforestation investments will be substantially reduced under the Treasury proposal. As is forcefully illustrated in exhibit B, the after-tax rate of return on a reforestation investment under the present tax treatment already is minimal—approximately 4 percent compounded annually. Notwithstanding this low rate of return under present law the forest products industry has carried on its task of reforestation with phenomenal success. The damage to future reforestation which will occur if the Treasury's proposal eventually becomes law is obvious when one notes the decline in dollars of return and the effect of the net after-tax rate of return. Although one might conclude that a dollar rate decline of, for example, $300 per acre at the 80-year age is not significant, this is the very margin that has provided the successful reforestation program carried on by the wood products industry over the past 19 years on its approximately 63 million acres of timberlands.

The certain conclusion from exhibit B is that investors and corporate management could not wisely invest in reforestation under the new tax proposals, and, therefore, that the necessary capital to finance reforestation (whether equity or borrowed) would not be available at this low level rate of return.

The impact which the new tax proposals would have upon the net after-tax rate of return of forest products companies (and therefore upon reforestation) is buttressed by a review of the financial picture of these companies today. There is an implicit assumption in the Treasury Department's proposals to deny capital gains treatment to the forest industry, that section 631 has conferred a "windfall" on companies in the industry, and that large companies have been particularly benefited. This not so—there is no "windfall"—indeed, as an industry, the forest products companies today are not faring as well as the average American industrial corporation.

Forest industry—All industry compared.—The 1962 Fortune Directory of the 500 largest U.S. industrial corporations contains 21 industry groupings including 2 forest products industry categories—"Lumber and Wood Products" and "Paper and Allied Products." This survey indicates that the median net after-tax return on invested capital for all industry was 8.1 percent in 1961 and 9.1 percent in 1960. Lumber and wood products companies averaged 5.6 percent—the lowest of the 21 industries in 1961—and in 1960 were next to the lowest with a return of 6.4 percent. Paper and allied products did little better, ranking 16 out of 21 in both years on a return of 7.1 percent in 1961 and 8.5 percent in 1960.

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[6] Source: Annual study of 2,000 leading manufacturing corporations conducted by the First National City Bank of New York.

The proposed elimination of present tax treatment would markedly depress the already below-average after-tax earnings of these industrial forest landowners—doubtless assuring these companies a permanent position at the bottom of the Fortune list—if they continue to invest in reforestation and forest management.

The proposed emasculation of section 631 will, of course, affect thousands of individual forest owners as well as the large industrial forest owners. Obviously, the sharper the impact upon a particular taxpayer's net after-tax rate of return on his forest investments, the more the proposed changed will discourage him from making such investments.

Who owns America's timber?—Great emphasis is placed by the Treasury Department upon the alleged relatively small number of timber owners who will be seriously hurt by the changes in section 631. Incongruously, Treasury also stresses the importance of continuing section 631 as a stimulus to good forestry practices in the case of the very small operators (only) notwithstanding that the very small operators have responded least to the stimulus of section 631. In view of the low rate of return on forest investment, even with capital gains treatment, it must be inferred Treasury's concept is that tax incentives should be offered to a class of taxpayers only if it has numerous members. Therefore, it should be noted that the proposed emasculation of section 631 will hurt not a few hundred corporations, but the more than a million corporate shareholders who own forest land derivatively. Detailed data, available on 46 large publicly owned timber products corporations reveal that they own a total of 39,600,000 acres. Based on the large number of stockholders in these companies, the average stockholder ownership is 46 acres. This compares with average ownership for the United States of 81 acres—assuming the usual methods of classifying timber ownership. When one considers the acreage applicable to corporate owners, that is 46 acres per owner, these owners can be considered small owners indeed.

Reduced rate of return—Effect on forestry.—In appraising the deterrent effect upon private forestry activities of any further reduction in the net after-tax rate of return on investment, the time cycle required for the growth of commercial timber must be considered, for it is the major element in the economics of private forestry. Trees planted today must be managed, protected, and cared for at annual additional cost for periods of from 20 years for southern pulpwood and 40 to 50 years or more for southern sawtimber, to 80 to 140 years for western sawtimber.

Keeping in mind the grave concern expressed by the U.S. Forest Service as to the future supplies of sawtimber, let us view the financial problems through the eyes of an owner of a managed sawtimber stand. According to the Forest Service, the earnest effort of such owners will be required to meet future timber demands.

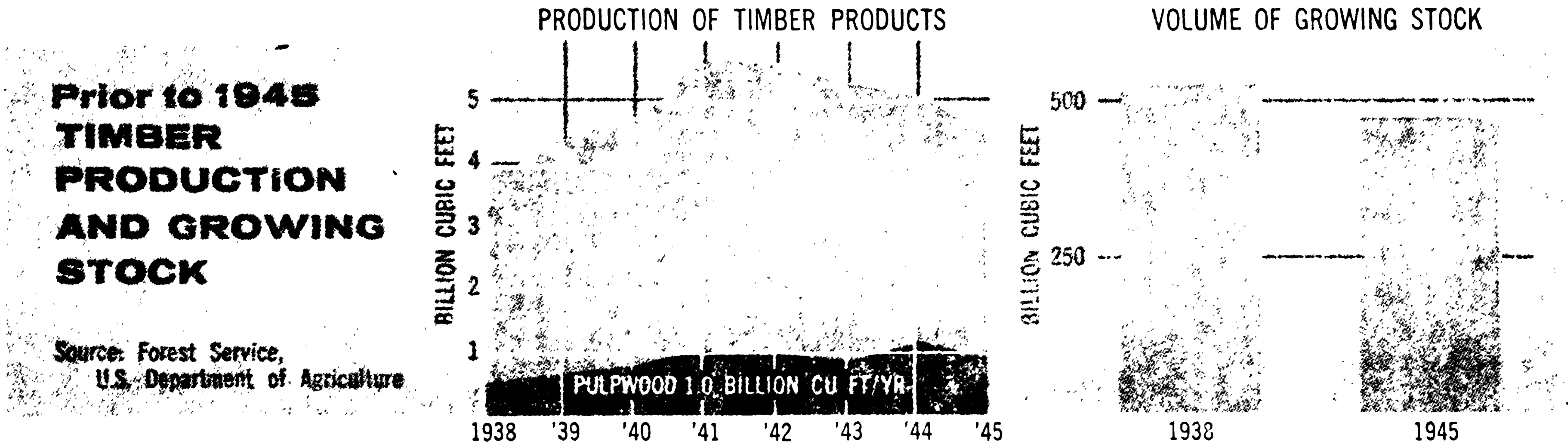
Using a low sawtimber growth time cycle—50 years—the timberland owner in any one year will be cutting timber from only one-fiftieth—or 2 percent—of his land. On an 80-year cycle he will be cutting timber from only one-eightieth—or 1.25 percent—of his land. The cost of replanting the land which has been cut is but a small fraction of his total annual costs. He must realize enough gain from such limited cutting to pay for carrying the base costs of reforestration, local taxes, fire protection, insect and disease control, and casualty losses—all for a 50-year or longer period.

Under these circumstances, the wonder is that private companies can afford to practice good forestry—even with present tax treatment. Under the new tax proposals, they simply could not afford it.

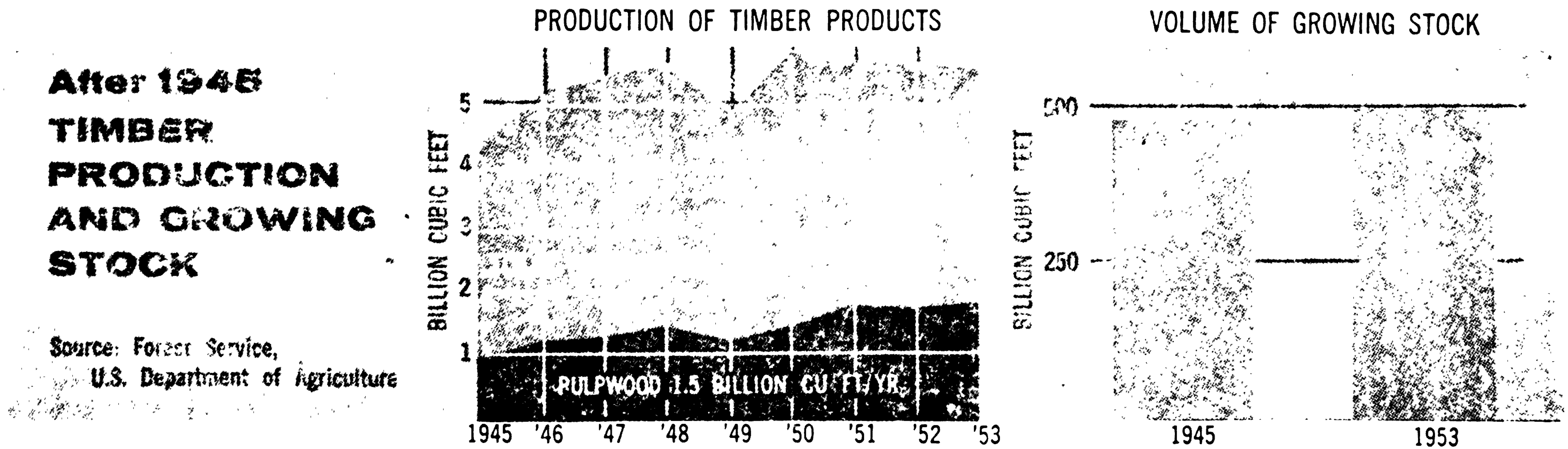
Exhibit A

Was Enactment of Timber Capital Gain Taxation in 1955 Effective National Policy?

There are two significant periods to be considered:
Prior to 1945 demand increased steadily—and timber growing stock was reduced.



Total production was 5.9 billion cubic feet per year and timber stock in total fell by 9 percent.
But after 1945 while demand was rising at a slightly greater rate—timber growing stocks held its own.



*Recast by Forest Service USDA to place on basis comparable to 1953 data.

In the 8 years following 1945 (the only years for which national data on growing stock is now available) total production was 7 billion cubic feet per year and timber stock more than held its own.

The dramatic difference between the periods before and after 1945 was made possible in large measure by the 1944 timber tax reform. Its effect was to remove a major impediment to investment by timber owners in such measures as—

Timber stand improvement, including pruning and thinning.
Reforestation, including land preparation, seeding, and planting.
More complete utilization of the tree.
Increased protection against fire, insect, and disease.

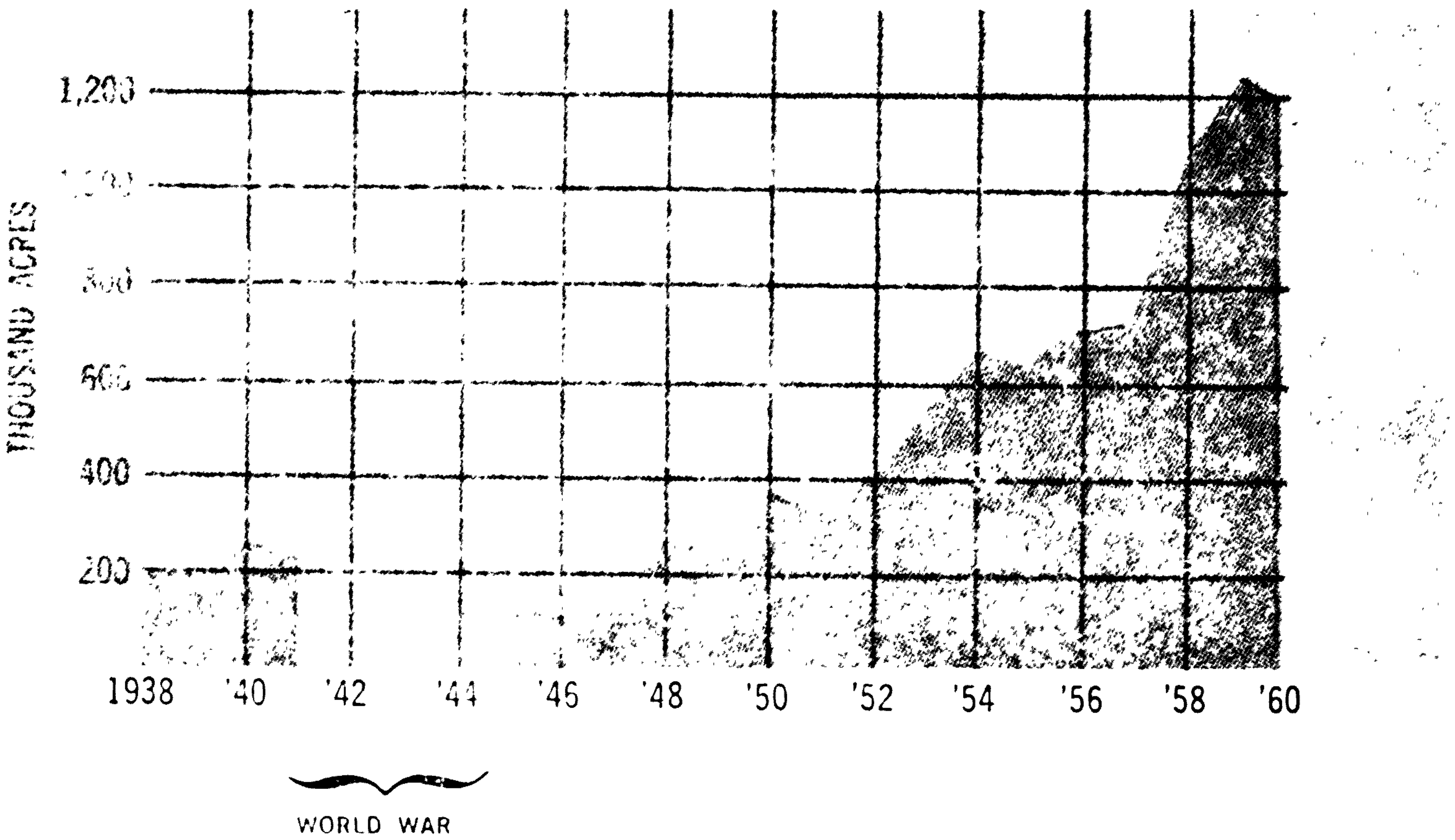
These factors, together with increased Government and industry cooperation in forestry management, halted the decline in trend of timber growing stock.

THE ACID TEST—THE RATE OF PLANTING

Here is a striking picture demonstrating the new investment that private owners are putting into forests for the future:

FOREST TREE PLANTING ON PRIVATE LANDS

Data excludes planting under soil bank program.
Source: Forest Service, U.S. Department of Agriculture



A great increase in the planting of trees began after the war period, almost as soon as seedlings were available. This increase was due in large part to the encouraging effect that fair tax treatment had on forest landowners.

Nevertheless, according to both the Forest Service and private sources, there is still a great need for acceleration in the rate of planting. This is one of the major objectives of forestry management.

These two economic developments since 1945—the change in trend of timber growing stock and the substantial increase in tree planting—both testify to the wisdom and effectiveness of timber capital gain taxation in implementing national policy.

EXHIBIT B

Reforestation Investment
Dollar Rate of Return at Date of Harvest
Compared to Compound Rate of Return Over Same Period

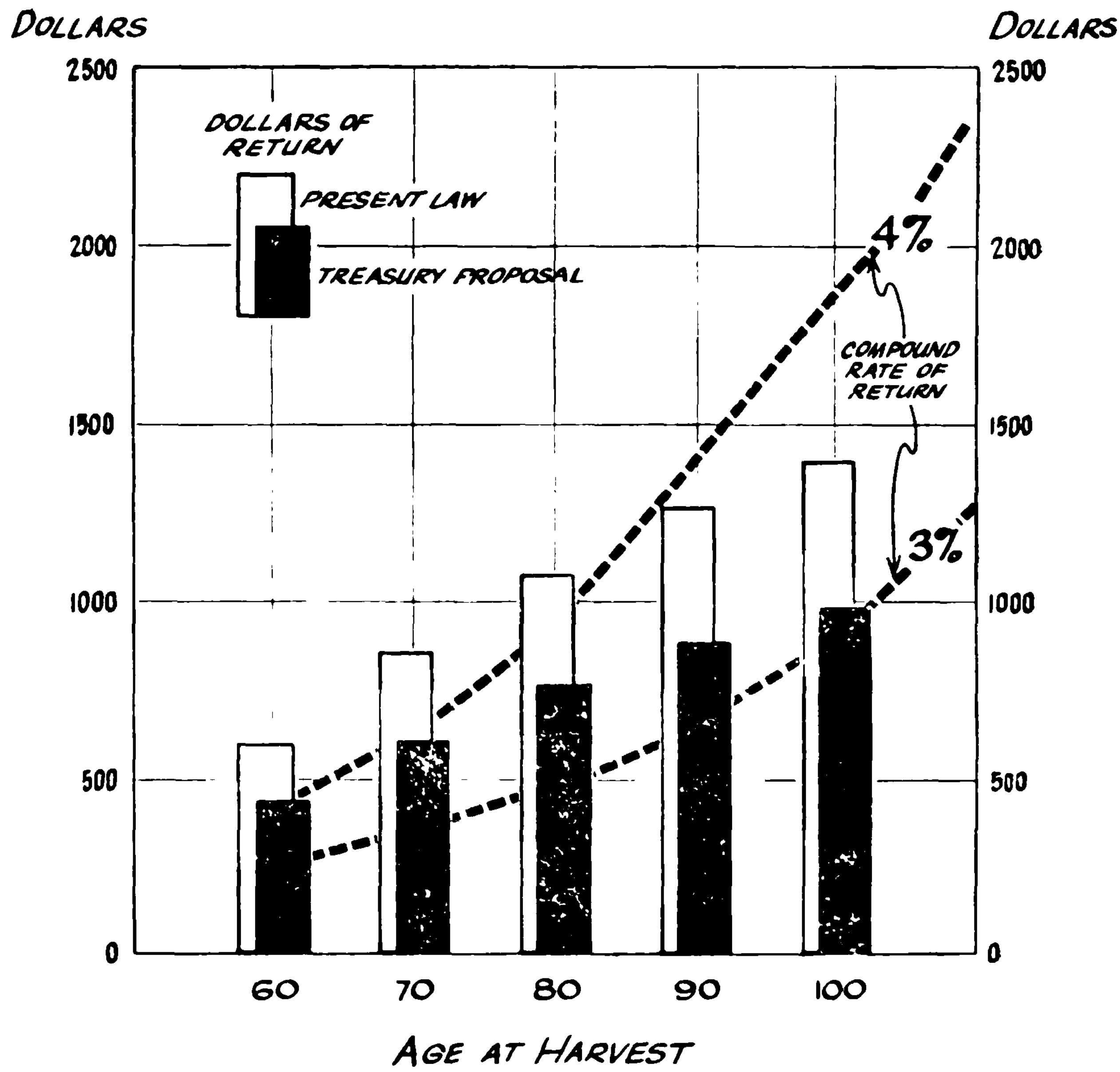


EXHIBIT 13

TAX TREATMENT OF TIMBER

A. TAXATION OF TIMBER SALES AND REFORESTATION EXPENSE

1. Proposals and their background

Several changes are being recommended which would alter the existing situation on capital gains on timber and at the same time liberalize the treatment of reforestation expense to encourage good conservation practices.

Prior to 1944, a farmer or timber grower who owned timber and cut it for use in his own business could not enjoy capital gains treatment on the cutting of the timber. No tax consequences attended such cutting; ordinary income treatment resulted upon the sale of the processed item in which the timber was used. If the timber was sold on a cutting contract with payment measured by the thousand board feet cut, the proceeds also were subject to tax at ordinary rates. However, if the timber was sold outright for a flat sum, or outright with the land, such sales were generally not considered to have been made in the ordinary course of business and hence were eligible for capital gains treatment.

The situation prior to 1944 was held to have certain undesirable elements, particularly for the farmer, in that he had to sell his timber outright to receive capital gains treatment, but if he wished to sell his timber annually or based on a dollar amount per thousand board feet cut he paid an ordinary income tax rate. This situation tended to confer ordinary income treatment on the very transactions which involved the best reforestation practices (sustained-yield forestry) and capital gains treatment on the least desirable conservation practices (outright liquidations of forest land).

Present law provides, in effect, that the sale of timber with a retained economic interest (for example, at so many dollars per thousand board feet cut) is accorded capital gains treatment. In addition, the timber owner (or one who owns a contract right to cut timber) who cuts his own timber is permitted to treat such cutting as a sale or exchange of the timber for an amount equal to the fair market value of the timber. Such sale is made subject to capital gains treatment.

The result has been that the farmer who owns a small tract of timber is generally eligible to receive capital gains treatment whether or not he is in the trade or business of growing or selling timber. The forest products industry, to the extent it owns timber or purchases standing timber for cutting and processing, whether the timber came from State or Federal forests or private lands, is also able to secure capital gains treatment.

The proposals in this area fully recognize the problems which then existed and are designed to avoid a return to the pre-1944 situation.

In brief these proposals would (1) treat timber income of corporations as ordinary gain and limit the amount of capital gain treatment on timber to $5,000 of gain annually in the case of individuals, whether realized on cutting or on sale, with or without a retained economic interest, and (2) permit the current deduction of expenses for tree planting and reforestation which are now required to be capitalized for income tax purposes. The normal tax rate applicable to the first $25,000 of corporate income would be reduced and alined with the corporate capital gains tax at 22 percent, so that small corporations would benefit from general tax reduction and be unaffected by the proposed change in the timber provisions. General averaging provisions being recommended for individuals would prevent hardship due to the impact of graduated rates on the bunching of income from large sporadic sales of timber in a single year.

Basically, timber used for one's own business should not be subject to capital gain treatment. Timber today is grown as a crop by many farmers as well as some of the large corporations in lumber, pulp, and plywood. While it is true that the trees to be used 20 to 80 years hence must be planned for today, often a regular annual cutting and replanting occurs. In the case of the farmer, cutting is intermittent because his holdings are usually too small to be cut annually.

The proposals for revision are fully cognizant of the need to provide proper incentives for conservation and in fact provide a more than ample recognition of this need.

2. Ownership of timberlands

One-third of the U.S. land area is classed as commercial forest land—488 million acres. About one-fourth of this area (130 million acres) is in Federal and State forests and these lands are managed, among other things, to provide a continuous supply of timber.

The remaining 358 million acres are in 4,510,700 private ownerships which average 79 acres each. Of these, there are 3,383,000 farmowners with 34 percent of the commercial forest, 165 million acres. The average farmownership is about 49 acres. There are 1,104,000 "other than forest industry" owners (business and professional people, wage earners, housewives, retired persons, and nonforest industries) who own 26 percent of the forest land, 131 million acres, with an average holding of 118 acres each. The forest industry group accounts for only 0.5 percent of all private owners, 23,000 holding 13 percent of the forest land, some 62 million acres with average holdings of 2,660 acres each.

Within the timber industry itself the average ownership among the 21,000 in this industry is about 1,630 acres. On the other hand, the average ownership in the pulp industry is 146,000 acres, with ownership holdings less than 500 in the aggregate.

3. How the proposals will operate

(*a*) *Capital gain treatment.*—Ninety-nine percent of all commercial timber owners own less than 500 acres. Hence the proposal to limit capital gain treatment in the case of individuals to an annual ceiling amount of $5,000 will continue capital gains treatment for the great majority of farmers, woodlot owners, and persons owning timber for sale (or cutting rights) for use in their own business.

Thus, the recommended $5,000 ceiling on capital gains which may be realized in any one year for tax purposes covers the overwhelming majority of timber owners and operators, for whom timber gains may be irregular, sporadic, and therefore taxed relatively heavily under regular graduated individual rates.

The proposed treatment will therefore not create the unsatisfactory situation existing prior to 1944 which, in effect, forced the sale of timber outright to secure capital gains treatment. Thus, it will tend to assist in stabilizing landownership, particularly in the millions of cases where the woodland is an integral part of a family farm unit.

Several factors are relevant to the $5,000 figure. The average timberland ownership in the farm group is 49 acres, for other owners 118 acres, and for the forest industries 2,660 acres.

The Department of Agriculture estimates in Forest Resource Report No. 14 issued in 1958 indicate that on a national average basis timber growth per acre is about 100 board feet per acre. In the South the average is 125 board feet, in the North 69 board feet, while in the West it is 96 board feet. Forest experts have advised that in some cases under good management and with proper soil and growing stock rates of 500 board feet per acre, and sometimes even more, may be realized.

Depending upon the rate of timber growth, at a rate of gain of $1 per thousand board feet, the $5,000 ceiling could cover a property as large as 70,000 acres where the growth rate is 70 board feet per acre per year. On the other hand, where the growth rate is as high as 500 board feet per acre per year, the average could be as great as 10,000 acres. With the gain at $5 per thousand board feet, the acreage covered would drop to 14,000 in the first situation and 2,000 in the second.

This level of coverage, $5,000, will still provide a full capital gain opportunity to over 99 percent of the forest and landowners, with partial coverage available to the few thousand out of the 4,510,000 whose holdings are larger than 5,000 acres. In the main, this latter category of ownership is the large industrial holding where timber is grown as part of an integrated forest products enterprise.

(*b*) *Proposed current deduction of reforestation expense.*—Industry sources point out that presently timber growth exceeds timber cut. They further point out that to continue the improved trend we shall require substantial reforestation each year from now on.

Under present law only the cost of soil preparation, fire breaks and timber stand improvement and temporary roads may be treated as an expense against current income. Other forest management costs such as reforestation must be capitalized. The revision suggested in this area is designed to maintain and increase the pace of private reforestation efforts to meet projected demands by inclusion of forest management costs as a deductible annual expense rather than as a capital investment item.

On the larger industrial forest holdings, as well as on the smaller holdings, the incentive to reforest will thus be promoted.

An important feature of the President's recommendations is the reversal of corporate normal and surtax rates, which will reduce the rate on the first $25,000 to 22 percent, and an accompanying reduction in the capital gains alternative rate from 25 to 22 percent. For the both individual and corporate forest owners the new, substantially lower tax rates, will increase investment capabilities. Under this more favorable tax rate structure, the differentiation between capital gains and ordinary income in the case of the small corporate taxpayer will disappear. This will greatly simplify accounting for timber for such taxpayers. At the same time, since the capital gains rate is the same as the proposed rate on ordinary income in the case of corporations with incomes under $25,000, the elimination of the capital gain classification for timber does not change tax liabilities in these cases.

4. What the recommendations will accomplish

The conservation and reproduction of timber will be encouraged. The proposed revision will not induce outright sales and will offer positive forestry aid to the small farm forest owners as well as the large.

By encouraging a proper rate of reforestation the trend toward a good balance between timber growth and harvest will continue without developing a substantial surplus of timber beyond the Nation's needs.

Under present law there is no requirement that there be any positive act for forest conservation in order to receive capital gains treatment on forest income. Thus, it is possible for a forest landowner to receive a substantial tax benefit from the cutting of timber but fail to reinvest any of this income in forest conservation.

In summary, the recommendations provide a number of positive benefits for America's 4,500,000 timberland owners:

(1) The cutting of old timber, an aid to conservation, particularly on small ownerships, will be encouraged.

(2) The small sawmill operator who purchases timber from farmers and other small owners will be helped. "Pay as cut" contracts between these persons will continue to qualify for capital gains treatment without the small purchaser having to make large lump-sum payments to secure cutting rights. The provision will allow gains on long-term cutting contract arrangements under which the annual growth of timber can be harvested on scientific methods to be taxed as capital gains.

(3) The 3½ million farmers who have timber on their farms and all other small owners will be better able to grow timber as a supplement to other income because of the expensing provision for reforestation costs.

(4) Communities dependent upon forests will benefit from stable operations in contrast to the "cut out and get out practice."

(5) A sound base of productive forest land ownership will continue to provide timber for economic development while meeting an essential obligation to local, State and Federal revenue needs.

5. Tax revision and the current economic situation in the timber industry

The timber industry is currently confronted with a variety of economic problems. Various aspects of its economic position which have received attention include the impact of softwood lumber imports from Canada, intercoastal shipping regulations, public timber sales policies, timber blowdown on the west coast, and others.

On July 26, 1962, the following statement on a program to aid the lumber industry was released by the White House:

"The President today announced a program designed to assist the lumber industry and improve its competitive position. The announcement followed a meeting with Senators and Congressmen from the Northwest. The program included both immediate and long-range actions designed to increase employment, improve efficiency, and raise earnings.

"The new steps outlined by the President called for—

"(1) The initiation of negotiations with Canada concerning the amount of softwood lumber imported into the United States.

"(2) The submission of a request to the Congress for additional funds for forest development roads and trails program to assure the prompt harvest of national forest timber.

"(3) The amendment of the intercoastal shipping laws to permit use of foreign vessels when those conditions exist which indicate severe hardship to American shippers. This amendment will reduce the handicaps suffered by American producers in the intercoastal shipment of lumber.

"(4) An immediate increase in allowable cuts which will make available 150 million board feet on the lands managed by the Department of the Interior.

"(5) The establishment of a preference for American products in the purchase of lumber by the Department of Defense, the General Services Administration and other Federal departments and agencies. This could be particularly significant in connection with the various aspects of the AID program.

"(6) Increased attention to loan applications filed with the Small Business Administration and the Area Redevelopment Administration by lumber mills in order to enable them to upgrade their production and better compete with imported lumber products.

"In addition, the President indicated that he was directing that there be a continuing review of the problems of the industry by an interagency committee in order that developments and problems might be anticipated and recommendations made to meet and overcome any difficulties or handicaps the industry might face. The Secretary of Agriculture would be specifically instructed to report to him by October 15 on both firm and interim increases in national forest allowable cuts to assure a continuation of timber sales at or beyond the record levels achieved in the most recent quarter of 1962.

"The President was informed that west coast lumber interests had already filed a request with the Tariff Commission for an escape clause investigation on softwood lumber and that the Tariff Commission has instituted an investigation. The President indicated he would request the Commission to complete it as expeditiously as possible."

A statement on the lumber problem, dated December 13, 1962, prepared in the Business and Defense Services Administration of the Department of Commerce, summarized the problems and the extensive actions taken by the Federal Government to assist the lumber industry. This statement indicated in part:

"The difficulties of the lumber industry are due to a complex of factors related to industry operations, governmental policies and regulations, technological changes, and domestic and international economic developments.

"A major factor in this situation is the substantial increase in softwood lumber imports resulting from the competitive advantages of Canadian producers in raw materials, production, and shipping costs and the devaluation of Canadian currency. However, the industry generally suffers from overcapacity. It is characterized by a few large mills, a moderate number of medium-sized mills and a preponderance of small mills. The smaller mills operate seasonally or on an intermittent basis when lumber prices are high and cease operations when prices are low. The number of active mills in the industry therefore varies considerably from time to time. As the original timber is cut in one region, the center of production shifts to new areas. In certain areas some of the remaining mills have become obsolete. Layout and equipment designed to cut large logs is less efficient when used in cutting smaller logs now available to them. Adjustment of mill size and equipment to the available timber resource and modernization of equipment and techniques is correcting this situation, but not fast enough.

"Overcutting of private timber in some areas has led to increased demand for public timber, particularly where public holdings are substantial. Adherence to good timber management principles, lack of access roads and other limitations have not always permitted an increase in the supply of public timber sufficient to meet the requirements of all installed capacity of the facilities of a given area. This has resulted in bidding up of log prices. In other areas sawmill capacity is not adequate to utilize available timber."

The proposed tax revision would not affect marginal firms in the industry which are not paying tax because they are not operating at a profit. The proposed $5,000 allowance for capital gains treatment in the caes of individuals, in combination with lowered capital gains rates and rate reduction would help the vast majority of individual timber owners or operators. Small corporations in the timber industry would receive general tax reduction, as would larger corporations, and smaller corporations would be completely unaffected by restriction of capital gains treatment since the tax rate for ordinary income and capital gains would be the same up to $25,000. The restriction of the capital gains treatment, which is now primarily of benefit to the larger concerns, would help restore a healthy competitive balance in the industry. Many believe that the capital gains feature has, in fact, been a source of distortion and overstimulation which has helped the larger firms to achieve higher after-tax profits, caused artificial and erratic bidding up of timber prices, and thus squeezed out many smaller sawmill operators.

B. EFFECT OF CAPITAL GAIN TREATMENT ON TIMBER IN STIMULATING ACCELERATED CUTTING AND DEPLETION OF TIMBER RESOURCES

A realistic analysis of the economics of the timber industry and the financial management of forest ownership dispels the claim that capital gain treatment encourages sound conservation practices.[1] In fact, capital gain treatment is often a factor contributing to accelerated liquidation of timber holdings.

As experts have observed, one of the major reasons for the purchase of timberlands is to protect and insure a permanent supply of timber for large industrial concerns making pulp, paper, cellulose products, plywood, lumber, poles, and other wood products. For these buyers, capital gain treatment on a portion of their profit margin resulting from the intricate operation of the cost-valuation comparisons provided under section 631 of the Internal Revenue Code is an essentially fortuitous tax advantage which reduces the effective rate of tax on this particular sector of manufacturing as compared with other industries. This advantage bears little or no relationship to conservation and good forestry management.

Another major reason for the purchase of timberlands is to profit by accelerated liquidation of the standing timber purchased in wholesale lots at less than going market prices. The practice of intensive efforts to acquire large timber tracts at wholesale and to sell at retail prices is well known in the timber industry.

Reports indicate that, depending on the tract size and location, purchasers of standing timber usually think in terms of a discount from retail appraisal of 20 to 40 percent. These figures are reported to have applied in some of the recent larger purchases of timberland.

If a company buys a block of timber at a 40-percent discount and accelerates its liquidation, it can work out a plan whereby in 10 or 20 years it will pay off the debt incurred to finance the purchase and still own timberland which thereafter may or may not be put on a sustained-yield basis.

The economics of the accelerated liquidation operation in timber rely in part upon capital gain treatment. The present tax law thus fosters a type of operation which is basically inimical to sound husbandry and development of the Nation's forest resources.

It is reported, for example, that X corporation has been buying large blocks of timber with heavy borrowing backed by accelerated harvesting for debt repayment. This corporation has stated that as a matter of policy it believes in buying timberland and standing timber with borrowed money, using common stock to raise capital to build papermills, lumber mills, plywood mills, distribution facilities, and for merchandising, in order to exploit timber ownerships.

Descriptions of recent timber company acquisitions and the subsequent disposition of their timber holdings suggest that the capital gain treatment is an important factor in stimulating liquidation operations. For example, a large aggregaton of timber and lumber properties in corporation Y was recently purchased by an investment banking firm through acquisition of corporation Y's stock for $100 million, a figure which netted the stockholders over twice the price the shares had been traded at in the market. Then, through a process of liquidation, the various properties were sold to interests able to utilize them in their business. The timber, consisting of about 4 billion feet of old-growth timber was ultimately sold for $70 million. While this complex operation doubtless had various business and financial motivations, it bears many of the earmarks of a liquidation operation, encouraged by capital gain treatment on timber sales, the effect of which was not consistent with the orderly use and management of timber resources.

Orderly cutting of old-growth timber is, of course, desirable to insure optimum utilization of timberlands and make way for the planting of new growth. However, the role of capital gain treatment in facilitating the wholesale cutting of accumulated timber stands in order quickly to pay off debt financing, is one which calls into grave question the effect of this feature of the tax laws on resource conservation.

C. EXAMPLES OF TAX CONSEQUENCES OF PREFERENTIAL TREATMENT OF TIMBER INCOME AND THE DISTRIBUTION OF TAX ADVANTAGE FROM CAPITAL GAINS TREATMENT IN THE TIMBER, PLYWOOD, AND PAPER INDUSTRIES, 1959

1. *Corporations*

Table 1 accompanying this exhibit presents examples of the unusual tax advantages derived from the existing capital gain treatment on timber income.

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[1] The following analysis and comment is based largely on and draws freely from a paper by William L. Moise, "Factors Which Attract Equity and Borrowed Capital to Timberlands—the Investor's Viewpoint," appearing in Financial Management of Large Forest Ownerships, Yale University School of Forestry bulletin No. 66, 1960, pp. 46–58.

based on the 1959 experience of 15 large companies in the timber, plywood, and paper industries. All of the companies in this group had assets in excess of $25 million ranging up to more than $250 million.

As the analysis shows, the capital gain provision on timber cutting and sales resulted in these companies reporting capital gains ranging in amounts from one-third to more than 100 percent of their net income. As a consequence, the effective rate of tax paid by these companies as a group in 1959 averaged less than 33 percent, as compared with the generally applicable 52-percent corporate rate and an actual average effective of more than 48 percent paid in 1959 by corporations as a whole. In some instances, the capital gains feature permitted these large companies in the timber, plywood, and paper industries to reduce their effective tax rate to less than half that normally applicable in their situation.

2. *Partnerships*

The accompanying table 2 presents illustrative data showing the tax advantages derived by a number of partnerships in the timber industry, based on tax returns filed for various years in the 1959–61 period.

Of the 13 returns summarized in table 2, all but 1 reported an overall operating loss from the timber business. On the other hand, all the returns show substantial long-term capital gains from the fair market value computation provided in section 631(a) of the Internal Revenue Code.

Five of the returns showed an actual deficit in gross income totaling about $425,000. This resulted from estimating the fair market value of the timber at such a high figure that the gross sales price manufactured from the timber was less than the section 631(a) "cost" of the timber. Total gross income reported in the 13 returns was $5,288,391 while the net loss from the operations of the lumber business was reported to be $2,321,292. On these same returns the long-term capital gains were reported to be $5,107,027.

This reporting means that these partners were reducing their ordinary income from all sources by their respective shares of the $2,321,292 and were, at the same time, reporting their respective shares of the $5,107,027 as long-term capital gains.

TABLE 1.—*Tax advantage of selected large timber, plywood, and paper companies from capital gain treatment on timber, 1959*

Company by industry	Corporation income tax as percent of net income: Under present law (actual 1959) (1)	Corporation income tax as percent of net income: If no capital treatment (2)	Tax advantage as percent of net income (col. 2−1) (3)	Net capital gains on timber as percent of net income (4)
Timber:				
Companies with assets over $25,000,000:				
A	26	51	25	92
B	25	49	24	98
C	29	52	23	85
D	8	15	7	33
E	43	49	6	25
F	29	52	23	83
Companies with assets over $50,000,000:				
G	35	52	17	63
H	31	51	20	76
I	19	36	17	63
Companies with assets over $100,000,000:				
J	39	52	13	48
K	24	51	27	98
L	35	52	17	61
Plywood and paper:				
Companies with assets over $100,000,000:				
M	32	52	20	74
N	25	54	29	101
O	34.5	46	11.5	44

NOTE.—In some instances, tax without capital gain treatment on timber continues to be abnormally low due to operating loss carryovers, intercorporate dividend deduction, etc. In 1 instance, tax includes 2-percent tax on consolidated returns.

Source. Office of the Secretary of the Treasury, Office of Tax Analysis, Feb. 6, 1963.

TABLE 2.—*Tax consequences from capital gain treatment on timber, selected partnership returns, 1959–61*

Year	Return	Gross income (excluding capital gains)	Deductions	Ordinary income or loss	Total, capital gains or loss	Capital gains from timber	Number of partners
1959	A	$242, 042	$230. 109	$11, 933	$937, 804	$827, 389	4
1959	B	844, 307	873, 582	−29, 276	160, 907	157, 919	(1)
1960	C	209, 797	486, 168	−276, 371	177. 464	177, 464	(1)
1961	D	528, 945	768, 724	−239, 779	117, 288	112, 555	(1)
1960	E	1. 683	3. 363	−1, 680	109, 253	109, 253	4
1961	F	406, 443	602, 432	−195, 989	80, 300	88, 800	3
1960	G	−7, 970	157, 558	−165, 529	127, 598	121. 802	2
1959	H	1, 141, 287	1, 593. 201	−451, 914	885, 826	886, 680	12
1960	I	2, 338. 316	2 708, 352	−370 0[illegible]7	1, 087, 382	1, 122, 392	12
1959	J	−59, 756	83, 925	−143, 681	520, 661	519, 961	5
1960	K	−184 074	81, 484	−265, 559	397, 560	397, 560	5
1959	L	−67, 761	8, 521	−76 282	308. 788	308, 788	2
1960	M	−104. 868	12, 260	−117, 128	196, 196	196. 196	2
Total	--------	5, 238, 391	7, 609. 679	−2, 321, 292	5. 107, 027	5, 026, 759	-----------

[1] Not available.

3. *Distribution of tax advantage from capital gains treatment in the timber, plywood, and paper industries, 1959*

An analysis of the distribution of the tax benefits from capital gains treatment in the timber, plywood, and paper industries in 1959 is presented in the accompanying table 3.

As this analysis shows, in the timber industry three companies received about 42 percent of the $44 million tax benefits from capital gains treatment on timber income in 1959. A dozen companies out of a total of 2,427 firms derived over half the benefits.

In the plywood industry, two corporations received more than 90 percent of the $11 million in tax benefits in 1959. Four firms in this industry received all but 5 percent of the tax benefits derived from capital gains treatment; the remaining 1,400 firms in this industry received all together less than $0.5 million in benefits from capital gains treatment.

The 15 largest paper companies out of 3,464 in the paper industry shown in table 2 received more than 82 percent of the benefits.

In the timber, plywood, and paper industries as a whole, 20 corporations derived over 60 percent of the total tax benefits on timber income.

Some 99 percent of all owners of timberland will, however, not be affected by the capital gains definitional changes proposed under the tax program.

Individuals and corporations will benefit from the privilege of expensing reforestation and related costs. The tax saving involved would be approximately $10 million.

TABLE 3.—*Distribution of tax advantage from capital gains treatment in the timber, plywood, and paper industries, 1959*

[In millions of dollars]

Number of corporations	Assets over $100	$50 under $100	$25 under $50	$10 under $25	$5 under $10	$1 under $5	Under $1	Total
Timber:								
3	$18.6							
2		$1.3						
7			$4.4					
23				$8.2				
32					$3.2			
245						$5.4		
2,115							$3.2	
Total timber								$44.3
Plywood:								
2	9.9							
1		0						
1			0					
7 [1]				[1] .6				
11 [2]					.1			
132 [3]						.2		
1,265							.1	
Total plywood								10.9
Paper:								
15	18.5							
All other (3,449)								[3] 4.0
Total paper								22.5
Total of timber, plywood, paper (more than 7,000 corporations considered)								77.7
Total of top 20 corporations (assets over $100 million)								47.0

[1] Primarily from 2 of 7 firms in this category.
[2] 1958 data.
[3] Included in $22.5 million.

D. CAPITAL GAIN TREATMENT AND THE SMALL TIMBER OPERATOR

(Loggers and Sawmills)

There is no evidence that the capital gain provisions are helpful to the survival of small contract cutters. Indeed, the available information shows that the number of small- and medium-sized sawmill operators (and to a lesser extent, of loggers) has been decreasing, as shown in the accompanying table 4.

The decline in the number of sawmills and loggers has actually been substantially greater than the Census of Manufacturers data shown in the table indicate. The reason for this is that the coverage of the Census of Manufactures is limited to the larger establishments and excludes a large number of "portable" mills and smaller loggers, the number of which is estimated by the Department of Agriculture Forest Service to have decreased about one-half during the past decade.

While the economic causes of the decline of the small sawmill operator, who is typically a contract cutter, are complex, one factor is apparently the squeeze on his profits engendered by the competition of larger firms both in buying timber and selling the product. The small operator does not now benefit from capital gain treatment to the same extent as the large producer because capital gains save the large corporate firm 27 percentage points and the small corporation only 5 percentage points of tax. Similarly individuals in the lower brackets now benefit relatively little. (Under the proposed rate reversal and 22 percent ceiling capital gains rate for corporations capital gain treatment will have no effect for the corporation with income under $25,000. Individuals will continue to receive capital treatment on $5,000 of gain annually.)

TABLE 4.—*Loggers and sawmill operators: Comparison of key data, 1954 and 1958*

[In millions of dollars]

	1954	1958	Change, 1954 to 1958 (negative sign indicates decrease)	
			Amount	Percent
Logging camps and contractors:				
Number of companies	12,789	12,627	−162	−1.3
Number of establishments:				
Total	12,865	12,805	−60	−0.5
With 20 or more employees	549	554	5	0.9
Employees	75,510	71,505	−4,005	−5.3
Payroll	$210.6	$226.7	$16.1	7.6
Value added by manufacture, adjusted	$392.8	$387.4	−$5.4	−1.4
Value of shipments	$774.3	$865.3	$91.0	11.8
Capital expenditures, new	$48.6	$67.9	$19.3	39.7
Sawmills and planing mills:				
Number of companies	(1)	(1)		
Number of establishments:				
Total	20,487	16,550	−3,937	−19.2
With 20 or more employees	3,500	2,854	−646	−18.5
Employees	341,350	278,003	−63,347	−18.6
Payroll	$962.3	$867.6	−$94.7	−9.8
Value added by manufacture, adjusted	$1,610.4	$1,341.1	−$269.3	−16.7
Value of shipments	(2)	$2,914.3		
Capital expenditures, new	$120.1	$129.4	$9.3	7.7

[1] Not available.
[2] Not published due to statistical duplication arising from shipments between establishments in the industry.

Source: Census of Manufactures, 1958.

E. RECOGNIZED TAX-SHELTER SITUATION IN MATCHING CAPITAL GAINS FROM TIMBER AGAINST ORDINARY INCOME DEDUCTIONS

The capital gain treatment on timber income has created opportunities for tax-avoidance arrangements which have been publicized in the tax services as having special appeal for high-bracket individuals.

This is illustrated by a recent item in a well-known tax service publication which advises executives with high-bracket income that timber makes an ideal "second business" because of the tax shelter.

"*Towering tax breaks.*—First of all, your investment constantly grows in value—tax free. There's no tax at all until there's a cutting or disposition of the timber. You can almost see those dollars growing on the trees. You can set things up so that you get capital gain treatment when the timber is cut. You can deduct the current maintenance and operating costs against your current tax-eroded executive income. And, you can deplete—or offset—the capital cost of your timber investment against your sale proceeds." [2]

[2] Executive Tax Report (Prentice-Hall, Aug. 13, 1962).

F. CHARACTERISTICS OF OWNERSHIPS OF TIMBER

The characteristics of the various types of ownerships of timber resources are described in the following quotations and accompanying tables from "Timber Resources for America's Future," Forest Service, U.S. Department of Agriculture, Forest Resource Report No. 14, January 1958, pages 81–86.

The basic characteristics of the four major ownership groups (forest industry, farm, "other" private, and public) are summarized in table 5.

"FOREST INDUSTRY OWNERSHIPS

"*Few in number and small in total area*

"There are about 23,000 forest industry ownerships in the United States, or less than 1 percent of the total number of private forest land ownerships. In numbers, this group is the smallest of the major ownership groups. About 21,000 of these owners are engaged in the manufacture of lumber. This estimate should not be confused with the 60,000 or so sawmills in the United States. Many sawmill operators do not own forest land, but purchase their timber or logs on the open market.

"Commercial forest land owned by the forest industries represents 13 percent of the national total. It is a little more than a third as much forest land as owned by farmers, and about half as much as owned by 'other' private ownerships or by the public agencies. Lumber manufacturers own 7 percent of all commercial forest land, and pulp manufacturers 5 percent.

"Although the total forest land held by forest industry is small in relation to other major ownership groups, the average individual forest industry ownership is relatively large—2,660 acres. Lumber industry ownerships average 1,630 acres, and pulp industry ownerships nearly 150,000 acres. About 84 percent of the forest land owned by the lumber industry is in ownerships of 5,000 acres or larger, but the average for the lumber industry is considerably smaller because of the many small manufacturers whose individual acreage is in the smaller size classes. Ninety-four percent of the pulp industry ownership is in holdings of 50,000 acres and larger (table 6).

"Of the 58 million acres in ownerships of 50,000 acres and larger, nearly three-fourths is owned by the forest industries. The 283 large ownerships in this class average 206,000 acres. The seven ownerships of more than 1 million acres apiece average 2,100,000 acres.

"Over half (54 percent) of the commercial forest land owned by forest industry is in the South. The remainder is almost equally distributed between the North and the West * * *. The lumber industry ownership is concentrated in the South and West; pulp industry ownership in the South and the North * * *.

"FARM OWNERSHIPS

"*Large in number and total acreage*

"Of the 4.5 million private ownerships of commercial forest lands, 75 percent or 3.4 million are farmownerships. Farmowners constitute by far the largest number of forest land owners.

"One-third of all commercial forest land and close to half of all the privately owned commercial forest land is in farmownerships; farms have more commercial forest land than all public holdings combined. Of the commercial forest land in the United States, one acre in every three is on a farm.

"Not only are farm forests important in supplying our national needs for timber, they also are a vital part of a sound farm economy. About 60 percent of all farms have woodland, and nearly one-fifth of all farm acreage is in forest.

"Like forest industry, more than half (54 percent) of the farm forest land occurs in the South. But whereas the remainder owned by forest industries is distributed about equally between West and North, 38 percent of farmownership occurs in the North, and only 8 percent in the West * * *. Thus, over nine-tenths of all farmownership is in the East.

"Most farmers own very small tracts

"The average farmownership is 49 acres. In contrast, forest industry ownerships average 2,660 acres, and the 'other' private ownerships 119 acres.

"With respect to size of forest holdings, practically all farmownerships are less than 5,000 acres. Eighty-three percent of the farmowned acreage is in tracts of less than 500 acres, and nearly half is in tracts of less than 100 acres (table 7).

"From the standpoint of number of owners, it is significant that, of the 3.4 million farmers owning forest land, over half own tracts of less than 30 acres, and two-thirds own tracts of less than 40 acres * * *.

"OTHER PRIVATE OWNERSHIPS

"By 'other' private ownerships is meant privately owned forest land which is not in farm or forest industry ownership. It includes a miscellaneous group of owners embracing a large number of occupational pursuits and some nonforest industries such as railroads and mining. This group shows great diversity in such owner characteristics as occupation, tenure, residence on or off the property, and interest, knowledge, and intent with respect to forestry.

"The 1.1 million holdings in this group represent one-fourth of all private ownerships and contain one-fourth of all commercial forest land. The 'other' private category includes twice the acreage owned by forest industries, is equal to that owned by all public agencies, and is exceeded only by farmownerships. Half of the total area in this classification occurs in the North, with most of the remainder in the South * * *.

"It is more difficult to characterize the 'other' private ownership according to size class than either forest industry or farmownerships, probably because of its heterogeneity. Whereas forest industry acreage is clearly concentrated in the medium and large holdings, and farmownerships in the very small holdings, the 'other' private ownerships are more evenly distributed among size classes. Nevertheless, three-fourths of the forest area in this category is in small holdings (under 5,000 acres) and 60 percent is in holdings of less than 500 acres.

"The average size of holding is 118 acres, which is over twice that of the average farmholding, but only a small fraction of the average industry holding. The problem explanation of this dispersion is that there are some large holdings in this group which lessen but do not overshadow the influence of the tremendous number of miscellaneous small holdings. It is evident from table 7 that one-half of the 1.1 million ownerships have less than 50 acres each, and account for 3 percent of all commercial forest land.

"PUBLIC OWNERSHIPS

"One-fourth of commercial forest land publicly owned

"Public ownerships of commercial forest land comprise one-fourth of the national total—about the same in area as the 'other' private ownerships, twice the area owned by forest industry, but significantly smaller than the area in farmownerships. The principal public ownership, in terms of area and timber volume, is the national forests with 17 percent of the Nation's commercial forest land and 37 percent of the sawtimber volume.

"The geographic location of publicly owned forest lands, follows a distinctly different pattern from that of farm, forest industry, or 'other' private. Public ownership is concentrated in the West because of the overriding influence of the national forests. On the other hand, a majority of the State, county, and municipally owned forest land occurs in the North. Of all publicly owned commercial forest land, 62 percent is in the West, 25 percent in the North, and 13 percent in the South."

TABLE 5.—*Comparative characteristics of forest ownership in the United States and coastal Alaska, 1953*

Type of ownership	Number of ownerships		Commercial forest land: Area	Commercial forest land: Average holding	Live sawtimber volume: Total	Live sawtimber volume: Softwood	Live sawtimber volume: Hardwood	Live sawtimber volume: Average stand per acre	Growing stock	Proportion of recently cut land in upper productivity class
	Thousands	*Percent*	*Percent*	*Acres*	*Percent*	*Percent*	*Percent*	*Board-feet*	*Percent*	*Percent*
Private:										
Farm	3,383	75	34	49	15	9	41	1,900	20	41
Forest industries:										
Lumber manufacture	21		7	1,630						73
Pulp manufacture	(1)	(1)	5	146,390						84
Other wood manufacture	2	(1)	1	2,200						23
Total, forest industries	23	1	13	2,660	37	35	47	4,000	39	27
"Other" private	1,104	24	26	118						52
Total, all private	4,510	100	73	79	52	44	88	3,000	59	56
Public:										
National forest			17		37	45	6	9,000	31	81
Indian			2		2	3	1	6,500	2	74
Bureau of Land Management			1		4	5	(1)	12,700	3	80
Other Federal			1		1	(1)	1	2,000	1	80
Total, Federal			21		44	53	8	8,700	37	80
State			4		3	3	3	3,300	3	77
County			2		1	(1)	1	1,500	1	76
Municipal and local			(1)							93
Total, all public			27		48	56	12	7,500	41	80
All ownerships			100		100	100	100	4,200	100	65

[1] Less than 0.5.

TABLE 6.—*Proportion of commercial forest land in private ownership, 1953*

Type of ownership	Size of holding (acres)					
	All sizes	50,000 and larger	5,000 to 50,000	500 to 5,000	100 to 500	Less than 100
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
Farm	33.8	0.1	0.9	4.8	12.1	15.9
Forest industries:						
Lumber manufacture	7.1	3.8	2.2	.6	.4	1
Pulp manufacture	4.8	4.5	.3	(1)	----	----
Other wood manufacture	.9	.4	.5	(1)	(1)	(1)
Total, forest industires	12.8	8.7	3.0	.6	.4	.1
Other private	26.7	3.1	3.2	4.1	7.5	8.8
Total, all private	73.3	11.9	7.1	9.5	20.0	24.8
	Acres	*Acres*	*Acres*	*Acres*	*Acres*	*Acres*
Average size of holding	79	206,067	14,879	1,001	167	51

(1) Less than 0.1 percent.

TABLE 7.—*Area and number of farm and "other" private ownerships, 1953*

Size of forest holding (acres)	Farm					"Other" private				
	Number		Area			Number		Area		
	Thousands	*Cumulative percent*	*Million acres*	*Cumulative percent*	*Cumulative percent* [1]	*Thousands*	*Cumulative percent*	*Million acres*	*Cumulative percent*	*Cumulative percent* [1]
Less than 10 [2]	671	20	4.2	3	1	125	11	0.9	1	(3)
10 to 20	742	42	10.2	9	3	122	22	1.9	2	1
20 to 30	485	56	11.2	15	5	95	31	2.5	4	1
30 to 40	279	64	9.4	21	7	89	39	3.0	6	2
40 to 50	197	70	8.5	26	9	157	53	6.8	12	3
50 to 75	324	80	18.7	38	13	189	70	11.3	20	5
75 to 100	193	85	15.6	47	16	196	88	16.3	33	9
100 to 500	492	100	59.2	83	28	131	100	36.6	61	16
500 and larger			28.2	100	34			51.4	100	27
All ownerships	3,383	100	165.2	100	34	1,014	100	130.7	100	27

[1] Percent of total commercial forest area in the United States.
[2] East only, 3–10 acres for number of owners; 1–10 acres for area.
[3] Less than 0.5.

LAW OFFICES, ROBERT F. SPINDELL,
Chicago, Ill., March 25, 1963.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR MR. BYRD: Perhaps I should give my background of experience and explain that I spent between 40 and 50 hours writing the material set forth in this letter. A graduate of Harvard College and Harvard Law School with 20 years of Federal tax practice in Chicago (including 8 years as part-time instructor in Federal taxation at DePaul University Law School), I have been chairman of the Federal Taxation Committee of the Chicago Bar Association and chairman of the Chicago Federal Tax Forum. Currently, I am a member of the Executive Tax Council of the Chicago Bar Association, which passes on all proposals for legislative changes submitted by the Federal taxation committee. Since the taxation committee does not make proposals until it has a tax bill to consider, I have made the following study of my own. I did this because the President's proposals and the 93-page "Technical Explanation" later submitted by the Treasury were in essence a tax bill themselves and the changes proposed were so extensive that comment by someone qualified seemed imperative.

Another very important consideration, I believe, is that since 1959 I have studied probably a thousand pages in the three volume "Tax Compendium" of papers submitted to the Ways and Means Committee in 1959. This provides an almost necessary insight into the tax objectives sought by the professors and others who wrote the papers submitted to the committee and thus into the process of thinking of those in the Treasury Department who drafted what most people call the 1963 tax bill.

One paramount point stood out in the papers written by Messrs. Surrey and Heller and the other professors. They started from the premise that all items receiving capital gains treatment—and indeed, including gains on sales and exchanges—should be given ordinary income treatment, some with and some without the averaging provision. Like good professors should do, they followed this premise to its logical conclusion, with little or no attention to the historical background or to the current economic reasons for giving a particular item special treatment.

As you and your colleagues are well aware, however, it does not make commonsense in an economy as complex as ours to try to make every situation fit into one general rule. Things are too complicated; hence the hundreds of exceptions and limitations in the code. This means, of course, that it is the arduous task of your committee to consider each of the professors' proposals from every side and also to consider the effect its adoption would have from the points of view of (*a*) justice to the taxpayers affected, (*b*) collection of the revenue, and (*c*) the effect it will have either in stimulating or depressing the economy.

A careful analysis of the 1963 tax bill shows that the bill will mean very little, if anything, to most taxpayers with incomes between $15,000 and $60,000 and will be highly disadvantageous to a large number of taxpayers in that range. The chief difficulty, of course, is that the proposed tax cut is loaded heavily in favor of taxpayers in the lowest brackets. Instead of a flat rate cut across the board—say 10 percent—for everybody, the reduction is graduated downward from 12 percent for taxpayers with incomes of $20,000 to $50,000 to 40 percent for those in the lowest brackets. The 40 percent consists of a 30 percent reduction and a $400 standard deduction which is equivalent to another 10 percent.

Opposition to the Treasury's proposed plan to disallow deductions up to 5 percent of adjusted gross income developed so quickly and so strongly that the Treasury has now submitted to the Ways and Means Committee a new rate schedule that would apply if the 5-percent limitation on deductions is not adopted. For example, those in the lowest income bracket would pay 14.3 percent instead of 14 percent and those in the $20,000 to $22,000 income bracket would pay 49 percent instead of 45 percent. Note the disparity between the two increases. The current rates for these two income brackets are, respectively, 20 to 56 percent. After the dividends receive credit and some of the other proposed reforms are taken into account, it is apparent that for most taxpayers in the middle and upper middle income brackets the proposed reduction will be illusory.

The Treasury's figures show that the net benefit after the so-called reforms is $7,400 million for those under $20,000, as contrasted with $1,200 million for those over $20,000.

To conclude, one of the President's two main objectives, namely, the reduction of taxes to enable the "middle and higher income families" to save money and invest in productive business, will be defeated by the diversion of an excessively large proportion of the tax reduction to the lowest bracket taxpayers. The President's other objective, the creation of consumer purchasing power among the lowest bracket taxpayers, probably would be achieved. Admittedly, however, this is not enough alone; and its effect would be much slower.

WHAT ARE THE LOOPHOLES?

In the article submitted by Professors Surrey and Heller and in most of the other articles the authors spoke of closing "tax loopholes" and often the only reference to "reform" was in the titles. Now, in the 1963 tax bill the terminology is different: "Closing the loopholes" is now referred to as "reforms." Apparently, we are supposed to treat them synonymously. If so, we may properly inquire, just what are these loopholes? The usual connotation is a defect in the existing law which gives the taxpayer an unintended tax break. Let us apply this test to the proposed "reforms."

1. *Deduction for interest paid and State and local taxes.*—These deductions have been in the income tax law since its inception in 1913 and for reasons well understood by Congress. Obviously, there are no loopholes here.

2. *Deduction for contributions.*—A few years later Congress allowed the deduction of contributions for religious, educational, and charitable purposes and over the years has substantially liberalized it. Congress was motivated by the policy of encouraging voluntary organizations to help others instead of leaving the job to the Government. There is no evidence of a change in this policy.

3. *Deduction for casualty losses and medical expenses.*—These came, we believe, in 1928 and 1942, respectively. Congress has shown no disapproval on its part.

Clearly, none of the five deductions are loopholes.

4. *Is the Treasury about to surrender on the 5 percent disallowance of deductions?*—The Treasury now seeks to disallow these five deductions as a whole in an amount equal to 5 percent of the taxpayer's adjusted gross income. Since the Congress adopted each of these deductions only after careful deliberation and has thereafter indicated its continued approval by repeated reenactments, it would seem that the Treasury will have an uphill battle trying to change its mind.

5. *Elimination of double exemption for taxpayers over age 65.*—The Treasury would disallow the additional $600 exemption and the retirement income credit for taxpayers over age 65 and substitute for it a $300 tax credit, reduced by a part of the social security benefit received. This substitution helps taxpayers in the lowest brackets but hurts taxpayers over age 65 who have more than $6,000 of taxable income.

6. *Taxation of disability wages.*—Under current law the first $5,000 of wages received each year while disabled is excluded from tax. The Treasury now proposes to tax it. This, however, is a minor item of limited applicability.

7. *Stock options eliminated.*—Congress, after much deliberation, provided for capital gains treatment of gains realized on the exercise of a qualified stock option. It did so in furtherance of the belief that it would be beneficial to our economy to provide means whereby management could obtain a stake in the business for whose successful operation it is responsible. In the "Tax Compendium" this was repeatedly categorized by the professors as a tax loophole and the Treasury now proposes to close it. The adverse effect this would have on the President's objective to move the economy ahead to new heights is readily apparent.

8. *Group insurance and split-dollar insurance plans.*—Group insurance in substantial amounts has long been a useful and important way to compensate executives. Now the Treasury would tax to them the cost of all group insurance above that repetitively magic figure of $5,000. One of the best methods devised in recent years to attract and hold able young executives is the split-dollar insurance plan, whereby they receive valuable insurance protection at a declining cost as long as they stay with the company. The Treasury would discourage these plans by taxing the executives on an amount equal to interest on the cash value, which represents the portion of the premiums paid by the company.

9. *Lump-sum distributions from pension and profit-sharing trusts.*—Few of the alleged reforms make as little sense as the attempt to tax as ordinary income lump-sum distributions from qualified pension and profit-sharing plans. To

tax as ordinary income, even with an averaging provision, an employee's accumulations in the plan over his working life would violate the principal objectives Congress had in mind when providing special tax benefits for qualified plans. The unrealized appreciation on company stock distributed to employees, as in the Sears, Roebuck profit-sharing plan, for example, would hereafter be taxed as ordinary income.

10. *Annual premium life insurance purchased with borrowed funds.*—The Treasury would like to extend the disallowance of interest on loans incurred to purchase or carry single premium life insurance and annuity contracts to loans incurred to purchase or carry annual premium contracts. Since the latter type of contract is used probably a thousand times more than the single premium contract and since policyholders have all kinds of legitimate reasons for borrowing against the policy, the burden thus placed on the policyholders would far and away offset any loss of revenue that might result from any current abuse of present law.

11. *Repeal of the dividend received credit and exclusion.*—Congress has refused repeatedly to follow the administration on this point, because its Members individually and collectively have the American repugnance to double taxation, and because they think it will help encourage the investment of funds in the capital market. By taking away this loophole, it is clear that the effect would be in the opposite direction from the President's main objective of stimulating growth in the economy.

12. *Gain on sale of real estate taxed as ordinary income to extent of depreciation previously taken.*—The gain realized from the sale of real estate has heretofore always been taxed at capital gains rates. But now the Treasury would tax such gain as ordinary income to the extent of depreciation taken. As with so many other reforms, the Treasury would try to minimize opposition to its proposal by having the change apply only as to future depreciation and by using a sliding scale cutoff. It does not require much imagination to see the depressing effect this radical change would have on the real estate market and on the construction of industrial and commercial buildings. It would also run counter to the administration's announced objective of modernizing our economic plant.

13. *The Treasury proposes to reduce oil depletion through the back door.*—We have found surprise in the press that the President did not request a reduction in depletion rates. But when we saw the details from the Treasury, we learned otherwise. Under current law the 27½ depletion allowance cannot exceed 50 percent of the net income from the particular property. The Treasury now proposes to reduce the 50-percent net income limitation by carrying forward from year to year the excess of deductions (e.g., intangible drilling costs) over gross income: *Provided, however,* That the 27½ percentage depletion would not be reduced more than 50 percent. So the effective reduction is, after all, from 27½ to 13¾. And it will doubtless apply in most cases. The irony here is that independent well drilling during the last few years has declined to a trickle; and this would finish it off. Yet to do so would be contrary to established congressional policy to encourage wildcat oil exploration by independents.

The Treasury would also tax the gain from the sale of any oil property as ordinary income to the extent of any capital chargeoffs, such as intangible drilling costs and depreciation on equipment. In this highly speculative field, where even success is limited by severe State restrictions on production, the professors' statements that such gain must be taxed as ordinary income, because the investor has the loophole of "converting ordinary income into capital gain," shows a complete unawareness of the risks involved in oil exploration and development.

14. *Capital gains tax on appreciated property at time of death or gift.*—While this provision is included in the proposed new capital gains section, it is in legal effect an excise tax levied on the transmission of property, whether at death or by gift. The capital gains tax would be in addition to the regular estate and gift tax. It would be measured by the amount of appreciation at the time of death or gift over the decedent's or donor's cost basis. The tax would be deductible in determining the gross estate or taxable gift.

This proposal has never before been formally presented and differs completely from the Treasury's attempt in the 1940's to prevent the use of fair market value as the basis for a decedent's assets in case of his death. The double tax aspect of that proposal was such an anathema then that the proposal died a natural death.

The proposed new tax would seriously affect the owners of stock in closely held corporations, the great majority of whom have a low basis for their stock

They would have to make provision for capital gains taxes as well as estate taxes at the time of their death. They would also find that the capital gains tax incurred when making gifts could very well exceed the gift tax itself.

The Treasury's tax explanation gives three examples. But they are highly misleading, because in every case they use the maximum marital deduction (which is to be applied to the capital gains tax as well as the estate tax) and because they use abnormally low income tax rates when starting the averaging provision. Let us take another example. Suppose the basis of the owner's stock were $25,000 and the fair market value $525,000; the $500,000 appreciation would be subject to capital gains tax. Assuming the owner a year before his death had an income of $50,000 and was single, the capital gains tax on the $500,000 of appreciation would be 17.4 percent (58 times 30 percent) of $87,000. When this is added to his estate tax of $120,140 on a total assumed estate of $600,000, the total cash needed to pay his combined taxes would be $207,140.

So many palliatives are offered by the Treasury in an attempt to soften the impact of its tax that the taxpayer could justly paraphrase Shakespeare, "Me thinks the government protesteth too much." Aside from an averaging provision, a $15,000 exclusion and the exclusion of a residence, the palliatives merely affect the method or time for paying the tax.

THE 1963 TAX BILL COULD BE THE GREATEST TAX TRAP IN THE LAST 50 YEARS

Suppose Dr. Heller's prognostications for 1964 and 1965 are no better than those for 1962—after all, neither he nor anyone else can be omniscient—and the $10 billion tax cut does not stimulate the economy as anticipated. The President and Congress may very well be required, in the national interest, either to stop the 1964 or 1965 reduction or to increase tax rates to provide the necessary money to run the Government. In the meanwhile, the reforms would have become irrevocably imbedded in the code. In this way, the taxpayers would have been caught in a tremendous tax trap, potentially the worst since the enactment of the income tax law 50 years ago.

We fear that this is more than a probability, because many of the proposed changes will have such a depressing effect on the economy that they will slow down the anticipated effect of the tax cut. We mention four in particular:

A. The share of the tax reduction allocated to middle and upper middle income tax brackets ($15,000 to $60,000) is so small, both in dollars and percentagewise, that one of the President's two primary objections—to enable the middle and upper middle income groups to save money from the tax cuts and invest it in productive business—would not be achieved.

B. The Treasury proposes to accelerate the current collection of income taxes from corporations that have an anticipated annual tax liability of $100,000 or more. This would be spread over 5 years. According to the Treasury's own tables, the amount collected from corporations during the next 2 years would exceed the amount of the proposed tax reductions for those years. It seems very clear that the effect on corporations as a whole would be to hinder, rather than stimulate, their growth and the growth of the economy.

C. The tax bill hurts corporate executives more than any other group (except possibly owners of closely held corporations) and thus reduces the incentive of the very group whose wholehearted cooperation is necessary to make the economy grow and move ahead.

The high income tax brackets have made ordinary methods of compensation inadequate incentive to induce the ablest men to devote all their waking hours and their highest energies to the operation and growth of large- and medium-size business organizations in which they have no ownership. Accordingly, it became necessary to devise special methods of compensation to attract and hold good corporate executives.

Now the administration proposes, in effect, to abolish all these methods of compensation—excepting only the deferred compensation plan.

D. Finally, the proposed new tax on property transmitted at death to the extent of the appreciation thereof over cost will have a very serious effect on the owners of thousands of closely held corporations.

With kindest regards, I am,

Yours very truly,

ROBERT F. SPINDELL.

LIBERTYVILLE, ILL., *March 28, 1963.*

Hon. HARRY FLOOD BYRD,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: As chairman of the Board of Trustees of Grinnell College, Grinnell, Iowa, I am submitting herewith a copy of a resolution adopted by the board of trustees pertaining to proposed changes in the Federal income tax law. I would like to request that this resolution be made a part of the record of the hearings being held by the Senate Committee on Finance.

Thank you for your careful consideration of this resolution.

Sincerely,

EDWIN SHIELDS HEWITT,
Chairman, Board of Trustees, Grinnell College.

RESOLUTION OF GRINNELL COLLEGE, GRINNELL, IOWA

At their meeting on February 3, 1963, the Board of Trustees of Grinnell College unanimously adopted the following resolution pertaining to proposed changes in the Federal income tax law.

"The trustees of Grinnell College, conscious of the increasingly difficult task of financing non-tax-supported institutions of higher education, note with deep concern the recently announced proposals of the administration for revision of the Federal income tax law.

"Among the proposals are several which reduce the tax-saving incentive of individuals to contribute to the support of independent colleges and universities.

"Independent institutions of higher education perform an invaluable public service with private funds. In addition to enrolling a large fraction of all students now attending college in this country, these institutions provide diversity of educational policy and purpose essential to the integrity, progress, and strength of all of higher education—both public and private.

"The present Federal tax law provides attractive incentives to taxpayers to support independent colleges and universities. Any weakening of these incentives poses a threat to the continued progress and development of independent colleges and to the American dualistic system of higher education.

"We, therefore, respectfully petition the officers of the administration, Members of Congress and of the Senate, to consider most seriously the implications of current tax revision proposals which adversely affect all institutions of higher education."

LAW OFFICES OF LEVINSON & LEVINSON,
Smithfield, N.C., April 21, 1963.

Hon. HARRY FLOOD BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Find enclosed photocopy of proxy statement just received from the Magnavox Co. wherein it is shown that since January 1, 1962, the president of this company exercised an option to purchase 138,915 shares of the company's stock at $4.43 per share. The stock is now selling for approximately $41 per share, which gives the president about $4 million worth of stock free of taxes. In addition, he received salary of $75,000 and pension benefits of nearly $23,000.

This watering of the company's stock and giveaway of its property without requiring the recipient to pay taxes like other people are required to pay on their earnings, is getting, in my opinion, to be a public disgrace and doubtless has a lot to do with the thinking of the average taxpayer that he is being unjustly taxed while the rich go untaxed.

The contention that the stockholders vote the stock options for the various companies is misleading. For instance, the president of the company in the instant case owns more than 585,000 shares and the vice president owns more than 25,000 shares. This, with the right of the management to solicit proxies and recommend the way they are to be voted constitutes absolute control of the annual meeting of shareholders and dominates the business conducted.

It is my judgment that the Internal Revenue Code of 1954 (Senate bill 1625) should be amended so as to tax all compensation received whether in the form of stock options or otherwise as income during the year in which received. This would be a great boost to the economy of the country as it would stop the equivalent of legalized larceny which has been going on for years and would increase the tax take tremendously. It would also discourage this giveaway of a company's assets.

The argument that the only way to keep good management is to practically give the company's assets to such management is untenable, for if all officers of a corporation were treated alike, the argument would lose its relevancy. The answer is simply to pay management whatever the stockholders think they are worth and require them to account for State and Federal income taxes to the same extent as other individuals.

Some people are wondering if some Members of the Congress, or their close relatives, are not the recipients of some of this special tax treatment and that if this is not the reason why Congress has not heretofore acted to close this loophole.

While it is not a valid argument that one tax evader is entitled to be exonerated because some other person has escaped the payment of taxes, it occurs to me that the jury is going to hesitate to convict the little man charged with fradulent tax evasion when they find out that the big fellow goes "scotfree" and escapes the payment of taxes involving millions of dollars.

With all good wishes, I remain,

Sincerely yours,

L. L. LEVINSON.

(III) RETIRED FROM ACTIVE PARTICIPATION WITH THE COMPANY AS OF DECEMBER 31, 1962. HIS PENSION IS BEING PAID ON AN ADJUSTED MONTHLY BASIS COMMENCING AS OF JANUARY 1, 1963

STOCK OPTIONS

On October 31, 1956, the shareholders of the company approved a stock option plan pursuant to which 50,000 shares of the company's capital stock were made available for option. On October 28, 1959, the aforementioned option plan was amended and an additional 50,000 shares were set aside for option until June 30, 1962. The company's stock on November 2, 1959, was split on the basis of two shares for one. On July 20, 1961, the company's stock was again split on the basis of three shares for one. As a result of such splits and declaration of stock dividends, the outstanding options were adjusted proportionately in accordance with the provisions of the option plan and amendment.

Options for all shares authorized pursuant to the 1956 plan and the 1959 amendment were issued from time to time to 147 persons, including 13 officers, some of whom are no longer with the company. Officers who as a group received options pursuant to the original option plan and the 1959 amendment thereto exercised such options and purchased an aggregate of 185,289 shares (on an adjusted basis).

As of February 1, 1963, none of the persons listed in the section entitled "Remuneration of Directors and Officers" had an unexpired option, nor are any of them entitled to purchase shares, other than George F. Smith who holds two unexpired options. One is for 1,500 shares at $48.21 per share, issued in June 1960, when the average market price per share was $52. This option was subsequently adjusted to 4,500 shares at $16.07 per share when the company's stock was split on the basis of three shares for one. The second option was for 1,500 additional shares at $41.44 per share, issued in May 1962, when the average market price was $36.75 per share.

All other officers of the company as a group at February 28, 1963, held options for the purchase of shares as follows:

Month of option	Original number of shares	Number of persons	Option price	Market price	
				High	Low (ii)
June 1960	2,050	4	$48.21	$55.00	$49.00
November 1960	188	1	39.07	43.38	38.63
January 1961	500	1	46.31	54.75	46.00
May 1961	200	1	87.40	95.75	82.25
June 1962	5,000	1	31.35	34.63	27.00

Since the beginning (January 1, 1962) of the last fiscal year to February 28, 1963, the company, pursuant to its 1956 stock option plan and the 1959 amendment which expired on June 30, 1962, granted an option to George F. Smith on May 3, 1962, as above mentioned, and granted options to all other officers as a group (none of whom is a director of the company) as follows:

Number of shares, 5,000.
Number of officers, 1.
Month of option, June 1962.
Option price, $31.35.

Market price:
High, $34.63.
Low (ii), $27.

Since the beginning (January 1, 1962) of the company's last fiscal year Mr. Freimann exercised on February 22, 1962, an option to purchase 138,915 shares at $4.43 per share, and all other officers as a group (none of whom is a director) exercised previously granted options to purchase shares of its capital stock as follows:

Month of exercise of option	Number of shares purchased (i)	Price per share (i)	Market price	
			High	Low (ii)
February 1962	2,070	$4.90	$44.88	$30.25
March 1962	872	4.94	47.38	40.38
May 1962	4,346	4.94	45.25	28.67
Do	1,500	16.07	36.25	31.13
November 1962	187	13.02	37.25	30.38
February 1963	2,070	4.90	39.38	36.75

THE UNITED PRESBYTERIAN CHURCH
IN THE UNITED STATES OF AMERICA,
Philadelphia Pa., August 5, 1963.

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR: The General Assembly of the United Presbyterian Church in the United States of America meeting in Des Moines took the following action with respect to the proposed Federal income tax revision:

"The General Board of the National Council of the Churches of Christ in the United States of America expresses its concern over the possible effects of the administration's proposal to 'place a floor' under the legally allowable itemized deductions for individual income taxpayers. The effect of the proposal if enacted, would be to deny the individual taxpayer itemized legal deductions (State and local taxes, interest paid, charitable gifts, etc.) up to the first 5 percent of his adjusted gross income. This would have the effect of making it advantageous for an estimated additional 6½ million Americans to use the standard tax deductions of adjusted gross income rather than to itemize their actual legal deductions.

"Before enacting this proposal into law, the Congress is asked to consider the following comments and questions:

"It is recognized that the Congress has the constitutional right to tax an individual's gross income and that therefore any deductions granted in the Federal income tax code are at the full discretion of the Congress. It is also recognized that the Federal Government faces a severe fiscal problem in attempting to grant a general tax reduction as a stimulus to the economy at a time when Federal expenditures are already at a level above foreseen income even at present tax rates.

"We agree with the original position of the administration that any tax reduction should be accompanied by tax reform which reform should include the elimination of any unfair provisions in the present tax code. The questions we raise about this specific proposal have to do with whether this is really tax reform and whether such a proposal if enacted would not have both direct and indirect effects injurious to our free society.

"Treasury officials have expressed the opinion that this proposal would not adversely affect charitable giving and that when it is combined with their proposed general tax reductions almost all taxpayers would receive at least a slight net reduction despite the 5-percent floor put under previously allowable itemized deductions.

"We have no means of knowing whether the former of these predictions is accurate and we do not raise our questions about this administration proposal as a special plea for charitable organizations.

"Our major concern is whether this administration proposal, if enacted, would have the long-run effect of discouraging what heretofore has been encouraged by the tax laws of the Federal Government; namely, support of the broad variety of voluntary associations of our citizens which assume personal and private responsibility for programs and organizations freely established for social ends in which they believe. One does not need to approve the purposes or performances of all this amazing variety of voluntary activities that make up the unique fabric of American society in order to believe that it is a good thing for Government to continue to encourage private initiative. Long before there was any income tax, many wise observers of the American scene remarked on the proclivity of our citizens to form associations for various civic, social, and religious purposes.

"We believe that the further encouragement of the use by American taxpayers of the standard deduction as against the detailed itemization of actual taxes and interest paid and of charitable gifts actually donated will be in the long run injurious to the morale and morals of the American taxpayer. It may well be a crucial step in that too prevalent modern tendency to remove social responsibility from individuals in the form of a greater and greater reliance upon officially planned and federally supported social programs.

"In the light of these concerns we request the Congress and the administration to consider the following questions:

"1. Is there any good reason why charitable deductions should not be separated from tax and interest deductions if it is desired to put the 5-percent floor under the latter?

"2. Is it not possible to achieve an equitable general tax reduction which the Federal Government can afford without immediately recouping $2.3 billion from a particular group of taxpayers for whom the general tax cut was supposed to be equitable in the first place?

"3. At a time when other Federal tax proposals and rulings are laying a heavy bookkeeping burden on business firms, is it defensible to encourage an increase in the use of the standard deduction by individuals, thereby discouraging them from maintaining proper records of their legal tax deductions?

"4. Is the auditing advantage of this proposal really worth modifying the long history of the U.S. Government's encouragement of free and voluntary association and enterprise?"

It is further requested that permission be granted that a copy of this action be placed in the record of the hearings on the proposed income tax revision.

Sincerely,

By SILAS G. KESSLER, *Moderator*,
EUGENE CARSON BLAKE, *Stated Clerk*.

MAUMEE, OHIO, *August 26, 1963*.

Senator FRANK LAUSCHE,
Senate Office Building,
Washington, D.C.

DEAR SENATOR: Introduced in the House by Representative James J. Delaney is H.R. 320, a bill which would provide Federal aid for all American schoolchildren in the form of an allotment of $20 per pupil, regardless of school attended.

Needless to tell you, the cost of administering such a program, worthy though it be, would be considerable. It would continue the seemingly inevitable trend of mushrooming Federal bureaucracy, so unnecessary if a little commonsense and local pride be applied.

This bill might never reach the Senate, so my letter may appear superfluous. However, I believe the Senate can propose and adopt a very sensible alternative which would accomplish the same objective at next to no cost.

Sooner or later, the Senate will receive for consideration the House tax measure now being worked upon in the latter body. The Senate could amend it to include a provision for a credit of $20 against income tax for each school pupil. This would not add noticeably to the present costs of the Internal Revenue Service, it would not add anything to the costs of the Department of Health, Education, and Welfare, and, perhaps, the Federal aid controversy would be solved.

If the rules do not permit the Senate to amend a tax bill, I'd appreciate it if you could pass this suggestion along to a friend in the House. I am writing Representative Thomas Ashley, but hope to drum up more support for this idea.

Your consideration will be appreciated.

Sincerely,

WILLIAM J. WELTER.

P.S. My proposal assumes that there is still enough local initiative to take advantage of an income tax credit by funneling the additional money available directly to local school boards.

AKRON, OHIO, *September 2, 1963.*

HON. FRANK J. LAUSCHE,
U.S. Senate, Washington, D.C.

DEAR SENATOR LAUSCHE: I have read in the newspapers that one of the modifications of the tax bill is that widows, widowers, and husbands of incapacitated wives will be allowed a maximum deduction up to $900 for child care, and that the maximum deduction remains at $600 if the taxpayer is a single woman or a working wife.

There is no justification for such discrimination against single women or a working wife. Anyone who has any knowledge of economics must know how much more difficult it is for a single woman, working wife, or wife of an incapacitated husband to make ends meet than it is for a man, since discrimination in pay in the first place is all in favor of the man. I believe that the same deductions should be allowed for all, whether widow, widower, husband of incapacitated wife, single woman, working wife, or wife of incapacitated husband. I am not for further discrimination against women in the tax law.

Further if a single person or married person is supporting a dependent helpless parent or other person for whom they have to hire sitters, etc., this same deduction should be allowed. Such helpless persons are usually more expensive to care for and certainly require as much or more care than a child. I have had this experience and I know how costly it is.

Further, I think a deduction should be allowed when a working wife hires household help to maintain her home. This is a business expense which is required by virtue of her job. It furnishes employment to another, and certainly should qualify as readily as tools, etc., that a craftsman is allowed to list as deductions.

Will you please advance these suggestions to the proper persons. I will appreciate a reply from you.

Yours sincerely,

MRS. FRANCES R. SMITH.

ALL FUNDS, INC.,
New York, N.Y., September 9, 1963.

SENATE FINANCE COMMITTEE,
Senate Office Building,
Washington, D.C.

GENTLEMEN: I would appreciate your consideration in regards to the following tax legislation. We would like to register our concern with you.

The dividend received, credit and exclusion, currently provide a small measure of relief from the double taxation of corporate earnings that are paid out to investors in the form of dividends; i.e., corporations pay a 52-percent tax on earnings above $25,000 and dividends paid from their afterearnings are taxed again when received by investors, whether directly or through their ownership of mutual funds. As part of the present tax program, it currently is proposed to increase the $50 exclusion but eliminate the 4-percent credit, thereby increasing the aggregate tax on total dividend payments to investors. We believe that if any change is made it should be a reduction in the tax on dividend income to provide further relief from the discriminatory double taxation of corporate earnings. We are against an increase in the tax on dividend income and for reduction in discriminatory double taxation of corporate earnings through lower taxes on dividend income.

We appreciate the opportunity of making our views known to you, our representatives. We hope these views will gain your support.

Sincerely yours,

GEORGE R. NELSON, *Branch Manager.*

AMERICAN METAL-LUX, INC.,
Hartford, Conn., September 17, 1963.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The enclosed statement is also printed in volume 5 of the records of the hearings held by the House Ways and Means Committee on the administration's tax bill.

It opposes the bill for being ineffectual as a stimulant to our economy, with or without a reduction in Government expenditures. The opposition is based on strictly technical reasons.

I trust you will find in this statement convincing arguments in support of your wise position against this ill-advised bill.

Should you deem it useful and desirable I will gladly testify at the Senate hearings when the time comes.

Respectfully yours,

PHILIP SAVY, *President.*

Mr. LEO H. IRWIN,
Chief Counsel to the Committee on Ways and Means,
House of Representatives, Washington D.C.:

Written statement submitted for the consideration of the committee and for inclusion in the printed record of the hearings, in lieu of presenting testimony in a personal appearance on the subject of the President's tax recommendations.

This statement represents the personal opinion of this writer in his capacity as financial analyst, economist, and small businessman. It purports to challenge the validity of the administration's claim that a tax cut, per se, is an effective measure against unemployment and a sluggish economy.

Respectfully,

PHILIP SAVY.

It is the considered opinion of this writer that the proposed "revision of the tax structure" as outlined in the Document No. 43 of the 88th Congress, fails dismally in its avowed purpose of stimulating the economy and promoting full employment and growth.

The equitable taxation: The proposal is off to a wrong start, right in the preamble to the message: "* * * the revision of our Federal tax system on an equitable basis is crucial * * *" the implication being that the goal of full employment, growth, etc., is to be pursued through a tax revision, sociologically desirable first and economically effective next. That word "equitable" betrays the philosophy which inspires the proposal and is responsible for the faulty approach to the problem.

What constitutes an equitable taxation? There is no standard of equity for taxation. It is strictly a matter of personal opinion. What is held as equitable by one, may appear inequitable to another and iniquitous to a third party.

It is significant that the present administration is calling oppressive and unrealistic the tax rates which appeared quite equitable and realistic to the administration which imposed them. The administration message, therefore, presents a prescription for attaining full employment and growth, by which whatever is necessary for the solution of the problem must conform and be subordinated to the particular sociological bias and dogma of its architect or group of architects. It must reflect their own interpretation of what is equitable and what is not.

Putting dogmatic limitations to the pursuit of the full employment goal is as absurd as the behavior of a member of a sect who tells the doctor, "Find a cure for my illness but exclude surgery, for that is against my religious tenets."

In the age of science, this elastic approach to technical problems spells one thing only: failure.

Fallacy No. 1. Once social dogma is given priority, as conditio sine qua non, in planning economic measures, the inevitable consequence is a resorting to economic empiricism wrapped in pseudoacademic gobbledegook. Hence on page 3 we spot fallacy No. 1: "* * * total output of economic growth will be stepped up by an amount several times as great as the tax cut itself."

This fallacy, also known as the multiplier effect, has no foundation whatever, scientific or otherwise.

It purports to assert that in an economy of about $550 billion, some $10 billion or so, if constituted of tax rebates, would acquire the "magic" of multiplying several times; a "magic" denied to the other $540.

This miraculous revelation fails to specify, however, such trifles as when the multiplication starts, when it ends, why it starts, why it ends, and why shouldn't we rebate $50 billion and multiply ourselves into an orgy of high living.

All this evokes enchanting memories of the world of witches, gnomes, fairies and magic wands of our early childhood, but also a rather frustrating image of the sorry level of adulthood of the economic art as conceived in some official circles.

Thus, until such time that some scientific evidence is presented to vouch for the alleged existence of a multiplier effect, we have no alternative but to consider it a wild-eyed statement of opinion ranking with astrology in scientific foundation. Meanwhile all the glowing predictions predicated upon it in page 3 of the message can be readily dismissed as mere wishful thinking. No prosperity will ensue, attributable to a tax cut; namely, nothing exceeding the recurrent mild fluctuations of the business cycle.

Benefits to the taxpayers: Contrary to the views expressed in the document, benefits can only be illusory and temporary—Illusory, because there is no real benefit in paying less tax if the problem of a laggard economy is not solved first. A lower rate of taxes is a meager compensation for poor business, lower earnings and chronic unemployment. Temporary, because failure of the tax cut to benefit the economy, will soon force the Government to raise taxes again. However, the same specious "equity" which accounts today for a bigger proposed cut on the lower income group will account tomorrow for a greater burden to be placed upon the higher incomes.

Thus, in the end, the middle and higher incomes will bear a much more oppressive tax load than what the administration itself is deprecating today, and the present lopsided tax structure will end up as more lopsided than ever.

Fallacy No. 2. A paragraph on page 6 of the message reads: "It would be a great mistake to require that a tax reduction today be offset by a cut in expenditure * * *."

Clearly, the authors of this sentence seem to be convinced that if a tax rebate of $10 billion without any offsets is granted, these $10 billion will constitute an additional purchasing power injected into the stream of the national economy.

We regret to have to shatter one more misconception:

With or without a cut in expenditures, there is no addition, but only a shifting of purchasing power, between the so-called private sector and the public sector, as shown next.

For the sake of reasoning only, we shall set the GNP at $500 billions, out of which the Government is now subtracting $100 in taxes.

	Billions
Private spending and capital formation	$400
Government spending	100
GNP	500

If the Government rebates taxes and also trims its expenditures by $10 billions, we have:

Private spending and capital formation	$410
Government spending	90
GNP	500

If the Government rebate taxes but does not reduce its own spending the result will be the same:

Private spending and capital formation	$410—[1] 10
Government spending	90+[1] 10
GNP	500

[1] That 10 is in loans instead of taxes. This because the Government will have to borrow from the people as much as it rebates in taxes, unless, God forbid, it resorts to the printing press.

In all 3 cases the total spending will remain 500 and, whatever the juggling, not a single job nor a single hour of work will be added to the ailing economy.

The third alternative, viz, tax rebates without expense cutting will produce, however, harmful side effects. Let's follow the developments step by step and we will see why:

The Government cut rebates $10 billion, mostly in favor of the low-income group. Of that sum, presumably $9 billion will go into spending for consumer goods and only $1 billion into capital formation (savings). The Government, short $10 billion, will have to dip its hand into the national capital pool (the people's savings) and get $10 billion as loans.

The result of all this is that a net of $9 billion is thus being actually converted from capital into consumer spending.

This is over and above the further pumping, out of the same pool, for covering current budget deficits.

What this huge subtraction is going to do to a capital market already strained to the breaking point, and to the dollar, is something we don't feel we should discuss at this time.

CONCLUSION

Based on the analysis we have just made of the tax proposal, it appears that the administration plan of tax cuts and reforms aiming at stimulating the national economy out of its sluggishness, is poorly conceived, undocumented, falling wide of its mark, and therefore doomed to failure.

The preamble to the message contains a number of generalizations and vague denunciations of faults about the state of the national economy, but it fails to establish a documentable direct relationship between them and the measures proposed to restore health to the economy.

It is as if a doctor, after a simple glance at a patient gravely declared that "the patient is sick and therefore needs an appendectomy."

Nobody will deny that the present tax system is a hodgepodge of charges, deductions, and exceptions, badly in need of streamlining, but, from that to the assumption that any arbitrary reshuffling of it will spur the American economy out of the doldrums, it is taking too much for granted.

Why is our economy off balance? Is it because of automation? Or inadequate purchasing power? And whose purchasing power? Capital's? Labor's? Is taxation responsible? If so, what taxation? Is the lopsided income tax at fault? Or is the whole philosophy of taxation at fault with its dogmatic redistribution of wealth, and its overreliance on income taxation? And what about wages? Has their level anything to do with the rate of unemployment?

No answer to those questions and many more has been sought or even considered. No comprehensive diagnosis of what ails the economy has been made. On the basis of arbitrary assumptions alone, the verdict has been arrived at that a tax cut is the remedy for a disease not yet identified. To boot, the remedy is the poisonous mixture of two economic fallacies.

We are instead of the opinion that a rational analysis of the economy, carried on a scientific level and doing away with empiricism, would lead to entirely different but reliable conclusions as to what makes our economy falter periodically and what causes unemployment. Furthermore, we claim that, astonishing as it may sound, it is possible today to create such conditions as to attain full employment with a 40-hour or even a 48-hour week if we so wished. All this, of course, still making full use of the most advanced automation techniques. A 25-percent increase in the national standard of living could be within our reach today.

Unfortunately, we all seem to have forgotten that technology did not spring up from nowhere. We created it, and we should reasonably be able to ply it to our benefit and not to our frustration. However, we achieved it through the scientific method and we cannot expect to control it through empiricism and dogma.

Inasmuch as the administration's fiscal proposals fail to demonstrate their economic effectiveness, we respectfully suggest that they be rejected and that the public be spared a cruel and bitter disappointment.

CUMBERLAND CENTER, MAINE, *September 14, 1963.*

HON. MARGARET CHASE SMITH,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR SMITH: In regard to the proposed new tax reform bill which you will soon be asked to approve, I would like to bring one point to your attention.

The present law states that parents of mental patients who are in State institutions similar to the Pinelant Hospital and Training Center in Pownal, Maine (with which you are no doubt familiar), are allowed to deduct only in excess of 3 percent of their gross income.

I believe that a full hospital deduction should be allowed as when you consider the "expense account" allowed for entertainment for business house salesmen, plus the $100 per week for so-called sickness for life, and about which I know for a fact is a very much abused "exemption."

Hoping that you can see the unfairness of the present tax law in regard to mental patients who are in our State hospitals for life.

Thanking you for your kind indulgence and praying for a favorable report, I am,

Respectfully yours,

HARRY I. STEELE.

DALLAS, TEX., *September 17, 1963.*

Re Capital gains tax treatment of timber cuttings.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR MR. BYRD: The tax reduction bill, according to the newspapers, shortly may come before the Senate Finance Committee for hearings. I would like to ask you to consider giving the same capital gains treatment to timber cuttings as the House Ways and Means Committee has recommended for sales of other assets, stocks and bonds for example. The House committee would give a lower tax rate to sales of stocks and bonds.

First, let me say that I don't understand the justification now for a general tax reduction, and am opposed to this measure. Only if there were significant reductions in Federal spending should there be a general tax reduction, it seems to me, and then we would be wiser to start paying off our national debt rather than reducing taxes across the board.

But if we do have a tax reduction measure, as is likely this year or next, I would urge you to look deeply into the matter of conservation and regeneration of one of our country's greatest resources, timber, as affected by giving stocks and bonds generally better capital gains treatment. If the House committee action stands, there would be not only deep discouragement to individual tree farmers but also a precedent for future legislation imposing even greater relative tax loads on timber cuttings. Although I believe the need for conservation of timber alone justifies its preferential treatment in any tax, all I ask in the interest of conservation is that the capital gains treatment on timber cuttings be kept on the same level as on stocks and bonds; that there be maintained the current policy of equality of capital gains treatment between the two kinds of property.

Senator, although my overriding interest is in conservation, I admit proudly to a selfish interest. Over the past decade I have accumulated a small holding, 440 acres, of forest land, much of it heavily mortgaged, in and near Sevier County, in southwestern Arkansas. My wife, a Louisiana lady familiar with forests, and I have planned and worked arduously toward the rehabilitation of our lands. With persistence we have overcome some, but not all human and natural obstacles. Over the years we have set out about 90,000 pine seedlings and have engaged in much timber-stand improvement. We have alternately been frozen, drenched, and burned up. Some of our lands, happily, have been certified as tree farms; on other portions there is still more to do before we can be satisfied with the conditions of growth. To date, we have not netted a cent on our operations, because they have been essentially developmental. But in the future, if fire does not destroy our trees, if they are not broken by high winds or ice, if they are not killed by insects or fungi, we will be able to make a return on those trees—provided the market at that time is good; and simultaneously we will have the satisfaction of knowing that a few acres in this country are, and will continue to be better for what we have done. Too, the community will be more prosperous and the watershed conditions will have been improved.

In this future period when hopefully we may be able to start getting a return from our woods, we had planned (since we firmly believe in stewardship of the land) only to make selective or partial cuttings, in accordance with all the principles of conservation espoused by the Department of Agriculture to assure perpetual forest growth with its accompanying soil stability. But if we do that, if we follow the sound preaching of the Department of Agriculture, the Internal Revenue Service, according to the House committee action, will tax us on the proceeds at the highest capital gains tax rate, higher than if our assets had been stocks or bonds.

Conversely, if we flout all the tenets of conservation in which we genuinely believe and for which appropriations for many years have been given to the Depratment of Agriculture to foster—if we cut all our timber at once (they are not even-age stands), then, for that breach of conservation, we will be rewarded by the Internal Revenue Service with the same capital gains treatment as if we had disposed of stocks or bonds. Or we could secure the same favor by voluntarily withdrawing from tree farming, which we do not desire, by completely liquidating our holdings.

It would seem to me, though I confess ignorance of all its ramifications, that the Congress in its tax policy should not so frustrate the congressional conservation policy.

Although my pride in seeking to accomplish an ideal of timber conservation will not be lessened by any tax action the Congress may take, yet I must admit it would be a blow to my judgment for the Congress now to say, in effect, that I would have been smarter to play the paper game of stocks and bonds, as an insignificant holder, than to have attempted to have created and improved the natural physical assets of our country. The place of stocks and bonds is important, of course, but not more so than the betterment of our natural resources. If the House committee action is followed, will not many individual tree farmers, feeling their place in the sun lowered, think it small privilege to invest further against risky nature?

A last word, Senator, this one about the big timber companies I have observed. Though I don't like to see them acquire more land, as this land almost always is forever taken off the market, I do understand the need of these companies to be assured of a permanent reservoir of supply for their mills, for which they must have large holdings; and it seems clear they tend to do a better job of timber management than those like myself with very small acreage. While I do not know the position of these companies in reference to the House committee action on capital gains treatment of timber, and while I know they use much of their timber cuttings in their own operations, I feel very strongly that their timber cuttings should receive the same capital gains treatment as on disposal of stocks or bonds. Without the efforts of these big timber companies over the last 30 years, it's probable there would have been no southern forests today. With these forests ever being improved, the industry will expand and expand. Surely, granting the big timber companies on their timber cuttings equality of capital gains treatment with stocks or bonds will prevent diversion of their capital, assure their continued reforestation and improvement of their lands, with all the consequent physical benefits to our country, and will tend, I would think, to the maintenance of fair payments by the companies to their small timber-owning suppliers. (As an afterthought, let me say I have no connection with any timber company, other than owning tw oshares of common stock of the International Paper Co.; that my concern is for conservation, by whomever practiced; and that my urgings for the benefit of the timber companies are based upon the simple notion of making the practice of conservation, because of its national importance, no less attractive, taxwise, than the holding of any other asset.)

Because Senator Ellender as chairman of the Committee on Agriculture and Forestry may be interested, I am sending a copy of this letter for his information.

With appreciation for your kind consideration, I am

Respectfully yours,

LEON KARELITZ.

ROANOKE CHAMBER OF COMMERCE,
Roanoke, Va., September 20, 1963.

Hon. HARRY F. BYRD,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: I am sure you are aware that tax legislation, as well as economies in Federal spending, have always been of great interest to the Roanoke Chamber of Commerce.

Consequently, the enclosed resolution was passed unanimously by our board at a special meeting held on September 19, 1963.

Your support of this legislation will be greatly appreciated.

Sincerely,

JACK C. SMITH, *Executive Vice President.*

RESOLUTION

Whereas this organization, on July 16, 1962, gave deliberation to the need of broad across-the-board tax reductions on the Federal level and in resolution voiced its stand for an immediate tax cut with a longer term tax reform program to be undertaken to remove all tax barriers to economic growth, and it was resolved further that this board reiterated its deep concern for growing deficits in the Federal budget and called for economies in Federal Government expenditures to bring them in line with anticipated revenues; and

Whereas the present tax cut bill H.R. 8363 now proposed is the only vehicle being considered by the Congress which will provide business with immediate tax reduction and further will stimulate the economy, after a brief transitional period, to the extent that increased revenues will result and tend to eliminate Federal budget deficits; and

Whereas section I of the bill declares: "It is the sense of Congress that the tax reduction provided by this act through stimulation of the economy will, after a brief transitional period, raise, rather than lower, revenues and that such revenue increases should first be used to eliminate the deficit in the administrative budgets and then to reduce the public debt. To further the objective of obtaining balanced budgets in the near future, Congress by this action recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective."; and

Whereas the President, in a letter to the Honorable Wilbur D. Mills, chairman, House Ways & Means Committee, on August 19, 1963, stated that "Tax reduction must also, therefore, be accompanied by the exercise of an even tighter reign on Federal expenditures, limiting outlays to only those expenditures which meet strict criteria of national need." And as further stated by the President, "Consistent with these policies, as the tax cut becomes fully effective and the economy climbs toward full employment, a substantial part of the increased tax revenues will be applied toward a reduction in the transitional deficits which accompany the initial cut in tax rates": Now, therefore, be it

Resolved, That the board of directors of the Chamber of Commerce of Roanoke, Va., Inc., urges the Senators and Representatives of the people of Virginia to support H.R. 8363 as a positive step which can be taken this year to gain for American business the needed tax relief long overdue.

JACK C. SMITH, *Executive Vice President.*

SEPTEMBER 19, 1963.

THE CHILDREN'S SERVICE SOCIETY OF UTAH,
Salt Lake City, Utah, September 19, 1963.

Senator HARRY F. BYRD,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR BYRD: It now appears that I should lay aside the ever pressing responsibilities of trying to keep an old voluntary child placing agency alive to send you one more letter concerning the effect which I feel the so-called, tax reforms of the President's tax bill have upon voluntary social work and upon me personally. It has been many a year since I have written you but these have been extremely busy years for both of us and it has always been a comfort to know that you "stay hitched." I think I voice the sentiments of many overworked people like myself when I say that each time that you have continued to accept the responsibilities of public office as the years have gone by, I have been personally grateful for your devotion to the country and not unaware of the great personal sacrifices involved.

Professionally I feel that the tax reform proposals will have an extremely adverse effect upon all gifts to united fundraising organizations and to the special contributions to agencies like our own. Like Mr. John S. Knight, I too, have been disappointed that there has not been more outcry by individual agencies and fundraising organizations. I understand however that in the past few months a few eastern community chests have made appropirate protests. Recently as an exceedingly small donor to the Church Divinity School of the Pacific at Berkeley (Episcopalian), I have been solicited to write our congressional leaders. I wrote in reply to the dean that, with one exception of the men from Utah, I could count on not only our entire membership to be opposed to these tax reforms, which affect church giving, but that I was also quite sure the Latter-Day Saints Church had already made its position clear to these individuals. I have had extremely cordial letters from Senator Bennett and Representative Burton but did not write Representative Lloyd since I have known him as a member of our State legislature for a number of years and know his convictions and beliefs.

I was extremely annoyed with some of the administration's spokesmen, who appeared before the House committee protesting that contributions to the great educational institutions has greatly increased in the recent past. This is quite true but I think it also should have been fairly presented at what enoromous costs and promotion these increased endowments have been made. So far as child placing agencies like this one are concerned, we simply do not have the capital with which to finance these enormous endowment drives, which all of the great private educational institutions have been making. There is hardly a month in which I am not solicited by the three educational institutions with whom I was enrolled and as an experienced administrator in a very small way, I am daily impressed by the enormous costs of these long-range campaigns. For some years I have felt that we small agencies were riding on the coattails of such institutions as Harvard and the great sectarian universities when it came to legislation of this nature.

When I was a young social worker, prestige and salaries were in the private agencies with corresponding requirements of intelligence, capacity, and professional training. Today private social agencies are on the bottom of the heap, completely unable to compete with the Veterans' Administration, the national district and State welfare departments, health departments, educational departments, etc. I am the only certificated social worker on our staff and for many years have kept tenure and caliber of service only by reason of the fact that I am employing older, married women, whose children are old enough for them to be employed part time and who are not certificated social workers. All of them are eligible for public welfare positions but it is only now that part-time positions are being offered by our local welfare department. My own salary is shockingly below what it would be if I were in public welfare. Fringe benefits simply do not compare and the pension plan, which is nationwide, will pay me less than one-third of what our State employees anticipate. With no family obligations for the past 25 years, I could afford to make this choice for which I shall pay the rest of my life. At the same time, the private savings which I have been able to accumulate are correspondingly small. My present taxation is really cruel and the proposed tax cut not only seems inconsequential but, at the same time, I strongly suspect without having a mathematical mind that this tax cut may be more than offset by the reduction in additional income which certain tax reforms will bring to me.

Of even more concern to me than my own past approach to retirement years, is the fact that I am unable to find recruits willing and able to carry on the responsibilities. This is not to say that because I run a professional agency I do not get applications. Every year there are three of four qualified applicants who would like to work here but all of them make more than I do. One of them who probably could succeed me said this summer that she would come for no reduction in salary, no increase in responsibility, even though she is reported to be a very fine, conscientious worker, and that under no circumstances would she ever attempt to do as much as she knew I was doing. Of course it is absurd and I make no pretensions to the fact that I am doing a good job in all of the responsibilities which I am carrying but at the moment we are surviving at least.

I shall also personally be hit by the President's recommendation concerning taxation on money set aside for annuities instead of current income. Since 1955 I have been putting a sizable portion of my income into an annuity and of course not reporting this income to the private retirement program to which our agency belongs and which is nationwide. To begin taxation of this part of my income will do nothing to improve the annuity payments which I must anticipate from the National Health and Welfare Retirement Association.

It has now been 40 years since I started my social work career in the oilfields of south Arkansas. I have watched many old private children's agencies die, be absorbed, and eventually lost in certain types of mergers and I wonder just how long we can take the buffeting. On the other hand I have been greatly encouraged by the strength and money which the Jews, the Catholics, and the Lutherans have been pouring into the extention and strengthening of their own agencies.

With every good wish for your continued good health and again my gratitude for your long years of magnificent service to your country and to your State, I am,

Very sincerely,

MRS. VIRGINIA LEE BENNETT, ACSW,
Executive Secretary.

LOS ANGELES, CALIF., *September 20, 1963.*

Re interest deduction on life insurance loans.

Hon. HARRY BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SIR: I understood that one of the laudable goals of this Congress was to simplify the Internal Revenue Code. The Committee on Ways and Means provision which purports to disallow only partially the interest deduction on life insurance loans, under a vague set of circumstances with four different exceptions, certainly doesn't meet this criteria.

There will be little or no additional revenue if the letter and spirit of the proposed change is honored by the Internal Revenue Service. There are quite a number of ways to avoid both the spirit and the letter of the proposed change. The main reason that I am concerned about the adoption of the proposal is that it will cause a great deal of inconvenience for everyone concerned without producing any appreciable revenue.

However, this plan could result in a "complete" denial of the interest deduction. The Treasury Department requested such a complete disallowal and I believe that they have accomplished it through this back-door approach to life insurance. Any man who has a mortgage on his home or pays any other interest can easily be accused of buying life insurance pursuant to a plan of purchase which contemplates systematic borrowing and having the premiums paid with borrowed funds. The IRS can, and probably will, contend that the interest on a taxpayer's home mortgage, at least in part, is not deductible because the borrowed money was used to buy life insurance—even though the taxpayer has no direct life insurance loan. The theory will be that if he hadn't bought life insurance he could have reduced his mortgage.

Now, we are faced with the blackmail of an IRS agent in interpreting what is a planned purchase of life insurance which contemplates systematic borrowing of part or all of the increases in the cash values of these contracts. Such a provision is not capable of honest enforcement. With the present approach and attitude of the IRS, it can reasonably be assumed that practically everyone who buys future life insurance can anticipate an agent finding a "plan" as above, and then be faced with paying the unjustified assessment because it is too costly to fight it.

I submit that the proposed change involving life insurance loans is impossible of honest enforcement, it can be easily circumvented so that it will not produce additional revenue except by IRS blackmail, it will unduly complicate the Internal Revenue Code, and any proposed purchase of life insurance will have so many possible and uncertain tax ramifications that life insurance business—and all of the many people indirectly involved—will suffer.

Perhaps this change can be reconsidered.

Very truly yours,

DONALD S. MACKINNON.

P.S.—These constant changes in the Internal Revenue Code disrupt the business economy tremendously and, in general, result in a lot less income for the Government. If a businessman could pursue his business activities without constant uncertainty on the part of himself and his prospects over tax law changes, there would be a lot more taxable income produced.

D. S. M.

COMMERCE ACCEPTANCE CO.,
Atchison, Kans., September 24, 1963.

Re H.R. 8363, revenue bill of 1963.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Since the start of the Second World War, possibly as a result of hasty but necessary military spending, Congress has gradually lost control of Federal spending. Consequently, our public debt has mounted until I am told it substantially exceeds the combined comparable debt of all of the countries in the world, including the more than 100 presently receiving Federal aid. This critical undermining of our economy has continued through every succeeding administration, regardless of party.

As these political hierarchies have developed in military; foreign aid; farm support program; health, education, and welfare; National Space Administration. etc., their expenditures have become astronomical to the point that the waste has attained the status of criminal negligence. Yet, any attempt to reduce these expenditures has met with the universal criticism that we are assuring Russian supremacy, endangering our future freedom, the farm economy, and other equally false and completely unfounded criticism.

The quality of our economic thinking has reached the stage that it is now proposed that we reduce taxes, which are effectively stifling free enterprise. If it is your intention to sign America's death warrant, you can find no better method than this proposal. We have reached the end of the road debtwise, make no mistake about this; but the answer is not in reducing taxes, but in reducing public expenditures, which then in turn will reduce taxes. In addition, the public is just beginning to recognize the extent of our Federal economic debacle, and any reduction in taxes will tend to mitigate this recognition. I cannot emphasize too strongly that any vague or promised reduction will not solve our problem. We have had this promise from every administration since the war. Yet, our promiscuous spending has continued to the point that promises are no longer adequate. Along with millions of Americans, I still have confidence in our ability as free Americans to meet our problems, if we can only achieve some sanity in our governmental expenditures. Therefore, I trust that you will decide to vote against any reduction in taxes at this time.

I am not given to such dramatic or critical letters, but, along with the rest of my fellow Americans, have reached the limit of my endurance; and I am willing to devote what abilities and facilities I have to return Members of Congress who will not continue to permit our Federal Government to follow its present program of economic destruction. I sincerely wish that there were a more courteous, yet at the same time effective, way to convey my personal sentiments.

Respectfully,

G. E. WAINSCOTT.

ASSOCIATION OF CUSTOMERS' BROKERS OF WASHINGTON, D.C.
Washington, D.C., September 27, 1963.

Senator HARRY FLOOD BYRD of Virginia,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We would like to call your attention to a provision of the Internal Revenue Code which is grossly unfair to the small investor. Section

1211(b) requires the individual taxpayer to limit his loss from the sale of capital assets to $1,000 in any one year, yet when the situation is reversed taxes must be paid on all profits in the year the profits are realized.

For example, if an individual taxpayer had made a profit of $10,000 from the sale of capital assets in 1962, he would have been required to pay Federal income tax on the $10,000 from the sale of capital assets, he is permitted to take a loss of only $1,000. In addition, the taxpayer cannot make use of his dividends in offsetting these losses. In the absence of gains, it will take the taxpayer 10 years to recover these losses.

We believe the same rules which apply to banks and insurance companies should apply to the small investor in order that he may deduct all of his losses in the year in which the losses are sustained.

The individual taxpayer must postpone losses above $1,000 to future years, and may or may not be able to take advantage of such losses in future years. This double standard results either in the taxpayer being deprived of the use of his capital or the loss of his capital.

The amendment which was adopted by the House of Representatives merely extends the 5-year limit to an unlimited time. The $1,000 limit should be increased or removed.

It will be appreciated if you will look into this inequity. We would also welcome your views on this matter.

Respectfully yours,

RALPH NEWMAN, *President.*

JOSEPH P. KESLER CO.,
Long Beach, Calif., September 16, 1963.

Re tax credit on dividend income.

Hon. THOMAS H. KUCHEL,
Senate Office Building, Washington, D.C.

MY DEAR SENATOR: It is wrong to double tax corporation profits. As you know, dividends were exempt from normal income tax until 1936. In 1954 Congress recognized the injustice of this double taxation and partly corrected it by providing the small measure of dividend exclusion and tax credit now available. If any change is to be made in the law, it should be to increase the tax credit respecting dividends or to eliminate this feature of the law altogether.

It is about time that the Congress of the United States begin to recognize the capitalistic free-enterprise system under which this country operates and to stop passing legislation which shackles the hands of capitalism. The survival of freedom in the world depends upon a strong, healthy economy in this country. Passage of socialistic schemes will certainly not help in America's fight against communism.

P.S. I would greatly appreciate this letter being entered in the record of hearings with respect to this subject.

Yours very truly,

JOSEPH P. KESLER.

U.S. JUNIOR CHAMBER OF COMMERCE,
Tulsa, Okla., September 26, 1963.

Hon. HARRY FLOOD BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: In the coming weeks, you and other Members of Congress will be given serious consideration to tax legislation.

The junior chamber of commerce feels strongly that tax rate reform is vital to the economic growth of our country. The tax rate schedule contained in the bill passed by the House Ways and Means Committee, however, does not reflect this need in its entirety.

The steep graduation of rates through the middle-income brackets was not eliminated by the committee. These rates must be reduced, as they are a major source of investment capital for economic expansion. This has been the guiding principle of the tax-rate reform program conducted by the U.S. Junior Chamber of Commerce over the past 5 years.

I urge you to do all that is possible to achieve meaningful tax rate reform in these middle income-tax brackets.

As you consider the saving of taxpayers' money, we would appreciate your recognition of the vast manpower of civic organizations such as ours. Why not utilize this reserve of manpower in meeting community needs rather than resorting to a national service corporation?

Volunteer groups are already doing a tremendous job in their own communities. If the feeling prevails that more effort is required to solve local problems, Congress should call upon local people to do the work. I am confident citizens living in their own community know their problems best. At the same time, American taxpayers would not have another financial burden.

In a recent referendum, presidents of our 4,800 chapters across the Nation voted by a margin of 2 to 1 against the concepts of the Domestic Peace Corps.

Your attention to these important matters will be greatly appreciated.

Respectfully,

RICHARD H. HEADLEE, *President.*

NEWARK, N.J., *September 27, 1963.*

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I understand that your committee will soon be studying and holding hearings on the proposed tax reduction bill which is advocated by the Kennedy administration and has already been passed by the House of Representatives. It is my opinion that, without a simultaneous and equal reduction in Federal expenditures, a tax cut of the size advocated could well be responsible for accelerating an inflationary trend which there are some indications has recently developed. The 1963 dollar has depreciated approximately 55 percent in purchasing power as compared to 1940, and during the intervening years there has been a steady procession of serious deficits in the Federal budget. I cannot help but believe that there is a definite relationship between deficit spending and a deterioration in the purchasing power of our currency.

Any savings in taxes granted at the present time could be highly illusory if the reckless fiscal policies of the Government are permitted to continue. I for one would rather continue to pay taxes at the existing exhorbitant rate than to anticipate that during my retirement a few years hence I will be forced to get along on a 30- or even 20-cent dollar received from social security and a company pension earned over a period of many years.

There must be many other citizens who feel exactly as I do. If I thought it would do any good, I would write to each of the U.S. Senators from New Jersey but their past voting record leads me to believe that such action on my part would be futile.

Very truly yours,

O. ROY CARLSON.

P. R. MALLORY & CO., INC.,
Indianapolis, Ind., September 18, 1963.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

SIR: Our company has been following with great interest the revenue bill of 1963 (H.R. 8363) which was ordered reported to the House of Representatives on September 10, 1963, and the interest equalization tax bill of 1963 (H.R. 8000) based on the balance-of-payments message of the President dated July 18, 1963.

I would like to express the objection of our company to the proposal in the 1963 tax bill to reduce and eventually repeal the dividend received credit presently provided under the Revenue Act of 1954, as amended. The House Ways and Means Committee has recommended that the dividend received credit be reduced to 2 percent, effective January 1, 1964, and be completely repealed on January 1, 1965. We believe such action would provide an injustice to taxpaying shareholders on their dividend income, which injustice was recognized in the Revenue Act of 1954, and in part alleviated by the provision for dividend received credit. As I am sure you know, profits of corporations are, in effect, taxed twice—once at the corporation level and again by taxing dividends received by share owners. Many foreign countries, such as Great Britain and France, do not tax dividends received by share owners and accordingly avoid such double taxation. The Revenue Act of 1954, while not providing total relief, did permit some alleviation of this unfair and inequitable taxation. We recognize that arguments have been advanced that share owners should not be set apart as a separate category of taxpayers. We can only point out that separate categories of taxpayers are recognized in many phases of our taxing structure, such as the special privilege afforded in respect of depletion accorded to owners of minerals; the economic reason for the introduction of depletion, namely, the national necessity for exploration for oil has passed and, in fact there are controls of production in most oil-producing States because of surpluses.

It is our firm conviction that the business community and the best interests of our country would be adversely affected if the dividend proposal were to be adopted.

We also wish to express our views concerning H.R. 8000 which places a temporary excise tax on the acquisition of stock and securities issued by foreign corporations, governments, or other persons. We are confident that responsible American business enterprise supports the aims of the present administration to reduce the outflow of gold and to improve the country's balance of payments. However, we submit that it is improper to use taxation so to effect the economy; taxation should principally be used to raise revenue to operate the Government. The proposed excise tax, in any event, would only reach the effects of these problems, not the cause. Additionally, the proposed bill provides a built-in discrimination against new investors since sales of existing holdings by U.S. residents to other U.S. citizens are exempt. We would suggest that this legislation is contrary to the spirit of cooperation with EEC, LAFTA, and the purposes of the Trade Expansion Act. It would also weaken the competitive position of U.S. corporations in relation to the position of corporations of other industrial nations by effectively restricting the impetus of expansion of American enterprises into foreign countries. We submit that this legislation is ill conceived and its adoption would not be in the country's best interest.

We solicit your cooperation and assistance in defeating the above proposals or any similar statutes which would accomplish their purposes. Our company has one or more plants or offices located in your State.

Sincerely,

G. B. MALLORY.

PULLMAN, INC.,
Chicago, Ill., October 4, 1963.

Hon. HARRY FLOOD BYRD,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: I appreciate that many items in the revenue bill of 1963 are controversial and I am content to rely upon the good judgment of your committee under your excellent chairmanship to arrive at the proper course of action.

There is one item of the bill, however, that I believe merits unanimous support. Section 222 repealing the 2-percent penalty tax on consolidated returns is a much-needed and long-awaited reform. We heartily endorse this repeal.

Mr. Larmee has prepared the attached statement elaborating our views. I would appreciate if you could arrange to have this statement filed for the record in connection with the forthcoming hearings before the Finance Committee of the Senate.

Very truly yours,

CHAMP CARRY.

STATEMENT OF PULLMAN, INC., BY D. H. LARMEE, ASSISTANT VICE PRESIDENT, TAXES, IN SUPPORT OF SECTION 222 OF H.R. 8363 REPEALING THE 2-PERCENT PENALTY TAX ON CONSOLIDATED RETURNS

Section 222 of the revenue bill of 1963 would repeal the present 2-percent penalty tax levied on the consolidated net income of affiliated corporations filing consolidated returns. We heartily endorse the repeal of this inequitable and unwise tax.

An affiliated group of corporations may, in general, report their taxable income either by one consolidated return or by separate returns for each corporation. The consolidated return combines the income and deductions of the several members to arrive at a consolidated net income figure for the economic unit.

The inequity of assessing a 2-percent penalty on consolidated returns has been recognized by all who are familiar with this aspect of the law. Both President Eisenhower and President Kennedy have recommended to Congress that this penalty be repealed. Many organizations have advocated its repeal. The most recent example was the action of the section of taxation of the American Bar Association in August of this year.

A start was made by the 1954 code which removed the penalty with respect to returns of regulated public utilities. The second step was taken by the passage by the House of Representatives of H.R. 8363. Favorable action by the Senate on this proposal would complete the removal of this unjust tax.

I. THE USE OF CONSOLIDATED RETURNS SHOULD BE ENCOURAGED RATHER THAN PENALIZED

A consolidated tax return more properly reflects the taxable income.—Businessmen, accountants, and others have long recognized that a consolidated financial statement is the best way to reflect the income of an affiliated group of companies. This is illustrated by the fact that, almost without exception, financial reports to stockholders are on a consolidated basis.

An affiliated group is an economic unit and should be taxed as such.—This principle is already recognized in the tax law. For example, an affiliated group of corporations is treated as a single entity for the purpose of the $25,000 and $50,000 limitations of the investment credit. An affiliated group is also treated as a single taxpayer in computing the additional first year depreciation allowance on the $10,000 limitation.

Consolidated returns reduce the administrative task of the Revenue Service.—The auditing of one return from a central Internal Revenue Service office involves far less work than auditing many returns which may be scattered in various Internal Revenue Service offices. Furthermore, a consolidated return minimizes the need to audit intercompany transactions, such as intercompany sales, loans, service fees, and dividends. These transactions are frequently complex and require much audit time and effort.

The 2-percent penalty tax is economically unwise.—Despite the proposed reduction in corporate rates, the tax burden will continue to make it difficult for corporations to provide the capital for the replacement and expansion of machinery and equipment which is so necessary for a healthy economy and full employment. To add to this burden by an additional levy on consolidated returns is economic folly, particularly in view of the small revenue loss estimated to be only $50 million a year.

The 2-percent penalty is inequitable.—Only those companies which for legal or economic reasons must operate through subsidiary corporations are subject to the tax. Other companies which can and do operate through branches and divisions rather than through subsidiaries pay no such penalty. The exclusion in 1954 of regulated public utilities from the operation of the 2-percent penalty was predicated on the fact that such businesses are usually required to operate through subsidiary companies. However, there are many other business enterprises besides regulated utilities which cannot readily function as a single corporation. The tax treatment of such businesses should be equated with that of the public utilities by the elimination of the 2-percent penalty.

The historical reason for the 2-percent penalty no longer exists.—A penalty on consolidated returns was first imposed for the year 1932. Prior to 1932, operating losses could be carried forward 2 years. Starting with 1932, this provision was eliminated. It was realized at that time that the effect of eliminating loss carry forwards could be avoided by an affiliated group filing a consolidated return. In such a return, the loss of one company could be offset by the profits of another company. The penalty tax was thereupon conceived and enacted to offset this advantage of the consolidated return. All remnants of this reasoning have now disappeared. The present law permits operating losses to be carried back 3 years and forward 5 years. This is a far more liberal arrangement than that which was repealed in 1932.

II. THE REPEAL OF THE 2-PERCENT PENALTY SHOULD NOT BE DEPENDENT UPON OTHER PROVISIONS OF H.R. 8363

Sectilon 222 repealing the 2-percent penalty tax is complete in and of itself and should in no way be dependent upon or coupled with the proposed reduction of surtax exemption contained in section 223. An affiliated group of corporations which files a consolidated return is automatically limited to one surtax exemption and in no way is concerned with the problems which the proposed reduction of surtax exemption seeks to correct.

The proposed change in normal tax rates for corporations will increase the value of the surtax exemption from the current $5,500 to $7,000 in 1964 and to $6,500 for 1965 and subsequent years. To prevent this increased benefit from being proliferated, section 223 reduces the benefit to certain groups of multiple corporations whether or not they can file consolidated returns. Thus, the proposed reduction of the surtax exemption is the product of change in the tax rate structure and should not be related to the 2-percent penalty imposed upon consolidated returns.

III. RECOMMENDATIONS

For the reasons set forth above, we respectfully urge that the Finance Committee of the U.S. Senate take favorable action to repeal the 2-percent additional surtax now imposed upon affiliated corporations filing consolidated returns.

HAVERTOWN, PA., *October 3, 1963.*

Hon. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: Now that the Revenue Act of 1963 is passed the House and in the Senate, I feel a few views should be aired before the measure goes further.

As to the suggestion of tying the tax reduction to budget control, the theory is good, but probably completely unpopular as most voters, I believe, are not yet debt conscious, either in Government or in their personal affairs. Fiscal responsibility is needed in all sectors of the economy, and our Federal Government makes this need most evident. Maybe restricting tax revenues will restrict Government expenditures, but to date, this theory has not proved out, and only in Government can such a policy prevail for prolonged periods, but eventually the economy must pay the price for such irresponsibility.

As to the tax rate reductions, they seem fair and reasonable, but coupled with some reforms which are extremely unequally distributed, I am inclined to label the Revenue Act a more or less purely political measure. For example, we have a progressive rate structure supposedly based on ability to pay. Coupled with this, in the new bill, is a procedure for minimum and maximum standard deductions which grossly accentuate the effect of this progressive taxation. We will allow the small taxpayer, paying taxes at lower rates already, to deduct under a standard method, amounts he actually didn't spend, and on the other hand, we are going to disallow some deductions which the heavier burdened taxpayer has previously been allowed to deduct because he actually spent the money. I would be wholeheartedly in favor of revising, or even eliminating altogether, itemized deductions, provided an equitable standard deduction schedule were permitted, such as a flat 10 percent. The Revenue Act of 1963 not only continues progressive taxation through rates, but accentuates this progression by giving greater, proportionately, deduction benefits to the smaller wage earner. This, I declare, is adding insult to injury.

The effect of the 1963 Revenue Act, in this respect, is merely to remove some 1,500,000 taxpayers from the tax rolls, and I might add, it would remove these persons from the "tax awareness" categry, too. As I said in my article in the November 1962 issue of CCH Taxes magazine, being a member of a nation is somewhat analogous to being a member of a church, in that both involve the element of support, financial, and otherwise. I think every citizen receiving income should be subject to tax, even if it is only a minimum of $5 or $10 a year—every income recipient should be aware of at least some financial responsibility to his Federal Government, for this is the cost of freedom (so we're told).

The only other provision of the Revenue Act of 1963 which I feel requires a very careful look is the proposal to do away with the dividend credit. I realize the increase in the exclusion will offset this for small dividend recipients, but the theory of taxing dividends seems wrong. I firmly believe that if dividends, paid out of income after taxes, are also taxed to the owners of the business, they why should we not also tax partnership income (after reasonable partnership salaries) before the partners take up such income as taxable on their own returns. The same should be true of professional profits, over and above reasonable salaries—these should also be taxed twice to the owners of the business.

In conclusion, there seems to be considerable discussion by the advocates of the tax bill to broaden the base as far as taxable income. This probably has some merit, but, I would go further and say we should also broaden the base as far as numbers of taxpayers. I frankly would not resent having any proposed tax reduction cut in half if it meant that there would be a definite effort to make support of the Federal Government a responsibility and privilege of the Nation as a whole, rather than a disproportionate burden placed upon a carefully selected group of citizens.

Yours very truly,

JAMES B. GRIFFITH.

UNITED LABOR COMMITTEE,
OF HENNEPIN AND ANOKA COUNTIES,
October 3, 1963.

HARRY BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR CHAIRMAN BYRD: The United Labor Political Committee of Minneapolis, representing some 40 unions, passed a motion recording its opposition to the tax bill passed by the House of Representatives, and ask you to work for a tax bill which will bring relief to those in low income brackets.

The new rates would range from 14 percent in the lowest bracket to 70 percent in the highest. The bill as passed by the House would not increase the purchasing power among those families who spend all or most of their income for goods and necessities each year.

A married couple with two children and an income from wages of $5,000 would get a tax cut of $77 in 1965. The reduction for such a couple with wage income of $7,500 would be $144.

On $10,000 of income the cut would be $202; on $20,000 it would be $535; on $50,000 it would be $2,207; on $100,000 it would be $5,278.

The House tax cut bill would provide for two-thirds of the tax cut in 1964 with the remainder in 1965.

We respectfully request you permit deductions for such things as State license fees, State taxes, as is permitted under the present Federal income tax law.

Respectfully,

L. J. LEVOIR, *Chairman.*
I. J. OAKE, *Cochairman.*
FAY FRAWLEY, *Secretary.*

RICHMOND, VA., *October 3, 1963.*

Re Federal taxation of group term life insurance.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

SIR: It is my understanding that in the Federal income tax bill which has just been passed by the House of Representatives and has been sent to the Senate for approval contains a Federal income tax proposal for taxing imputed income on group term life insurance in excess of $3,000. This bill also exempts retired employees from any tax liability. I also understand that the original bill had an exclusion of $5,000.

I object to this bill for the following reasons:

The American taxpayer is being made to believe that the administration is making an effort to give us tax relief and this type of tax reform is increasing our taxes. The unfortunate part of it is the average American citizen has no way of knowing the tax liabilities that are being imposed upon him until the bills have been enacted into the law. I also feel that this part of the bill is discriminatory inasmuch as the working citizen will have to carry the burden of taxes for retired citizens.

If this proposal is included in the tax bill that is passed, there is no assurance that at some later date, without too much publicity, this exempt figure could be lowered back to the original $5,000.

The whole idea of taxation on imputed income to the employee, which would be subject to withholding tax, would also create many recordkeeping problems on employers which would result in increased administrative expenses and in some cases, if the employers were not compelled by contracts, or agreements, to have group life insurance on their employees, there is a possibility they would discontinue this benefit.

This might also give some representative, at a future date, the idea of imposing this tax on any employer benefits. Therefore, as a representative of the people, I urge you to give this matter your earnest consideration not only for this proposal, but any other that may be detrimental to the welfare of the taxpaying public and exclude them from this tax bill.

Yours respectfully,

B. H. WALKER, Jr

RICHMOND, VA., *October 3, 1963.*

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

SIR: In regard to the Federal taxation of group term life insurance, I wish to state that I object strenuously to this bill for the following reasons:

The concept of this income tax may lead to employer-financed benefits, such as health insurance, social security and compensation benefits which also may be taken into account in the future tax legislation.

It would also create many recordkeeping problems which employers would find resulting in additional administrative and office expenses.

There would be nothing in the future to prevent the reduction of the amount of exemption of $30,000 possibly back to the original $5,000.

It would be discriminatory in that two employees of the same age and having the same amount of life insurance could be treated differently for tax purposes if one of the insured were in active employment and the other were retired. The retired employee would be completely eliminated while the tax burden on the active employee would continue to rise.

It is my understanding that the tax reduction bill that was passed by the House carries the above objections. I trust you will use your influence to see this bill is not passed by the Senate in its present form.

Yours respectfully,

P. B. SCHENK.

THE LIBRARIAN OF CONGRESS,
Washington, D.C., October 8, 1963.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I was pleased to note that H.R. 8363, the bill to amend the Internal Revenue Code of 1954, as reported and passed by the House of Representatives, contains a provision, in section 209(a), to extend to organizations that are publicly or governmentally supported the 30-percent deduction of adjusted gross income for charitable contributions which in the law now effective is applicable only to such contributions made to "educational institutions."

The acquisitions program of the Library of Congress has been severely handicapped by the fact that its donors are at present eligible for only the 20-percent deduction as compared with the 30-percent deduction allowed donors to "educational institutions," narrowly defined as those institutions having a regular course of study and a resident faculty. As you no doubt know, the Library of Congress depends almost entirely upon private gifts for enriching our collections of rare books and of musical and historical manuscripts. Section 209(a) of H.R. 8363 would place us on a par in our acquisitions program with college and university libraries.

Public libraries, historical societies, and museums which are publicly or governmentally supported and which are certainly "educational institutions" broadly conceived, would also benefit from this provision in the bill, as would other national institutions such as the National Archives, the Smithsonian Institution, the National Agricultural Library and the National Library of Medicine.

I therefore strongly urge that your committee, when considering the bill, retain the provision contained in section 209(a). A copy of my testimony before the House Ways and Means Committee is enclosed. I would appreciate it if this letter could be made part of the record in favor of this provision. If the Library of Congress can lend additional support, please call upon us.

Sincerely yours,

L. QUINCY MUMFORD,
Librarian of Congress

LAW OFFICES OF RITTER & BOESEL,
Toledo, Ohio, October 7, 1963.

In re H.R. 8363.

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN BYRD: The revenue bill of 1963, passed by the House of Representatives, section 215, provides in subsection (d) that subsections (a) and (b) shall apply to payments made after December 31, 1963, on account of sales or exchanges of property occurring after June 30, 1963.

We are writing you as regards this provision on account of the uncertainty and indefiniteness which results from the use of the words "sales or exchanges," and also the inference of this provision, in light of the fact that many contracts have been made in reliance upon the decisions of the Tax Court and the circuit courts of appeal, which hold that no amount of the payment received on account of deferred payments shall be treated as interest unless it is so provided in the contract.

The question of when a sale actually takes place is one very difficult to determine. In the case of *Commissioner* v. *Segall* 114 Fed. (2d) 709, the court stated:

"There are no hard and fast rules of thumb that can be used in determining, for taxation purposes, when a sale was consummated, and no single factor is controlling; the transaction must be viewed as a whole and in the light of realism and practicality. Passage of title is perhaps the most conclusive circumstance. *Brown Lumber Co.* v. *Commissioner*, 59 App. D.C. 110, 35 F. 2d 880. Transfer of possession is also significant. *Helvering* v. *Nibley-Mimnaugh Lumber Co.*, 63 App. D.C. 181, 70 F. 2d 843; *Commissioner* v. *Union Pac. R. Co.* 2 Cir., 86 F. 2d 637; *Brunton* v. *Commissioner*, 9 Cir., 42 F. 2d 81. A factor often considered is whether there has been such substantial performance of conditions precedent as imposes upon the purchaser an unconditional duty to pay. *Commissioner* v. *North Jersey Title Ins. Co.*, 3 Cir., 79 F. 2d 492; *Brunton* v. *Commissioner, supra; Case* v. *Commissioner*, 9 Cir., 103 F. 2d 283; *United States* v. *Utah-Idaho Sugar Co.*, 10 Cir., 96 F. 2d 756. See options and Sale Contracts in Taxation, 46 Yale Law Jour. 272, 279."

I am not attempting to cite various decisions of courts in relation to the time a sale takes place, but I wish to point out that the phrase "on account of sales or exchanges of property occurring after June 30, 1963" is indefinite.

We believe that it is unfair to impose a tax upon the owner of property who has in good faith, prior to the proposal of the Revenue Act of 1963, entered into agreements relating to the sale of property on an installment basis, in reliance upon the decisions of the Tax Court and the Federal circuit courts of appeal, as well as the office decisions of the Income Tax Unit of the Treasury, which hold that no part of deferred payments is interest unless so specified in the contract.

The Income Tax Department in 1933 issued I.T. 2674, contained in XII C.B. 96, which provides:

"The Bureau has consistently taken the position that where property is sold on a deferred-payment plan, and the contract of sale does not provide that any part of the deferred payments is interest, no part of such payments may be considered as interest. This position has been uphold in the courts. (Cf. *Daniel Bros. Co.* v. *Commissioner*, 7 B.T.A., 1086, C.B. VII-1, 8, affirmed 28 Fed. (2d), 761; *Henrietta Mills, Inc.* v. *Commissioner*, 20 B.T.A. 651, affirmed 52 Fed. (2d) 1931.)"

In addition to the cases therein cited, a similar decision was rendered by the Circuit Court of Appeals for the Second Circuit in *MacDonald* v. *Commissioner*, 78 Fed. (2d) 512.

We have over a period of a number of years, in reliance upon these decisions prepared contracts of purchase and sale and also contracts of options to purchase lands, considerations for which were payable over a long period of years. We were confident that we could assure our clients of their rights in making such agreements, for this office decision states clearly that the Bureau had consistently taken the position above quoted.

We have also prepared contracts in the form of options extending over a period of years. In some of these agreements the owner of the land is unable to deliver title until after June 30, 1963. We have also prepared contracts for payments extending over a period of years after June 30, 1963, on farm property, where the purchaser could not immediately meet his earlier obligation.

The optional provisions in contracts which we have drawn were based upon the desire of the purchaser or optionee to engage in a development of property, where he would acquire a tract, less than the whole, to begin a development, and as the tract already acquired had reached a certain stage of development he would then acquire another piece of property for further development. In these cases, under the proposed provision of section 215(d), certainly as to the properties under option the seller would be taxed on the basis of interest on deferred payments even though he had prior to any possible basis for anticipating a change in the law, made a contract by which he himself is bound.

We are not writing this letter in behalf of any client and are doing this solely on account of our sense of fairness.

We trust that the integrity of the decision in IT 2674 will be upheld as to contracts relating to sales, including options, which were made in good faith prior to June 30, 1963.

Very truly yours,

RITTER & BOESEL.

ROHM & HAAS CO.,
Philadelphia, Pa. October 8, 1963.

Re section 203 of the revenue bill 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Old Senate Office Building,
Washington, D.C.

DEAR SIR: This section provides for income tax to employees on the amount of the cost of providing life insurance coverage in excess of $30,000 under group term life insurance policies. I do not believe it achieves the intent of those who have written the bill.

My understanding is that the intent of this section is to close what some believe to have been a loophole which favored certain top, highly paid executives. If this is indeed the intent, I think the following figures will indicate that it goes far beyond what most people consider to be the executive level.

1. Our company has about 9,000 employees, among whom 1,100 would immediately pay income taxes under section 203.
2. Every employee who earns over $10,200 per year will pay taxes under section 203. In our research organization, of which I have direct charge, practically every scientist is affected by this bill, since the starting salaries for men just out of graduate school is in excess of $10,000.
3. Among our older employees, those who earn in excess of about $7,000 a year will be affected in the last few years before retirement.

You may feel that our company is not a typical case. While it has been our intent to be progressive in thinking of the protection of the families of our employees, I do not believe ours is a unique situation and I am sure that you will find the plans of many companies are quite comparable to ours.

If you are to consider, as I have suggested, whether or not this mechanism actually achieves the intent, I hope that in considering alternatives there are two other aspects of group term life insurance plans which you will consider.

1. Under section 203, each of us affected will pay a tax on money which we do not receive and for which we and our estates may never receive a cent. Since this is group term insurance, benefits occur only to the families of employees who die. If we live past the life of our insurance our estates receive nothing, although we will have paid taxes for a number of years on the company's contribution to the plan.
2. The employees have no discretion as to whether or not they receive group term life insurance. Every employee who has been with this company for more than 3 months receives this whether he wants it or not. Some of us would perhaps prefer to invest this amount of money in other ways if it is to be taxed as income. As it now stands, an employee must, from his regular salary, accrue enough to pay the income tax on his salary, plus

the tax on company payments made for his insurance. The latter represents money over which the employee has no control and which is taxed at the same rate as his regular income.

With the present trend to thinking of the welfare of those who are not themselves breadwinners, it seems to me basically wrong to require tax payments on company contributions intended for the protection of a man's family, payments over which the employee has no control, and payments for which the majority of our people will never receive a benefit.

Very truly yours,

RALPH CONNER, *Chairman of the Board.*

CHARLOTTE, N.C., *September 30, 1963.*

Hon. SAM J. ERVIN,
U.S. Senate, Washington, D.C.

DEAR SENATOR ERVIN: Please read the enclosure relating to the basis, for purposes of U.S. income tax, of inherited property in the hands of heirs.

I am concerned lest some form of this proposal of the Treasury Department be enacted into law. It was far too complicated for the ordinary taxpayer, and even some tax advisers to understand. It would give a tax advantage to big taxpayers who have top advice and hurt the small taxpayer who doesn't have it and can't afford it.

But that, in my opinion, is one of the lesser objections to the proposal of the Treasury Department.

The proposal is an impractical one, and one that would be most difficult to work with. Take, for instance, a case in which I personally am interested. My father died June 7, 1963, at the age of 87 leaving a relatively small estate consisting principally of corporate shares, including shares in a small business, that he acquired over a period of over 50 years. How on earth would his heirs, including myself, go about finding out when he bought them and how much he paid for them? We couldn't. And his basis is complicated by stock splits, stock dividends, stock reissues, and improvements to real property. We could not obtain the information necessary to file a correct return if the Treasury's proposal had been law at the time of his death. Small businesses in particular would be hurt by it.

And most important, I believe, is this: Our free enterprise system requires private capital in order to work. With high tax rates and high costs of living, it is most difficult for Americans to save money from current income to put to work as capital. The remaining source of capital for investment is inherited capital. If it is subjected not only to an estate tax, but also to an income tax, the largest remaining source of investment capital is further consumed by taxes, and America has taken another step toward state socialism, where the state owns all the means of production and all work for the state. This is true whether the gain is taxed as of the date of death (as proposed by the Treasury), or when the inherited property is sold (as initially approved by the House Ways and Means Committee), because often the heirs must sell, and have no choice but to do so. They must sell to raise money with which to pay estate taxes, or because they are not on the scene to care for real property, or to get money to educate their children, or for a hundred other reasons.

I was heartened when the House Ways and Means Committee eliminated the entire proposal from its bill, but from the enclosure you will see that the Treasury has not given up. I respectfully urge that you take every step available to you to kill the Treasury's proposal once and for all. The heirs, having paid estate and inheritance taxes, should in all fairness be allowed the new and higher basis provided for by present law, and should not be required to take the property at the decedent's lower basis.

Very truly yours,

ARTHUR M. JENKINS.

[From P–W Federal Taxes Report Bulletin, vol. XLIV, No. 39, Sept. 26, 1963]

TREASURY STILL STUDYING CHANGES IN RULES ON DEATH TRANSFERS

[¶ 32,466] Treasury did make one exception when it agreed to go along with the Ways and Means version of H.R. 8363, the revenue bill of 1963. See ¶ 32,159, it said it would give further study to the problem posed by nontaxation of before-death appreciation of capital assets of a decedent when actually sold by the heirs.

Here's an example of the problem Treasury has in mind:

Mr. X owns 1,000 shares of Z Co. stock for which he paid $10 a share in 1942. His basis: $10,000. When he dies in 1963, the stock is worth $250 a share. His estate will pay estate taxes on the $250,000 value of the stock in his estate. His heirs then get a $250,000 basis for the stock. Never taxed as income under present law; the $240,000 capital gain on the stock at the estate tax valuation date.

Ways and Means decided earlier this year against current taxation of these gains at death. But it did make a final decision to alter the heirs' basis; heirs would generally carry over the decedent's basis, with many complicated exceptions. RR 63-25, ¶ 27,513.25.

When the provisions of the bill came before the committee for final vote, however, the statutory language containing this change in the basis rules was eliminated. (Some observers believe this was done only because the legislative language was so complex.) But Ways and Means never issued a press release withdrawing its final decision to change the basis rules.

If the Treasury study produces more acceptable legislative language, Treasury may be able to add a provision on this subject to the Senate Finance Committee version of the bill.

EVANS, MCLAREN, LANE, POWELL & MOSS,
ATTORNEY AT LAW,
Seattle, Wash., October 11, 1963.

Re proposed revision of Internal Revenue Code.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate,
Washington, D.C.

DEAR SIR: Reports in the press indicate that the Senate will be asked to restore to the proposed 1963 Revenue Act one of the features which was considered and rejected by the House Ways and Means Committe, namely a change in the law to provide that a decedent's basis for gain or loss will continue to apply to inherited property in the hands of the heirs, adjusted only for the amount of estate taxes paid.

If the decedent's basis is applicable to heirs, presumably it is also applicable to the executor or other personal representative. Therefore, if property is sold by an estate during the course of administration, the capital gains tax would be payable.

If the estate is required to sell assets to pay taxes, expenses of administration, and debts of the decedent, the imposition of capital gains tax in addition to Federal estate tax might be disastrous. This would be particularly true if the estate is also subject to State death taxes. Therefore, I hope that the new law will contain relief provisions permitting sale without capital gains tax when necessary to provide for Federal or State death taxes, expenses of administration, or debts of the decedent. Section 303 of the Code relating to distributions in redemption of stock to pay death taxes is a precedent for relief of this sort.

Very truly yours,

GEORGE V. POWELL.

CHARLOTTE, N.C., *October 4, 1963.*

Re tax-cut bill H.R. 8363.

Hon. B. EVERETT JORDAN,
U.S. Senate,
Washington, D.C.

DEAR SENATOR JORDAN: This bill, H.R. 8363, is not only a tax-cut bill—it is also a reform bill. I believe the tax-cut bill should be just that and nothing else. The reform measures take away in large measure the relief granted by the tax cuts. Many of the reform features have been included, I believe, for the sake of making reforms; they have little bearing on revenue. Other reform measures open the door a bit to further reforms at a later date; for instance, the proposed tax on insurance premiums paid by an employer for group life insurance coverage in excess of $30,000, is a dangerous invasion on taxing fringe benefits. In the next year or two the $30,000 will probably be dropped to $10,000 or $5,000 and eventually eliminated. The elimination of certain taxes as allowable deductions is a step toward eventual elimination of all tax deductions and possibly other deductions.

On balance, I think this is still a bad bill, and the reform measures should be eliminated. The bill, however, does contain these measures, hence I am submitting specific comments as follows:

SECTION 111. REDUCTION OF TAX ON INDIVIDUALS

Probably the first thing that the average taxpayer does when a tax cut is announced is to check the Federal Income Tax Withholding Tax Tables to see how much more take-home pay he will have in his pay envelope as a result of the tax cut.

Now, let us look at some figures, see Exhibit "A" and "B" attached, and see what will happen:

1. A married taxpayer with two children and an annual salary of $7,000, no other income, would have a monthly withholding at present, 1963, of $66.20. Under the proposed revenue bill, his monthly withholding in 1964 will be $55.20, or an increase in take-home pay of $11 monthly, which represents a 16.62 percent reduction in taxes. Then in 1965 under the proposed revenue bill, his monthly withholding will be $51.50, or a further increase in take-home pay of $3.70 monthly for a total increase in take-home pay of $14.70 monthly or a decrease in taxes of 22.21 percent as compared with present tax costs.

If this taxpayer files his return and uses the standard deduction, his actual tax liabilities will correspondingly decrease about 22.69 percent, thereby giving said taxpayer a "true" tax reduction. However, if this same taxpayer files his return and uses the itemized deductions, his actual tax liabilities will decrease only about 18.10 percent, thereby giving the taxpayer only a "partial" tax reduction.

2. A married taxpayer with two children and an annual salary of $14,000, $300 of dividend income, would have a monthly withholding at present, 1963, of $170. Under the proposed revenue bill, his monthly withholding in 1964 will be $141.70, or an increase in take-home pay of $28.30 monthly, which represents a 16.65 percent reduction in taxes. Then in 1965 under the proposed revenue bill, his monthly withholding will be $132.23 or a further increase in take-home pay of $9.47 monthly, making a total increase in take-home pay of $37.77 monthly, or a decrease in taxes of 22.21 percent as compared with present tax costs.

If this same taxpayer files his return and uses the standard deduction, his actual tax liabilities will correspondingly decrease about 18 percent, the 3 percent variance due to the insufficient withholding on salaries over $1,000 per month, thereby giving the taxpayer a "true" tax reduction. However, if this same taxpayer files his return and itemizes his deductions, his actual tax liabilities will decrease only about 11.87 percent, thereby giving this taxpayer only a "partial" tax reduction.

This revenue bill discriminates against the taxpayer who itemizes his deductions on his tax return. The bill is unfair and unsound in that while it reduces the tax rates it also increases the taxable income and also reduces the allowable deductions. It gives relief with one hand and takes away some of the same relief with the other hand.

EXHIBIT A

Taxpayer A, married, 2 children, $7,000 per annum	Federal withholding tax		Actual Federal tax	
	Monthly	Year	Standard deductions	Itemized deductions
Year 1963	$66.20	$794.00	$780.00	$630.00
Year 1964	$55.20	$662.40	$662.00	$570.00
Supposed increase in take-home pay, 1964 over 1963	$11.00	$132.00		
Actual saving in annual tax			$118.00	$60.00
Expressed as a percentage (to 1963)	16.62	16.62	15.13	9.52
Year 1965	$51.50	$618.00	$603.00	$516.00
Supposed increase in take-home pay, 1965 over 1964	$3.70	$44.40		
Actual saving in annual tax			$59.00	$54.00
Expressed as a percentage (to 1964)	6.70	6.70	8.91	9.47
Total tax savings expressed as a percentage (1964 and 1965)	22.21	22.21	22.69	18.10

EXHIBIT B

Taxpayer B, married, 2 children, $14,000 per annum, $300 dividends	Federal withholding tax		Actual Federal tax	
	Monthly	Year	Standard deductions	Itemized deductions
Year 1963	$170.00	$2,040.00	$2,408.00	$2,110.04
Year 1964	$141.70	$1,700.40	$2,114.50	$1,994.30
Supposed increase in take-home pay, 1964 over 1963	$28.30	$339.60		
Actual saving in annual tax			$293.50	$115.74
Expressed as a percentage (to 1963)	16.65	16.65	12.19	5.59
Year 1965	$132.23	$1,586.76	$1,974.00	$1,859.60
Supposed increase in take-home pay, 1965 over 1964	$9.47	$113.64		
Actual saving in annual tax			$140.50	$134.70
Expressed as a percentage (to 1964)	6.68	6.68	6.64	6.75
Total tax savings expressed as a percentage (1964 and 1965)	22.21	22.21	18.02	11.87

SECTION 201. DIVIDENDS RECEIVED BY INDIVIDUALS

The 4-percent dividend credit would be reduced to 2 percent in 1964 and repealed in 1965. At the same time the exclusion for dividends received from domestic corporations would be increased from $50 to $100 effective in 1964. In the case of married couples filing a joint return, the maximum total exclusion would be $200. This provision is not in the best public interest in that it is detrimental to the young investor seeking to share in American industry and also it is detrimental to the elderly retired couple trying to live off their meager dividend income as a supplement to the pension and social security payments.

Apparently the tax law writers lost sight of the fact that many a laborer and clerk is also a shareholder in industrial companies these days. The bill attempts to avoid being tainted as a "rich man's bill" by elimination of the 4-percent dividend credit. Actually it is hurting a larger number of smaller taxpayers than "rich" ones. In addition, it return to the "double taxation" concept—corporate income is taxed in full and when dividends are passed on to shareholders, the dividends are also taxed. It appears surprising that other countries, such as Canada, are more progressive and intelligent in this respect than the United States.

SECTION 202. REPEAL OF REQUIREMENT THAT BASIS OF SECTION 38 PROPERTY BE REDUCED BY 7 PERCENT

This repeal measure is good and should be enacted. Nothing in recent years has caused more unnecessary bookkeeing and confusion than the requirement enacted last year to reduce the basis of property by the 7-percent credit.

SECTION 203. GROUP TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES

This section is an invasion of fringe benefits. The bill intends to tax the group term life insurance premiums paid by the employer for coverage in excess of $30,000. The net amount of revenue to be gained by this section is estimated by the Treasury Department at $5 million. This section appears to be a reform measure for the sake of making reforms. And it puts a wedge in the door for further tampering with this type of benefit.

If the attempt is to avoid having someone obtain free coverage of $1 million, then a suitable formula could be applied, say, "not to exceed two times annual earnings or $50,000 coverage, whichever is less."

The inclusion in income of the cost of insurance over $30,000 purchased by an employer for his employee is a personal incentive atrophying measure. It tends to limit insurance benefits for employees since it would require the employer to withhold tax on this benefit. It is another phase in a philosophy that contends our country's business managers cannot possibly be worth the compensation they are receiving. It is ironic because even the Government realizes that it must offer higher rewards in order to get men qualified to lead this country.

SECTION 204. INCLUSION IN GROSS INCOME OF REIMBURSED MEDICAL EXPENSES TO THE EXTENT THAT THE REIMBURSEMENT EXCEEDS THE EXPENSES

Apparently the tax law writers believe that it is a pleasure to be sick and that people actually go out of their way to devise a means of making money out of illness. This is another reform for the sake of "reforming," as the Treasury Department's own estimate of increase in revenue under this section is stated to be negligible. Then why have it?

Under present law, insurance recoveries under health or accident insurance policies are treated as reductions of the taxpayer's medical expenses and are not included in gross income. But where a taxpayer has more than one health or accident insurance policy and receives reimbursement for the same medical expenses more than once, the bill wold require him to include in gross income the amount by which the reimbursement exceeds the actual expenses. Since when can pain be measured in dollars and cents.

This provision is more or less contrary to the goals of the present Federal administration with its so-called program of medical care. Here a taxpayer is being penalized by increasing his taxable income because he is being prudent and carrying two hospital and/or surgical policies. The taxpayer is trying to maintain his proper station in life by providing ample medical coverage for himself and his family and then he is penalized under this provision. This section should be eliminated.

SECTION 207. DENIAL OF DEDUCTION FOR CERTAIN STATE, LOCAL, AND FOREIGN TAXES

This section is estimated by the Treasury Department to increase revenue by $520 million. This proposal is a step toward eliminating all allowable deductions of this nature in the future. It reflects the high cost of taxes on various items and the greater tendency for taxpayers to itemize deductions rarther than using a standard deduction. It penalizes the poor as well as the rich.

This provision would eliminate the deduction of certain State and local taxes for Federal income tax purposes. No longer deductible would be the taxes on gasoline, cigarettes, and tobacco, and alcoholic beverages. Also, nondeductible would be the motor vehicle license plate fees, fees for driver' licenses, poll taxes, and miscellaneous selective sales taxes, such as admissions taxes, and occupancy or transfer taxes. Foreign taxes—other than real property and income taxes—would also be nondeductible.

This provision is a costly item to the average taxpayer. Consider the taxpayer, rich or poor who must use his personal automobile for transportation to and from his work, especially where there is no public transportation available. He could formerly deduct the gasoline tax, license plate fees, drivers' license fees and now these deductions are no longer allowable. This taxpayer wears out a capital asset, his personal automobile, never being allowed charges for depreciation, repairs, etc. This provision does not seem at all equitable.

SECTION 208. PERSONAL CASUALTY AND THEFT LOSSES

Under present law casualty or theft losses of nonbusiness property are deductible in full by taxpayers who itemize personal deductions rather than use the standard deduction. A new provision would limit the amount of the deduction for personal casualty or theft losses to the amount of each loss in excess of $100.

Since the routine casualty is that cost of an automobile accident not covered by insurance ($50 or $100 deductible) this virtually eliminates the casualty loss deduction for most people.

Since casualty losses in these amounts probably effect the lower bracket wage earner to a greater extent than the "rich" taxpayer it is difficult to conceive why this section is included. The revenue gain by the Treasury Department is estimated to be $50 million. What the tax law writers lose sight of is the fact that this section will force car owners to purchase adequate coverage, thereby taking away part of the money supposedly resulting from the tax cut. This section should be eliminated.

SECTION 212. MOVING EXPENSES

The bill continues the rule that an old employee transferred to a new job location does not have to report any reimbursement of his moving expenses as income. The bill gives him a deduction (even though he elects the standard deduction) for nonreimbursed expenses.

Under old law, a new employee moving to a new job had to include reimbursements in income but received no deduction. While he'll still report the income, the bill gives him a deduction on a parity with the old employee.

"Moving expenses" include only the expenses of moving household goods and personal effects and the traveling expenses (including meals and lodging) of the taxpayer and his family from the old home to the new job location.

The trouble is that under the old law and proposed law "moving expenses" as defined, do not include all the sundry types of expenses connected with a move such as hotel expenses for he and his family while waiting to move into a new home, certain allowances for curtains, carpets, etc., and other incidentals. There is an area of definition which should be clarified. All moving expenses should be allowed as deduction.

SECTION 214. EMPLOYEE STOCK OPTIONS AND PURCHASE PLANS

The present tax treatment of employee stock options is further restricted, the principal additional restrictions being that (*a*) the stock when acquired must be held for 3 years or more; (*b*) the option must not be for a period of more than 5 years; (*c*) the option price must at least equal the market price of the stock when issued; (*d*) stockholders' approval for the options must be obtained; and (*e*) the extent to which new options may be exercised when the old options are outstanding is restricted.

The expected revenue effect is negligible.

Again this is a reform not having anything to do with the purpose of the bill, the cut in taxes. The intent of this "reform" is to lessen management compensation.

I do hope you find the time to give this bill serious study and consideration. I know it will be difficult because of the mass of material to study and evaluate. I trust the Senate can improve on the bill and make it a real tax-cut bill, if the economy of the country warrants it. Personally I believe in living within my means and I think the Government also should do it.

Sincerely,

HENRY J. DOHRMANN.

WAINSCOTT, LONG ISLAND, N.Y.,
October 10, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I have just learned from a radio broadcast that the Senate Finance Committee will open hearings on the administration's tax bill next Tuesday.

My special concern with this measure is H.R. 8000, which incorporates the President's proposal of a 15-percent tax on purchases of foreign securities bought abroad.

I admit to a personal interest in this tax as I have a substantial interest in a Canadian asbestos mine, the market for which on the Canadian exchange has all but frozen since the President first announced the proposal.

From an objective viewpoint, however, I feel quite certain that you consider this tax not only as discriminatory but also as most damaging to our friendly relations not only with Canada, but with Britain, Japan, France, and Western Germany as well.

A number of responsible persons in the financial community testified against this tax during the House hearings, and I hope they will do so again before your committee. I shall watch the newspaper accounts of the hearings very closely and hope that I shall find one day that your committee has rejected H.R. 8000.

Sincerely yours,

LUCILLE CARDIN CRAIN.

THE AMERICAN CHAMBER OF COMMERCE IN JAPAN,
Tokyo, October 8, 1963.

HON. HARRY F. BYRD,
U.S. Senate,
Washington, D.C.

DEAR SIR: The American Chamber of Commerce in Japan has studied with interest the testimony made before, and statements filed with, the Committee on Ways and Means of the House of Representatives in connection with the proposed Interest Equalization Tax Act of 1963 (H.R. 8000).

While we are opposed to this legislation for many reasons already stated in previous testimony (and we have no intention to fill the record with repetitious arguments), we would like to point out one detrimental aspect of the act which may have been previously overlooked. This concerns the effect of the act on the U.S. citizen living and earning money abroad, who, incidentally, while making an immense contribution to projecting the American image abroad on a day-by-day basis, has in recent years been the subject of much harrassment in the way of adverse tax legislation in the United States.

The detrimental aspect of the act, as drafted, that may have been overlooked is that the tax applies to a U.S. citizen, residing abroad, who purchases a non-U.S. security from funds generated, in foreign currency, from his employment. The purpose of the act is designed to stop the outflow of U.S. funds which may eventually be used to deplete the U.S. gold stock. In the case mentioned, there is no outflow of U.S. funds involved. To compound the error, in the case of a U.S. citizen living in Japan, the act imposes a tax payable in dollars on a transaction carried out in a currency which, for many purposes, is a blocked currency. This same situation do doubt exists in other countries.

We realize that there may be an administrative problem in drafting the act to correct this situation as it would be difficult to determine the true source of funds used to purchase non-U.S. securities in a case where the individual has income in U.S. currency as well as in foreign currency.

As—

(1) The purpose of the act is not to raise revenue, and

(2) The proposed tax has a much more severe effect on the individual as compared to the possible effect on the U.S. gold supply resulting from the outflow of a relatively small amount of U.S. funds that might be involved.

We would suggest, if for reasons of national policy the act has to be enacted, that blanket exemption from the tax be granted to U.S. citizens resident abroad or to those who can show that their cumulative earnings in foreign currency, or some percentage thereof, exceed the funds used for the purchase of non-U.S. securities.

In this same connection, it cannot be assumed that U.S. citizens living abroad (some of whom are not even to this date aware of the implications of the Revenue Act of 1962 which is already law) are currently informed on pending legislation. Accordingly, it is entirely inequitable that they be subjected to the retroactive aspects (July 19, 1963) embodied in the proposed bill.

We sincerely hope that the foregoing comments will be given earnest consideration in further deliberations on H.R. 8000, "Interest Equalization Act of 1963."

Yours very truly,

CARL H. BOEHRINGER,
Executive Director.

CITIZENS COMMITTEE FOR TAX REDUCTION AND REVISION IN 1963,
Washington, D.C., October 8, 1963.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: As a member of the Senate Finance Committee, we respectfully call to your attention the attached resolution adopted by the Citizens Committee for Tax Reduction and Revision in 1963, at its meeting in Washington last week, urging favorable Senate action on the tax program this year.

The citizens committee, which is composed of leaders in the fields of small business, housing, labor, agriculture, education, aging, and welfare, was formed earlier this year in an effort to win widespread acceptance and support for enactment of the tax program.

We believe, as stated in the resolution, that if the tax cut fails this year, we can expect an economic downturn and increased unemployment that can lead to a recession in 1964.

While we agree that the Senate Finance Committee needs a reasonable period of time to deliberate the tax bill, we urge you, as a member of the committee, to expedite hearings in order that the Senate may take favorable action during the present session.

Sincerely yours,

HOWARD R. BOWEN, *Chairman.*

Following is text of a resolution adopted by the Citizens Committee for Tax Reduction and Revision in 1963—at a meeting in Washington, October 3, 1963:

"Whereas the tax bill as passed by the House of Representatives with overwhelming support on September 25 is in general agreement with this committee's statement of principles;

"Whereas we believe that needed economic expansion and increased jobs to lower the high unemployment rate can only come through the long-range benefits of a tax cut;

"Whereas we agree that the Senate Finance Committee needs a reasonable period of time to deliberate the measure, we recognize that the current economic upswing is to a substantial degree based on anticipation of a tax cut;

"Whereas we believe that if the tax cut fails this year, we can expect an economic downturn and increased unemployment that can lead to a recession in 1964;

"We, therefore, reaffirm our support of the general provisions of the House-passed tax bill and call upon the Senate Finance Committee to expedite hearings in order that the tax program may be enacted into law during this present session of the Congress.

MINNEAPOLIS, MINN., *October 10, 1963.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: This letter is to express my views on three aspects of the tax bill recently passed by the House of Representatives, which seem to me to be discriminatory and highly improper.

1. The tax bill restores over a 2-year period full double taxation of corporate earnings paid out as dividends. Other business-derived income is taxed only once: Payroll and interest are deductions from gross revenue, and tax thereon is paid only by the recipient. As a matter of economic justice, either all or part of earnings paid out as dividends should be a tax deduction to the paying corporation, or the tax on dividends received should be reduced.

2. I have not seen a copy of the bill; but in all published discussions of it that I have seen, there has been no mention of taxation of the interest paid on bonds issued by States or their governmental subdivisions. Such interest is free of income tax under the present law. I thoroughly disapprove of this legal loophole in theory; but I propose to crawl through it as long as it is to my advantage so to do. I believe that the interest on such bonds should be subject to full income tax; or if that is not politically feasible, at the very least the interest on so-called revenue bonds issued after January 1, 1964, should be so taxed.

3. Under the present law, businesses organized as so-called cooperatives enjoy a very considerable income tax exemption. I do not subscribe to the theory that they are "not organized for profit." I believe that they are organized for the profit of their owners, despite any legal definition to the contrary; and that consequently their profits should be subject to the same tax or taxes imposed on other corporations. After paying their proper share for the support of the Government, they may if they wish pay dividends on the basis of patronage instead of investment. That is certainly their privilege.

The Senate now has an opportunity to correct some or all of the inequities of the House measure. I hope that they will at least give them consideration.

Yours very truly,

THOMAS C. WRIGHT.

CHICAGO, ILL., *October 10, 1963.*

DEAR SENATOR BYRD: I have received a thoughtful article in this month's Monthly Economic Letter from First National City Bank, New York, in regard to the tax bill presently under consideration in your committee. Entitled "The Debate on Fiscal Responsibility," it contains what seems to be a pretty fair analysis of the reaction of the business community to this bill. To quote a passage or two:

"When reforms are enacted they should be required to conform to two acid tests—do they simplify obedience to the law on the part of the tax-form-weary citizen; do they enlarge the base of taxable income? These objectives got lost in the welter of discussion of * * * new complications * * * the bill would free around 1½ million persons from paying any Federal income taxes at all while adding to the burden of tax homework for tens of millions of others. The controversial petroleum depletion allowances provide an illustration * * * the Senate could save time, accelerate action, and spare millions of man-hours of tax drudgery if it laid aside the reform package and simply enacted appropriate rate cuts for January 1, 1964, and January 1, 1965. Simplifying, base-broadening reforms could be tied to a later, third step of major rate reductions. "* * * Many businessmen are inclined to support the bill * * * for all its faults (it) would do a major job on income tax rates, including the higher rates which deter people from seeking additions to their taxable income (i.e., investment) and induce them instead to seek out channels for avoidance (trusts, foundations, and speculations)."

The brackets are mine. The statement goes on further to say, "Congress needs to regain control of expenditures * * * but methods attempted are indirect and ineffectual * * *."

Although I do not agree with everything in this statement, it does seem to me a good idea not only to cut out the fat from Federal expenditures but from congressional logrolling, such as those appropriations which benefit a relatively small constituency or a pressure group. Might I suggest Vo-Ed as an example here? (Why, for instance, do we need to train more persons to be farmers when so many farmers no longer seem to be able to make a living in a "surplus" occupation? On the other hand, assistance to students who desire to become scientists and doctors seems to be not only sensible but an investment in our country's future.)

I would send you the article itself, but this is my only copy. I do strongly suggest that someone on your committee pick it up for you.

Sincerely,

Miss MARIAN WEBB.

THE CHICAGO BAR ASSOCIATION,
Chicago, Ill., September 5, 1963.

Re tax legislation to encourage voluntary disclosures.

Hon. HARRY FLOOD BYRD,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR: I have this day written to the Secretary of the Treasury, on behalf of the Chicago Bar Association, to urge him to include in the legislative program of the Department a proposal for the establishment of the voluntary disclosure policy which was in effect administratively some years ago. The American Bar Association last February adopted such a proposal and has brought it to the attention of Congress. I enclose a copy of my letter to Secretary Dillon which expresses the need for such legislation.

Our association requests you and your committee to give serious consideration to this matter and, if appropriate, to include this proposal in your general tax revision program.

Respectfully yours,

NORMAN H. NACHMAN, *President.*

SEPTEMBER 4, 1963.

Re proposed tax legislation to encourage voluntary disclosures.

Hon. DOUGLAS DILLON,
Secretary of the Treasury,
Department of the Treasury,
Washington, D.C.

MY DEAR MR. SECRETARY: The Chicago Bar Association, through its board of managers, acting upon the recommendation of the committee on Federal taxation, has directed me to notify you that the association favors the adoption of legislation to grant immunity from criminal prosecution for tax frauds in the case of taxpayers who make full and voluntary disclosures prior to the beginning of any tax investigation.

You are of course aware that prior to 1952 the Internal Revenue Service, as a matter of administrative policy, did not recommend prosecution in cases where the taxpayer had made voluntary disclosure. Since 1952, the Internal Revenue Service's position has been that even a true voluntary disclosure of a willful violation will not, of itself, guarantee immunity from prosecution, although such a disclosure will be taken into account, along with other factors and circumstances, in deciding whether or not to recommend prosecution.

The section of taxation of the American Bar Association has made every effort to persuade the Treasury Department to reestablish the pre-1952 voluntary disclosure policy. After it became apparent that such efforts would not succeed, proposed legislation on the subject was prepared by the section of taxation and approved by the house of delegates of the American Bar Association at its meeting in February of this year.

The reasons supporting a voluntary disclosure policy and legislation which would reestablish it are well stated in the following excerpts from a report of an advisory group appointed several years ago to assist a subcommittee of the Ways and Means Committee in making a study of the administration of the revenue laws (see progress report of the subcommittee dated Apr. 22, 1957, pp. 70–71):

"On balance, however, the advisory group believes that a soundly constructed voluntary disclosure policy should be a part of the Federal internal revenue structure. Income tax evasion is a unique crime, in that our system of self-assessment imposes peculiar temptations upon taxpayers, and in that this self-assessment system affects millions of taxpayers widely differentiated as to education, experience, intelligence, emotional stability, social consciousness, etc. Hence, the Service already distinguishes among various cases and gradations of income-tax crimes in determining which specific instances should be recommended for prosecution and which should not. The advisory group believes that a carefully drafted policy of voluntary disclosure would be of assistance to the enforcement authorities in making the aforesaid distinctions. We submit that voluntary disclosure prior to initiation of investigation in itself affords an adequate justification for including the taxpayer's case among those which are not to be recommended for prosecution. Such a policy could result in substantial collections of taxes, penalties, and interest from individuals who might never be caught in the enforcement net, or who, if caught, might not be successfully prosecuted because of lack of sufficient evidence.

"There is the question whether a voluntary disclosure policy would be dangerous in that taxpayers might omit returns or file fraudulent ones in anticipation of making a disclosure if and when detection of their fraud becomes imminent. There is no evidence that the Service's prior voluntary disclosure policy either did or did not increase the number of tax frauds while such policy was in force. The advisory group believes that reinstitution of the policy will not have the feared effect, provided (*a*) the policy is protected by fixed and definite standards establishing the cutoff event, occurrence of which will terminate the taxpayer's hope of making a voluntary disclosure; and (*b*) the voluntary disclosure mechanism is part of an overall policy of vigorous criminal investigations, like those now underway" (progress report of the Subcommittee on Internal Revenue Taxation to the Committee on Ways and Means, Apr. 22, 1957, pp. 70–71).

Accordingly, our association urges the Treasury Department to include in its legislative program the American Bar Association proposal to grant immunity to taxpayers who make voluntary and timely disclosures of their tax frauds.

Respectfully yours,

NORMAN H. NACHMAN, *President.*

PHOENIX MUTUAL LIFE INSURANCE CO.,
Hartford, Conn., September 10, 1963.

Senator NORRIS COTTON,
Senate Office Building,
Washington, D.C.

DEAR SENATOR COTTON: Attached is a copy of H.R. 8363 concerning interest deductions on debts incurred to purchase or continue life insurance contracts.

My company is one of the many companies which have available, policies with cash values which may be borrowed at the policyholder's discretion, for whatever purpose he desires. (This is his right, even as it is his right to borrow on any other asset he may own.

I am in complete disagreement with H.R. 8363 for the following reasons:

1. The bill discriminates against the purchaser of life insurance who has to borrow to pay premiums, as it places no restrictions on those who borrow to buy stock, mutual funds, real estate, or any other tangible item.

2. Many persons borrow to buy life insurance in all its forms, including term. Others borrow to pay future premiums or to use the money for other purposes. One-hundred and thirty-four million Americans own life insurance. Approximately 10 percent, or 13 million, have outstanding loans at all times. Why do we propose to penalize those who pay over $100 in interest to keep a policy in force?

3. Life insurance companies pay an income tax on investment income which includes the interest on loans. In 1962, outstanding loans in the United States amounted to $6.2 billion, at an average net return of 4.34 percent.

The proposed provision cannot help but reduce the outstanding loans and interest earnings. Result: lower taxes paid by the insurance companies.

4. An estimated $5 billion of insurance (out of a total of $79.4 billion) was purchased in 1962 with borrowed funds. The proposed bill will virtually eliminate this market to the detriment of the insured's family and the life insurance salesmen involved.

5. The preceding sales in 1962 provided the following approximate taxable incomes:

	Millions
Agents' estimated commissions	$75
Managerial estimated override	18
Home office estimated interest income	5

This taxable income will be severely curtailed if interest deductions are not available.

6. State taxes on premiums, $301 million in 1962, will reduce if this avenue of sale is closed.

7. Life insurance does more to protect our citizens against economic disaster than any other private media. In 1962, over $9.3 billion in benefits was paid out to policyholders, their families, and other beneficiaries. Does this make us subject to discriminatory revenue regulations?

8. One asset of life insurance is its emergency fund value. I can withdraw cash values as I need them and repay at my convenience. If I want to retain my insurance, I must pay interest. I have used such values many times and I dislike the idea of having to divulge to Internal Revenue the use to which I put such funds, before they will let me deduct such interest as an expense.

If you own life insurance on which you have made loans, I am sure you, too, must feel that such loans are nobody's business but your own and should not be subject to scrutiny.

I sincerely believe that the estimated $10 million in revenue gain will be more than offset by the tax losses incurred through the reduced incomes of the life insurance agency force.

I do hope you will see fit to give careful scrutiny to this provision and that you will vote against its inclusion in the 1963 tax recommendations.

Sincerely,

ALVIN H. POLLEY, Jr.,
Regional Vice President.

THE ESBEC CORP.,
CHEMICAL SPECIALTIES DIVISION,
Stamford, Conn., October 14, 1963.

Subject: H.R. 8363.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The objectives of H.R. 8363, covering proposed reductions of personal and corporate income taxes, are very laudable, and we are in full agreement with them. There is one area, however, where we sincerely believe a change should be made in the House version.

This has to do with the really small businesses throughout the country, whose business is expanding (which means expanding employment), but whose only source of additional working capital is retained earnings.

True, H.R. 8363 contemplates an overall reduction of 8 percent on the first $25,000 of net profits. But a saving of $2,000 doesn't go very far in the financing of expanding sales.

Furthermore, the proposed reductions seem to be far more helpful to large corporations than to small ones.

For many years, we have been hearing a lot about what the Federal Government is doing to help small business. Possibly this assistance may be really meaningful to large "small businesses" (those with 200 to 250 employees), but what about hundreds of thousands of struggling businesses with 25, 50, or even fewer employees?

Those are the ones (and we are among them) who really need some tangible help in the form of tax relief.

I suggest that it would be far more equitable if corporate income taxes were graduated as personal taxes are: with a minimum on which no tax would be due, and a graduated scale from zero to 22 percent on incomes up to $25,000.

With such a start, the business with more than $25,000 net, before taxes, could easily afford to pay the surtax.

Favorable action on this suggestion will enable tens of thousands of businesses to grow rapidly. And, as they grow, they will be able to absorb more and more of the unemployed.

I sincerely hope that you and your colleagues will act favorably on this suggestion.

Yours very truly,

MORRIS S. SHIPLEY, *President.*

HARRIS INTERTYPE CORP.,
Cleveland, Ohio, October 14, 1963.

CHAIRMAN AND MEMBERS OF COMMITTEE ON FINANCE,
U.S. Senate, Washington, D.C.

GENTLEMEN: It is our understanding that section 214, revenue bill of 1964 (H.R. 8363), as recently passed by the House of Representatives, would, if enacted in this form, radically change the treatment heretofore accorded employees' stock options and that it is proposed that such changes be made retroactive to options granted after June 11, 1963.

In this connection, we strongly urge that any changes in the treatment of stock options not be made retroactive since we believe that such action would cause undue complications and serious inequities. In support of this belief, we wish to call your attention to the following situation which prevails at our company and which no doubt is generally typical as to many other companies.

Our company has in effect a stock option plan which was adopted by shareholders in 1959. The plan provides that options may be exercised over a 10-year period and that the option price shall be not less than 95 percent of the fair market value at time of grant. The plan also contains other provisions which assure that options granted under the plan qualify as restricted stock options under present section 421 of the Internal Revenue Code.

From time to time, options have been granted pursuant to this plan, including four options granted subsequent to June 11, 1963. Two of these four options were granted to new employees as a condition of employment. These options were granted in good faith, pursuant to a plan approved by shareholders, and at the time of grant they qualified as restricted stock options under the Internal

Revenue Code. The revenue bill of 1963 would retroactively disqualify these options as restricted stock options. In addition, the proposed legislation does not contain any provision permitting without adverse consequences the amendment or modification of options granted after June 11, 1963, in order to qualify them under the new requirements. Thus, if the revenue bill of 1963 is enacted in the form passed by the House of Representatives, these options granted by our company would be neither "restricted stock options" nor "qualified stock options" under the new requirements and, for practical purposes, there would be nothing that we could do to remedy the situation. This would mean that the employee option holders would have ordinary income in the year the option is exercised equal to the spread between the fair market value of the stock and the option price therefor at the date of exercise. Correspondingly, our company would have an income tax deduction for that same year in that same amount.

When our company's plan was approved by the shareholders and when the options were granted, it was intended that our company obtain no income tax deduction with respect to the options but, by the same token, that the employee option holder not have taxable income upon their exercise. Application of the new requirements retroactively would frustrate this intention, and would place our company in the position of virtually defaulting on its agreement with employees who received options subsequent to June 11, 1963. This would create a serious company-employee relations problem.

We therefore respectfully request your consideration of the complexities and inequities which would result from retroactive changes in stock options already granted, as proposed in the revenue bill of 1963.

Very truly yours,

F. C. SZUTER, *Secretary.*

WALLA WALLA, WASH., *October 3, 1963.*

Senator WARREN G. MAGNUSON,
Senate Office Building,
Washington, D.C.

DEAR SENATOR MAGNUSON: In view of our substantial work in the pension trust and insurance financing field, we have made a study of certain provisions of the new tax bill which was passed recently by the House of Representatives.

As you are no doubt aware certain sections of this limit drastically the use of financed premium payment insurance programs, except perhaps where certain deductions may be taken as business expenses. Since this would seem to seriously limit the use of ordinary life programs (as compared to temporary term insurance), the various associates which we have in these fields have asked us to correspond with you and the Senate Finance Committee in opposition to these sections and to determine what might be possible in having them stricken from the final bill.

From your study of these matters I am sure that you are aware that this basically amounts to discrimination against life insurance as collateral, and the point whether it is after several years of premium payments or as an initial matter seems to be relatively immaterial. It will have the further direct effect of emphasizing temporary term insurance which is certainly inflationary in nature by discouraging the use of cash value life insurance as a media for long-term thrift. Furthermore, even on personal income tax returns and calculations, the ordinary citizen (even as compared to business people and business deductions generally) are entitled to deduct interest paid on a multitude of different types of obligations. An interest deduction on life insurance loans would under the present provisions referred to be discriminated against in a marked fashion.

I would very greatly appreciate when you have an opportunity from your busy schedule to have an additional copy of this bill as I have loaned mine out for other parties to use and also your comments as to what efforts we might put forth in opposition to the particular provisions mentioned. If you desire additional statements more in the nature of a legal brief on this matter, I would be happy to submit something if it will be in sufficient time to be of affect with the Senate Finance Committee.

Very truly yours,

PAUL R. ROESCH, *Attorney at Law.*

DREXEL HILL, PA., *October 14, 1963.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: Permit me, if I may, to file with your committee the following objections as a taxpayer to H.R. 8363 "A bill to amend the Internal Revenue Code of 1954." My objections refer to the following provisions of the bill:

DIVIDEND CREDIT AND EXCLUSION

The bill would deny, after the passage of time, the present 4-percent dividend credit against the taxpayer's Federal income tax liability. It would also modify the amount of tax-exempt dividends. I am sure, my dear Senator, you appreciate that there are many thousands of people in this country whose income consists of dividends from securities and whatever they may realize under the old-age benefits tax.

These people need help and one way that they received it was through the route of the dividend credit. Now they are going to be deprived of that credit, hence increasing their tax liability, and I don't think it is proper that this credit should be taken away from them. After all, the Congress of the United States installed this credit several years ago to try to eliminate what was referred to as double taxation—one tax on the earnings of the corporation that paid the dividend and a second tax on the dividend recipient. I am sure there must be other ways of providing for additional revenue that this denial would produce without depriving many thousands of people of money to maintain them and to provide them with the necessities of life.

DENIAL OF DEDUCTION FOR CERTAIN STATE, LOCAL, AND FOREIGN TAXES

This section of the bill denies to a taxpayer the right to deduct the following:

State gasoline taxes.
State alcoholic beverage taxes.
Taxes imposed upon tobacco.
Autos and drivers' licenses.
Admissions taxes.

I don't think it is proper that the Congress of the United States should deny a deduction for State gasoline taxes. After all, an automobile is no luxury, it is an absolute necessity today, and any tax that is imposed upon us, and they amount to a great deal at the State level, should be allowed for Federal income tax purposes. The companion to this tax is the license plates for the automobile and the drivers' licenses. I would set forth the same reasoning to cover these two taxes that I have already expressed regarding gasoline taxes.

I am not too concerned about the alcoholic beverage tax or the tobacco tax; if it is the wisdom of Congress to take those from us I will go along. As far as the admissions tax is concerned, it doesn't amount to a row of pins anyway.

I sincerely trust that the Senate Finance Committee, under your guidance, will restore these credits and deductions for taxes that I have mentioned in this letter. I am sure that all of us want to assume our fair burden of taxation but I don't think the individuals who are in the lower brackets, or for that matter any other bracket, should be denied these deductions. Goodness knows, we don't get that much in the way of deductions that the revenue of the United States is going to be seriously harmed.

As far as bill H.R. 8363 is concerned, my feelings are there shouldn't be any tax bill unless there is a decided cut in Federal expenditures equal to the loss in revenue from this tax bill. After all, the time is long past when there should be a genuine effort to cut Government expenditures.

Sincerely,

JOHN MCFARLAND.

CATERPILLAR TRACTOR CO.,
Peoria, Ill., October 9, 1963.

Hon. HARRY FLOOD BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: One of the major hazards to maintenance of a good business climate is uncertainty. Whether it need be such a hazard is debatable, but there apparently are many who feel that in the absence of a reasonable degree of certainly they should not act. And this seems to be largely true, even when the matter in doubt is one of possible benefit with nothing more to fear than a continuance of the status quo.

That, I believe, is the position into which we are moving on the matter of tax reduction—now, later, or never. I would, accordingly, respectfully urge the members of the Senate Finance Committee, on their part, to have the matter resolved at the earliest time possible. If there is to be a tax reduction, the desired stimulant might then be given impetus in time to be effective before it is too late (for the short-term purpose). If there is to be no tax reduction, then the sooner business and personal planning is adjusted to that disappointment the sooner we will find a climate which has at least the numbing stability of a permanent handicap to investment enterprise.

Whether there is to be tax reduction or not, governmental expenditures should, of course, be kept to a minimum—and I appreciate that the members of the Finance Committee are even more responsible than others on that score. But if there is to be no tax reduction, then some other means will have to be found to encourage that kind of investment which will produce more tax revenues at lower rates, more domestic jobs, and more exports. I, myself, have been unable to find any such other means—and this has led me to favor tax reduction as quickly as possible. If you should find yourself in such an unfortunate predicament, I hope that you, too, will favor the only kind of action which seems to be available at this time, viz., tax reduction. Inaction will cure nothing and achieve nothing. Time alone cannot possibly be a satisfactory answer to the problems which lie ahead of us.

In the ordinary course, I happen to be one who would be happier in a state of affairs where governmental action was seldom necessary. In the present instance, however, I feel that the matter is largely one of facing up to a situation which is becoming increasingly dangerous. Taxes have reached levels where they inhibit risk taking, job creating, wealth producing investment, and the only course of action which seems constructively possible now is surely one which recognizes the error of our ways—and corrects it.

That, I believe, is the essence of the democratic process. It was never held that a majority would necessarily be right—but only that, after a while, a majority would probably have the wisdom to recognize wrong—and then act accordingly. That time, I believe, is here now.

Yours respectively,

W. Blackie, *President.*

D. A. Sargent & Co.,
Oakland, Calif, October 14, 1963

Re proposed Revenue Act of 1963, inherited property.

Senate Finance Committee,
Washington, D.C.

Gentlemen: As certified public accountants representing many small business firms over the past 40 years, we have seen the heirs experience enough difficulty to keep the business afloat paying the inheritance taxes, Federal and State, without having to pay a capital gains tax. Any provisions which would tax unrealized income would cause a much further drift of small businesses being forced to merge with larger concerns. The trend is fast enough without an impetus of this nature.

As we see it, there is no justification for increasing the value of the surviving spouse's interest either through the marital deduction devices or as a result of community property holdings. Such increment unjustifiably escapes capital gains tax as well as escaping estate taxes.

What happened is that quite a few years ago resident of noncommunity property States desired the community property benefits of split income, etc., without the penalties inherent in the community property system.

For your information the California State Legislature recently adopted a provision whereby the surviving spouse's share of community property does not get a stepped-up basis but retains its original cost. This same plan should produce substantial revenues and would be more equitable than the provisions which have been advanced by the Treasury Department.

Sincerely yours,

D. A. Sargent,
Certified Public Accountant.

HOWELL & SECREST,
Indianapolis, Ind., October 8, 1963.

Hon. HARRY F. BRYD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: It appears that it is now the Senate's turn to review the $11.5 billion tax cut which the House has adopted.

For a number of years I have been interested in Federal income taxes and when this new bill was introduced I wrote to Senator Hartke concerning an aspect of tax collection procedure which I feel should be made a part of this piece of legislation. I am enclosing a copy of my letter to Senator Hartke, a reply from Under Secretary of State Surrey and a reply to this letter.

I would appreciate your committee giving consideration to the insertion of an amendment which would permit taxpayers to recover their legal fees when they are successful in their efforts in connection with a tax matter. I can cite you an example wherein just recently the Government asserted a deficiency of approximately $75,000 against the taxpayer on a matter concerning constructive dividends. There were several circuit court cases supporting the taxpayer, yet this particular taxpayer was forced to defend his position in the tax court. After trying the lawsuit the tax court sustained the taxpayer's position, yet the taxpayer must pay legal fees for services rendered over a period of 4 years. In my humble opinion the lawyers should not suffer because the Government takes the position that cannot be sustained in court, and it hardly semse fair that the taxpayer should have to spend huge sums of money in order to defend a position which has already been litigated.

I am sure that many taxpayers pay taxes that are not legal because it is cheaper to pay the tax than it is to litigate the matter.

I wish to express my sincere appreciation for any consideration you might feel is warranted in this connection.

Very truly yours,

LESLIE E. HOWELL.

APRIL 10, 1963.

Hon. VANCE HARTKE,
Senate Office Building,
Washington, D.C.

DEAR VANCE: You have very successfully in the past "championed" the rights of the great mass of the people. Having embarked on this course as a means of helping people, I wonder if you have ever given consideration to the possibility of helping a great many taxpayers. I am sure, if you were able to help them, nothing would endear them to you more than giving them some help in their controversies with the Internal Revenue Service.

We currently have pending in the Congress a rather substantial tax program and, as a part of that program, you might want to consider a possible provision, which would help a great number of taxpayers. You are no doubt well aware of the fact that the tax caseload has increased enormously in the last 10 years and the probabilities are, with more contemplated tax laws, there will continue to be greater caseloads. Everywhere taxpayers are forced to defend their rights and, in a good many cases, at the expense of the Government establishing a principal. These taxpayers are spending thousands of dollars which they otherwise would not be required to spend. While I am not criticizing the Government in the administration of the Internal Revenue Code, I am of the opinion that the "learning" process which the Government is forced to go through in order to establish standards for enforcement of the tax laws is at the expense of the taxpayers. This really constitutes a double expense because the taxpayer must not only pay for his own costs in connection with processing or defending litigation, he must also pay the salaries of the Internal Revenue Agents and increased personnel which is being required because of the greater caseload. Now this seems like an undue burden to place upon a taxpayer who is willing to pay his taxes, but who doesn't want to be "put upon," and who is required to follow the statutes as written by Congress.

We have one other factor which needs to be considered, and it is: As the number of people in the Internal Revenue Service grows, we are bound to get some agents who either are not competent and cause the taxpayer to incur unnecessary expense, or, in an organization the size of the Internal Revenue Service, there are bound to be unscrupulous agents, just as there are unscrupulous attorneys and doctors and businessmen, who will cause the taxpayers to incur expenses. As you well know, Vance, the cost of "justice" is expensive.

I am, therefore, suggesting that, if you were to "champion" a provision in the current tax reform law to the effect, that the taxpayer would be reimbursed for costs in any tax litigation which he was forced to litigate and which he is successful you would make a tremendous number of friends.

As a U.S. Senator you are no different than other businessmen. You need research and ideas to carry on your activities, and I hope this little idea can grow to give you some stature and weight.

I remember very well, one time when I saw you at a banquet you shook hands with me and said: "Well, Les, as usual you are too late with too little." I hope I can make more of a contribution in the next go-around.

I would be interested in your reaction to this proposal.

I was, of course, pleased to note that your daughter who is now attending Indiana University was chosen to represent the university and was able to make a trip to Washington.

With kind personal regards, I am,

Sincerely yours,

LESLIE E. HOWELL.

TREASURY DEPARTMENT,
Washington, D.C., July 1, 1963.

Hon. VANCE HARTKE,
U.S. Senator,
Washington, D.C.

DEAR SENATOR HARTKE: This is in reply to your letter of May 10, 1963, regarding a legislative proposal recommended by Mr. Leslie E. Howell, Indianapolis, Ind., which would permit a taxpayer to be reimbursed for costs in any tax matter which he is forced to litigate and with respect to which he is successful.

Mr. Howell did not specify what "costs" he had in mind. However, if he is referring to court costs in litigation against the United States in a U.S. district court or in the Court of Claims, this matter is already covered by 28 U.S.C., section 2412(b), which provides:

"In an action under subsection (a) of section 1346 or section 1491 of this title, if the United States puts in issue plaintiff's right to recover, the district court or Court of Claims may allow costs to the prevailing party from the time of joining such issue. Such costs shall include only those actually incurred for witnesses and fees paid to the clerk."

Under this statutory provision, such items as fees for filing notices of appeal and certifying transcripts, court reporter fees, and amounts paid for printing, photostatic copies of papers, and appeal bonds have been assessed against the Government.

With respect to the Tax Court of the United States, there is no statutory provision for recovery of court costs by a prevailing taxpayer. Therefore, the Tax Court has no authority to award such costs. However, the actual court costs to a taxpayer in a Tax Court proceeding are normally quite modest, unless the taxpayer incurs substantial fees with respect to his own witnesses. The filing fee, for instance, is only $10.

If Mr. Howell is referring to costs other than those paid into court with respect to the litigation, such as attorney fees, there is, of course, no provision under existing law for compensating a taxpayer for these amounts, even if the taxpayer ultimately prevails in his position. As you may know, it has been the traditional rule in American jurisprudence that each party to a suit retains and pays his own counsel, regardless of the outcome of the action. There are certain very narrowly defined exceptions to this general rule, usually provided by State statutes. Some of the State statutes authorizing payment of the winning party's attorney fees as costs have been held unconstitutional as denying the losing party due process of law. Those which have been held constitutional are usually restricted to those cases where the losing party has been stubbornly litigious or motivated by bad faith.

When the Internal Revenue Service challenges a taxpayer's return or claim for refund, the Service's position is based upon its interpretation of the applicable law, arrived at by reference to the statutes, regulations, and rulings. The National Office of the Service maintains close contact with the various field offices in order to insure uniformity in the application of the law. Furthermore, the reports of the revenue agents who examine taxpayers' returns are subject to careful review through administrative channels. Before the Service litigates a matter in the Tax Court, its position is subject to further review by the Office of the Chief Counsel and the Regional Counsel, where the taxpayer resides. In refund suits before the U.S. district courts or the Court of Claims, or in appellate cases, the Department of Justice becomes chiefly responsible, with assistance from the Office of the Chief Counsel.

Even with this careful review of the Service's position in litigation, there are, of course, cases in which the taxpayer prevails. In some instances, the Service's position on a particular issue will be upheld in one forum and not in another. Even where a negative result can be predicted in a particular forum, the Government is sometimes forced to litigate its position to insure uniformity in the administration of the revenue laws. The Government does not litigate in bad faith, nor can its positions be characterized by being stubbornly litigious. Thus, if the Government were to be required by law to pay a taxpayer's attorneys, the Government would be subject to a harsher rule than private litigants.

It should also be pointed out that a taxpayer may deduct the costs of his attorney's fees which are incurred in tax litigation from his gross income for Federal income tax purposes, thus giving him substantial relief whether he wins or loses. To be entitled to this deduction for attorney's fees, it is not necessary that the controversy proceed to litigation.

Furthermore, if Mr. Howell's suggestion were carried to its logical conclusion, it would provide that in those cases in which the Government prevails, the Government should be entitled to recover its costs of preparing the case for trial. If this extension were not adopted, the Government would be required to pay two legal fees in the cases in which it loses, whereas, if it prevailed, it would still be required to pay its own litigating costs. Since such a result would be inequitable, it would be necessary to incorporate into the proposal which Mr. Howell suggests, a provision which would enable the Government to recover its litigating costs in actions in which it prevailed. However, imposing the danger of being forced to pay additional legal fees if he did not prevail would act as a deterrent to small taxpayers bringing suits to determine whether the Government's assessment of tax liability was proper. It is felt that such a threat would be an unreasonable deterrent to the bringing of tax actions.

It is hoped that the foregoing will provide you with the necessary information to reply to Mr. Howell's inquiry. If not, please do not hesitate to call upon us for further information.

Sincerely yours,

STANLEY S. SURREY, *Assistant Secretary.*

JULY 25, 1963.

Hon. VANCE HARTKE,
U.S. Senate, Washington, D.C.

DEAR VANCE: I appreciate your sending me the copy of the letter which you received from Stanley S. Surrey, Assistant Secretary, U.S. Treasury Department.

Mr. Surrey, in the last paragraph on page 1, attempts to compare rules prevailing in litigation where two parties are involved as against the situation where the taxpayer is proceeding against the Government to get money back which has been erroneously paid. Such a comparison in my opinion is not proper since the taxpayer pays the Government anyway. Mr. Surrey, on page 2 in the second paragraph, shows that the Government sometimes litigates its position and forces the taxpayer, who happens to live in a favorable tax climate, to spend money in order to protect his rights.

It's this very type of forced litigation that in my opinion is wrong from the small taxpayer's standpoint, and, further, I know of several taxpayers, and I am sure there are thousands of taxpayers, who pay tax bills knowing full well they are being assessed illegally but who cannot afford to litigate the question because of the legal fees involved. The statistics, which could be gleaned from an investigation would show the amount of money the Government collects in this manner, in my opinion, would be astounding. Mr. Surrey, on page 2 of his letter, states many procedural safeguards which "theoretically" should protect the taxpayer, but again I can tell you, Vance, in practice it doesn't work this way.

Mr. Surrey further points out that if my suggestion were carried to its logical conclusion, the Government should be reimbursed for the costs it pays in preparing for trial.

First of all, Vance, the taxpayer is paying the bill anyway, and it is the position of the Government lawyers that they do not care whether suit is filed or not. Their salaries go on, as do the other expenses. Secondly, the U.S. Supreme Court has held the 50 percent fraud penalty in a way of reimbursing the Government for its cost of investigation and litigating cases. So we do have a provision where the Government is reimbursed for its cost of investigating and litigating tax suits, but the "poor taxpayer" is not.

Mr. Surrey states that having to pay additional legal fees, if he did not prevail, would act as a deterrent to small taxpayers bringing suits. I would certainly agree with this conclusion. I am sure, if Mr. Surrey were to investigate this situation, small taxpayers do not now bring many tax suits where they have legitimate tax claims because they cannot afford to pay their own lawyers and accountants legal fees even though they are right.

I appreciate being heard in this matter, Vance. This has been a problem that I feel in my long practice of tax law has been a real problem. Today the doctors get paid by way of hospitalization and other medical insurance. We know that death and taxes go together, so I suppose taxes are just as bad as illness. It hasn't always been the situation that taxes affected so many people at such a prohibitive cost.

Very truly yours,

LESLIE E. HOWELL.

BIRMINGHAM, MICH., *October 11, 1963.*

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: This is to urge your careful consideration of the tax bill, H.R. 8363, that is now before the Senate Finance Committee. Aside from the fact that taxes are extremely high, does not overshadow the importance of "how" taxes are to be reduced. I feel that a thorough analysis of some of the provisions contained in H.R. 8363 is in order that would result in the actual realization of the goal we are all working toward—an expanded economy. This, in my opinion, can only come about if the Senate takes the opportunity to make the improvements required in the bill as it now stands.

Being in the manufacturing industry, it is hoped that this time the Senate will not change the investment credit allowance provision, as this is most important toward the purchase of new machinery that we must have to keep up to date and confident in the ever-increasing competition of world markets. The amendment added to this section in 1962 was, from firsthand experience, not good for the economy, the place I work, or for me.

Isn't this bill, H.R. 8363, while reducing everyone's taxes, at the same time actually increasing the proportionate share of the overall tax burden on the middle income group? This, to me, seems grossly unfair in that the tax load borne by this group is already way out of proportion and should not be increased.

Another portion of this bill that I oppose, because of its discriminatory shading, is the idea of taxing employer premium payments on group term life insurance over $30,000. I can see not intelligent justification of such taxation. The table of age brackets as set up by the law will only make it increasingly difficult on a person as he gets older. In addition, the small amount of money to be gained by the Government could never offset the cost and time required of a company to keep its records while withholding the amounts involved.

I further oppose that section of H.R. 8363 that would eliminate the 4-percent dividend credit allowance. I'm sure this would tend to discourage investment—to reach the goals of an expanded economy, investment should be encouraged.

The reduction of business taxes is, without a doubt, something that has been needed for quite some time—thus allowing extra capital for expansion, investment, etc. But the phase of this bill that deals with the acceleration of corporate tax payments has a tendency to defeat the very purpose of its intent.

Available cash from a tax reduction, if it were used for an expansion program, could not be considered an advantage if at the same time a company's tax payments are to be paid off in a shorter period of time, thereby increasing the amounts due.

To conclude—realizing, as you must, the importance of this tax reduction legislation and its passage through the Senate, I urge you to support H.R. 8363, but consider the necessary alterations to make this a fair and workable bill.

Sincerely,

D. W. LYSETT.

KNOXVILLE, TENN., *October 15, 1963.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Old Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: For a number of years I, along with many other Rohm & Haas employees, have participated in a noncontributory pension plan with the company paying the entire cost of the plan. Along with this pension plan the company provides a group term life insurance policy. Here again the premium on this policy is paid by the company.

I am writing to you to register my strenuous opposition to the President's proposal that individual employees be taxed on the amount of any permium which will provide death benefits in excess of $5,000 under the group term life insurance and to what we understand to be the committee's tentative decision to tax the amount of premium providing death benefits in excess of $30,000. I am the father of eight children and very frankly with the taxes that I have to pay to the State, the Federal Government, the county, and the city, the burden is extremely oppressive.

The experts tell me that the amount of revenue the Government would derive from such taxation would be negligible compared to the cost of administering such a program and compared to the injury that such a program would do to those who can least afford it. I realize the Government needs money to operate and realize fully my obligation as a citizen. With the billions that seem to be endlessly expended for various projects, however, I earnestly urge that you, as our representative, point out to some of the spenders in Government that there is a time "when the well runs dry" and that regardless of all the Federal money that is so loftily dispensed, the average man is beginning to realize that there is no such thing as "a free lunch" and that this money is coming out of his pocket.

I have been a supporter of yours for a number of years. I have approved and enjoyed your resistance to some of the irresponsible schemes that our so-called liberal politicians promote. I would deeply appreciate it if you would look closely into this matter and while I know you are but one in a large body, someone has to start our Government back on the road to fiscal sanity.

I hope you will earnestly consider this letter and use your not inconsiderable influence to bring about the defeat of such a measure.

Very truly yours,

S. J. MACDONALD.

OSBORN & OSBORN,
Jonesboro, Ark., October 15, 1963.

Re revenue bill 1963.

Hon. HARRY BYRD,
Chairman, Senate Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Although I doubt that you have the time to study this letter, or that it will accomplish much, I feel professionally obligated and duty-bound for sake of country to direct it to you.

As a professional I was much concerned with the Revenue Act of 1962, and further frustrated by the proposed Revenue Act of 1963. The administration has left the world of realities—the ever-increasing addition of complex burdensome law will ultimately destroy the law itself.

The current position of the courts and Internal Revenue Service on matters dealing with the taxpayer, and good accounting principles, frighten me.

I wish to take pointed opposition to proposed code section 1561—"penalty tax for multiple corporations." The committee reports recognize the present sections 269, 1551, 482 which are potent, remedial, and now in force. They would not delete these sections, but add another, which is abundant in complexities.

Proposed section 1561 raises a false premise that tax avoidance is the principal motivation for all situations where an individual owns more than one small corporation. It is not a provision that will affect large- or medium-sized businesses, it will effect what we recognize as small business.

You do not have time to consider all the objections which could be fielded against section 1561, they are numerous.

I would suggest that the administration be compelled to prove their case that this will eliminate a pending tax bonanza for large- and medium-sized business. IRS records will prove that the revenue recovery will come from what are properly identified as small business.

I submit, sir, that this proposed section be deleted (and that the whole proposed act be considered for rejection on the same grounds) because:

(*a*) Abuses represented for correction are amply covered by present law.

(*b*) This section is one more extremely complex law, where will it stop?

(*c*) This is presumptive law, which overcomes the burden of reasoning required by present law (secs. 269, 482, 1551).

Respectfully,

JAMES G. OSBORN.

ATLANTA, GA., *October 17, 1963.*

Re section 213, proposed tax revision bill.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: It is a tribute to the salesmanship of the American life insurance agents that they have been able to convince the public and the U.S. Government of two great fallacies, i.e.:

(1) A person who borrows money to buy life insurance pays less for his protection than the person who does not borrow.

(2) Life insurance is tax free.

Fallacy No. 1: Statements emanating from Government sources say that a person who borrows to buy life insurance "pays nothing but interest." However, the lending institution does not give the premium money to the borrower. It lends it and it must be repaid in addition to the payment of interest. It must be paid from the borrower's bank account, his policy values, or the proceeds at death.

Regardless of which pocket the repayment comes from, he pays premiums plus interest while the nonborrower pays premiums only. It may be a more convenient mode of payment as it is usually more convenient to finance the purchase of a home than to pay cash in full, but he does pay more.

This proposed bill strangely assumes that it is quite all right if such indebtedness is incurred in connection with the borrower's trade or business but if he borrows to provide protection for his wife and children, he is penalized. What sort of thinking is that?

Fallacy No. 2: There has been much talk about the "inside tax-free buildup" in life insurance contracts, referring to the interest accumulations credited to the policy cash values. The tax court has held that there is no constructive receipt of the interest on policy reserves since the policy owner would have to surrender the policy in order to get it, thereby giving up a valuable right. (Cohen, 39 TC No. 108.) Furthermore, for many, many years he could not surrender and realize any profit on his "investment." If he does, it is subject to tax as ordinary income.

Insurance proceeds at death are subject to the usual estate taxes.

The Institute of Life Insurance is quoted in the 1962 Life Insurance Fact Book that the total taxes paid by life insurance companies in 1961 amounted to $1,026 million, of which $609 million went to the Federal Government. If life insurance is tax exempt, then for that year alone the Federal Government collected $609 million to which it was not entitled.

President Kennedy has expressed a desire for expansion of the economy but a law which would disallow deduction of interest on life insurance loans would impede and otherwise interfere with the flow of commerce. Although future widows and orphans are the real victims, there are compelling economic reasons why no such action should be taken.

(*a*) It would result in fewer and smaller purchases of family protection thereby impairing the economic situation of future bereaved families.

(*b*) Lending institutions would lose interest income and would pay less taxes to the Government.

(c) Insurance salesmen and companies would lose business and would likewise pay less in taxes.

(d) Smaller sales of life insurance would cause a reduction in estates and hence reduce estate tax income to the Government.

(e) The many ramifications of this bill would require an increase in tax personnel to adjudicate the many claims that would be made under the exceptions of the law.

The total loss in Government revenue might well exceed the hoped-for tax increase. The tax structure should be geared to encourage, rather than obstruct, the economic growth if the broad picture is to be an expansion of trade.

Sincerely,

MRS. NOLA E. PATTERSON, C.L.U.

UNITED STATES GYPSUM CO.,
Chicago, Ill., October 16, 1963.

Re amendment No. 206 to H.R. 8363.

Hon. HARRY FLOOD BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Amendment No. 206 to H.R. 8363 cannot be justified and should be rejected by your committee.

This amendment concerns the current taxation of profits earned by controlled foreign corporations. Your committee considered this subject at great length only last year, and Mr. Norman A. Lang, our assistant secretary, appeared to present our views. The result of your consideration was what is popularly known as subpart F of the Internal Revenue Code. Your committee's report on the 1962 Revenue Act states that subpart F is "designed to end tax deferral on 'tax haven' operations by U.S. controlled corporations." This it certainly does, and we do not quarrel with the policy behind the provisions.

Amendment No. 206 to H.R. 8363, however, goes far beyond elimination of tax haven operations. It attacks all U.S. controlled foreign corporations, including bona fide operating companies. Your committee pointedly rejected this approach in 1962 after receiving approximately 4,400 pages of testimony and written statements. There is no reason whatsoever for resurrecting this subject again this year. Your committee's reasons for limiting subpart F to true tax-haven operations are just as valid now as they were in 1962. Penalizing bona fide foreign operations could not be justified then and it cannot be justified at the present time.

We strongly urge your committee to eliminate amendment No. 206. We also request that this protest be included in your committee's printed hearings on H.R. 8363.

Respectfully submitted.

C. H. SHAVER,
Chairman of the Board.

U.S. SENATE,
Washington, D.C., October 18, 1963.

Hon. HARRY F. BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR: My attention has been called to a situation wherein seven individuals, by reason of faulty advice on a technical provision of the income tax law, are being charged with a double tax in 1 year on approximately $610,000 of taxable income, which income represents a long-term capital gain. Their total tax on the $610,000, as proposed, amounts to about $612,000.

A subchapter S electing small business corporation sold substantially all of its property (including several parcels of real estate) for $1 million and at a long-term capital gain of about $610,000. Half the purchase price was paid upon execution of the contract and the balance was payable upon final closing. Shortly before the end of the corporation's taxable year (November 30), the board, relying in good faith on professional advice, declared a dividend of the remaining balance of the sales contract of $500,000. Final closing took place early in December and the remainder of the sale proceeds of $500,000 was immediately paid over pro rata among the shareholders. There had been no change in the shareholders nor in their stock interests during the interim.

The individuals were taxed, and properly so, on the $610,000 long-term capital gain. They are also being charged with having received an ordinary dividend of $500,000. Thus, the double tax with respect to the same transaction (i.e. sale of the property).

I am enclosing a draft of a proposed amendment and an explanation thereof. I have been informed that the amendment would not result in the individuals escaping any tax whatsoever on the company's taxable income for its taxable year. Rather, it would merely preclude the double tax feature. I understand that Mr. Colin F. Stam is familiar with the matter.

In my judgment, it is most unfair to tax the individuals twice on a single transaction especially when the second tax arises from inadvertence. Needless to state, a tax should never exceed the amount of profit realized. Subchapter S introduced an entirely new concept to the income tax law. As you know, the subchapter has been amended retroactively on at least three occasions. The proposed amendment must be made effective to taxable years beginning after December 31, 1957, the effective date of subchapter S, to be of any benefit.

I respectfully suggest that an amendment along the lines of the enclosed draft should be seriously considered for addition to the tax bill now pending before your committee. Your careful attention and consideration of this suggestion is sincerely solicited.

Sincerely yours,

FRANK J. LAUSCHE.

EXPLANATION OF PROPOSED ADDITION OF SUBSECTION (e) TO SECTION 1373

ESBC, an electing small business corporation, reported on a fiscal year ending November 30. All its shareholders were on the calendar year. On March 15, 1959, ESBC sold a substantial portion of its assets (including several parcels of real estate) to a financially responsible concern for $100,000. Half of the purchase price was paid in cash upon execution of the sales contract and the balance was payable upon final closing (i.e., after title examinations, etc.). The sale resulted in a net gain of $60,000. ESBC's income from operations (net of expenses) for the year amounted to $10,000. Thus, its "taxable income" for the year was $70,000. During November 1959 the board declared a cash dividend of $15,000, which was paid promptly and, in the same resolution, the board also declared a dividend of the remaining balance ($50,000) of the sale contract. This was done because it then appeared that the sale transaction would not be finally closed until early December.

The final closing took place on December 16, 1959. The purchaser paid the balance on December 16 which amount was distributed, immediately, among the shareholders. There had been no change in the shareholders, nor in their respective stock interests between the date of the dividend resolution and December 16.

Subchapter S of the Internal Revenue Code (sec. 1371 et seq.) is designed to tax the ESBC's "taxable income" *directly* to the shareholders, on a pro rata basis, and *not* at the corporate level. This is accomplished under section 1373. The amount of "*money* distributed as dividends during the [corporation's] taxable year" [emphasis supplied] is subtracted from its "taxable income." The "money" so distributed is *taxed* to the shareholders. The remainder is taxed to the shareholders as though such amount had been distributed to them on the last day of the corporation's taxable year (November 30). Thus:

ESBC's "taxable income"	$70,000
"Money" distributed and taxed to shareholders as dividends	−15,000
Taxed to shareholders on an "as if distributed" basis	55,000

It will be noted that only distributions of "money" made during the corporation's taxable year are subtracted from "taxable income" to arrive at the amount of "taxable income" which is to be taxed to the shareholders on an "as if distributed" basis. Thus, distributions in property (e.g., land) made during the ESBC's taxable year are not subtracted for such purpose.

It is questionable whether the remaining balance of the sale contract constitutes "money." If it does not then, under certain circumstances, the shareholders can be taxed with respect to such remaining balance ($50,000) as an ordinary dividend notwithstanding the fact that they are taxed (and rightfully so) on the entire amount of ESBC's "taxable income" ($70,000). The $70,000 of "taxable income" includes the $50,000 gain from the sale. Thus, the $50,000 profit from one transaction would be taxed twice to the shareholders: Once as a capital gain [1] and again as an ordinary dividend.

Subsection (e), as proposed, would afford ESBC an election to treat the December 16 distribution of the proceeds from the March 15 sale as having been made during its taxable year ended November 30. Hence, the entire amount of the ESBC's "taxable income" for its year ($70,000) would be taxed to the shareholders thus:

ESBC's "taxable income"	$70,000
"Money" distributed and taxed to shareholders as dividends	—[1](65,000)
Taxed to shareholders on an "as if distributed" basis	5,000

[1] $15,000, distributed in November, plus $50,000, balance of sale proceeds distributed on Dec. 16.

Obviously, the shareholders would not escape any tax with respect to ESBC's "taxable income" for its taxable year. Under proposed subsection (e), the amount of the postyearend money distribution plus the amount of the money actually distributed as dividends during the taxable year cannot exceed the ESCB's earnings and profits for the taxable year, as specified in section 316(a) of the code.

Subchapter S, which permits the taxation of a corporation's taxable income directly to the shareholders, introduced a novel concept to the law of Federal income taxation. It was enacted by the Technical Amendments Act of 1958, Public Law 85–866, September 2, 1958. Since then, subchapter S, has been amended retroactively in three instances: Subsection (c) of section 1371 by section 23(a) of the Revenue Act of 1962; subsection (b) of section 1374 by section 30 of the Revenue Act of 1962; and subsection (g) of section 1372 by section 2 of Public Law 87–29, May 4, 1961. The Internal Revenue Code, in several instances, affords an election with respect to postyearend transactions. The Supreme Court in *Fawcus Machine Co.* v. *United States* (1931) 282 U.S. 375 held that the "curtain" is not necessarily "pulled down" at the end of a taxable year.

"SEC. 2. ELECTION CONCERNING POST YEAR-END MONEY DISTRIBUTIONS. (a) ELECTION CONCERNING POST YEAR-END MONEY DISTRIBUTIONS.—Section 1373 (relating to corporation undistributed taxable income taxed to shareholders) is amended by adding at the end thereof the following new subsection:

"'(e) ELECTION CONCERNING POST YEAR-END MONEY DISTRIBUTIONS.—If an electing small business corporation distributes money to its shareholders during the next calendar month following the end of its taxable year (hereinafter in this subsection referred to as the "preceding taxable year") and if—

"'(1) on the day of such distribution, each of its shareholders owned the same pro rata share of the stock of such corporation as he owned on the last day of the preceding taxable year, and

"'(2) the money distributed represents proceeds attributable to a sale or sales of property made by such corporation during the preceding taxable year with respect to which a net gain was realized,

then such corporation may elect to treat such distributions as having been money distributed as dividends during the preceding taxable year, but only to the extent that such distributions, plus the amount of money distributed as dividends uring the preceding taxable year, are a distribution out of earnings and profits of such taxable year as specified in section 316(a)(2). Except as provided in the next sentence, the election may be made only at the time of the filing of the return for the preceding taxable year. The election may be made within 120 days following the enactment of this Act, if a return for the taxable year with respect to which the election is made, was filed on or before the date of such enactment, or filed within 90 days thereafter. Such election shall be made in such manner as the Secretary or his delegate shall prescribe by regulations.'"

"(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1957."

[1] Long-term capital gain characteristics at the corporate level carry over to the shareholders. Sec. 1375.

DETROIT STEEL CORP.,
Detroit, Mich., October 17, 1963.

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SIR: In my capacity as secretary of Detroit Steel Corp., one of my functions is to administer the corporation's insurance matters, including group insurance.

Many of our employees are greatly disturbed over a proposal in the new tax legislation now under consideration by the Senate Finance Committee which contemplates taxing them for the premiums paid by Detroit Steel Corp., for group term life insurance in excess of $30,000. We believe that this proposal is unfair and discriminatory for the following reasons:

1. There is no direct financial benefit to the employee personally since he has no option to receive the premium equivalent in cash, and the group insurance policy has no paid-up value either to the employee or to the employer. When an employee retires or terminates his employment prior to retirement he carries no benefit with him. Why should premiums on such coverage be considered taxable income?

2. The selection of a limit of $30,000 is arbitrary and capricious. Approximately 200 nonunion salaried employees of Detroit Steel Corp. (or a total of 500) are eligible for coverages in excess of $30,000, in varying amounts. It has been our practice generally to provide each employee with an amount of life insurance coverage equal to 3½ times his annual salary in order to provide for his dependents in the event of his death prior to retirement. For example, it takes a moderate income of only $8,571.45 to qualify for $30,000 in group insurance under our plan. Surely, loss of income of a higher paid salaried employee's family is just as acute proportionately as it would be in the case of a lower paid employee. Why should families of higher paid employees who are entitled to insurance benefits in excess of $30,000 be discriminated against merely because of a higher income?

3. The whole concept of the proposed law with respect to the measurement of "constructive income" to the employee is discriminatory. Under the proposed law, the older an employee is, the more tax he will have to pay. An employee aged 60 having the same amount of insurance as an employee aged 40 will have to pay more taxes merely because of his age. This will create a monstrosity in the computation and reporting of taxable premiums paid by the employer. In addition, it violates one of the fundamental principles of insurance; namely, that of level premium payment during the covered years.

4. I understand that this very onerous proposal will produce only $5 million in additional revenue.

5. It appears that the tax reform giveth with one hand but taketh away more with the other by inequitably increasing the life insurance cost of the middle-income groups. The $30,000 group insurance limitation is a case in point.

We urge you to vote for the elimination of this proposed provision from the tax bill currently under consideration.

Very truly yours,

NATHAN H. SIEGEL.

TORNWALL, LANG & LEE,
St. Petersburg, Fla., October 9, 1963.

Hon. SPESSARD L. HOLLAND,
Senate Office Building, Washington, D.C.

DEAR SENATOR HOLLAND: Mr. C. O. Lowe, chairman of the board, Union Trust Co., St. Petersburg, Fla., talked with us recently and asked that we write to you. We understand you talked with him on the telephone.

Mr. Lowe is one of the major stockholders in a family type corporation. The corporation owns a substantial amount of real estate and a large number of shares of the common stock of Union Trust Co. Mr. Lowe personally sold the common stock to the corporation and reported the transaction as an installment sale for income tax purposes. To acquaint you with the size of this problem, the corporation still owes Mr. Lowe in excess of $1 million on the sale of the stock. We would like to point out at this point that the corporation is not presently a personal holding company.

With this background, we would like to specifically call to your attention the revenue bill of 1963. We feel that certain portions of this bill will have a damaging effect to many family-type corporations and their stockholders. Since we are most familiar with Mr. Lowe's situation, we will set forth the facts in this case.

As mentioned earlier, the corporation is not a personal holding company. However, section 216 of the bill modifies the definition of personal holding company income which virtually legislates the corporation into becoming a personal holding company. With the extremely high tax rate applicable to personal holding companies, it is impractical to have the corporation remain in existence. We then turn to the possibility of liquidating. While the bill offers some relief to those corporations who do liquidate, we feel this relief is inadequate. In Mr. Lowe's situation, if the stockholders were to liquidate the corporation, assuming the 1963 revenue bill had passed, they would be required to pay a capital gains tax on the earnings and profits of the company in an amount estimated at $100,000. In addition, this would accelerate the reporting of the profit on the installment sale referred to earlier. This would amount to an estimated $200,000 additional tax.

It appears then that the stockholders would be faced with an additional $300,000 tax to pay or become a personal holding company. It would be costly to choose either.

Very briefly, we will pass our thoughts on to you. Some relief should be given stockholders who have sold property to the corporation at a profit and reported it on the installment method. Another thought would be to let the corporations report similarly to a partnership under subchapter S of the Revenue Code.

In the interest of Mr. Lowe and the many other stockholders who will be adversely affected by the stringent provisions of section 216, we would appreciate your looking into the matter and letting us have your comments. We will be happy to provide you with any additional information needed.

Very truly yours,

JACK L. COLLINS.

MEDINA, OHIO, *October 17, 1963.*

Senator HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I'm writing to express my views on H.R. 8363, otherwise known as the tax cutting bill.

It is extremely difficult for an average citizen to evaluate and effectively judge all the implications of the many bills which Congress considers each session. So-called, as well as, bona fide experts have testified as to the merits of a tax cutting bill.

Suffice it to say, that I believe a genuine case can be made for the position that the continuing burden of taxes has been a deterrent to our national growth. So many of our business decisions seem to be unduly influenced by the taxing implications, rather than sound business implications. In this critical period, wherein the continuance of the business recovery is under question and review, it would seem very judicious that serious consideration be given to the appropriateness of a genuine tax cut.

I, therefore, urge you and your group to continue the careful consideration you have been, and will give this bill. As an average guy, it would appear to me that there is more in its favor than in opposition.

While it would be helpful to tie spending curbs to the tax bill, I feel that since Congress appropriates the money which is spent, it ought also to exercise considerable discipline on the money it appropriates for spending, to the end that a tax cut will be meaningful, and that our savings will not be destroyed through inflation.

Sincerely yours,

M. E. SHANK.

U. S. SENATE,
Washington, D. C. October 18, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: On January 14, 1963, we introduced S. 161, which would amend the Internal Revenue Code to establish the depletion allowance at 27½ percent for minerals mined as a source of synthetic oil or gas. As you may know, there is a serious question presently as to the percentage depletion allowable for such minerals. Our own State of Colorado has large deposits of oil shale and we are hopeful that within the next few years a substantial industry may be established to extract the oil. We believe that enactment of S. 161 would be in keeping with the long-standing national policy to encourage the development of new industries and our natural resources.

For that reason, we respectfully request that your committee consider S. 161 as a possible amendment to the tax bill which has been passed by the House. If you would like any further information on the bill, we would be pleased to supply it.

Sincerely yours,

GORDON ALLOTT, *U.S. Senator.*
PETER H. DOMINICK, *U.S. Senator.*

U.S. SENATE,
Washington, D.C., October 18, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: Section 207 of H.R. 8363, presently under consideration in the Finance Committee, amends section 164(b)(5) of the 1954 Internal Revenue Code by striking subsection 164(b)(5)(B). We would like to request your consideration and ask that the section stricken be retained in its present form. The Internal Revenue Code of 1954 allows the deduction of real property taxes levied by a special taxing district if the district covers the whole of at least one county, at least 1,000 persons are subject to the taxes levied, and the district levies its assessments annually at a uniform rate on the same assessed value of real property, including improvements, as is used for purposes of the real property tax generally.

This language has application to a special taxing district in Colorado which was formed in the 1920's and is somewhat unusual legal entity. Court decisions construing its character have held the taxes which it levies are general ad valorem taxes on all real property in the district, including improvements erected subsequent to its formation. Hence, we feel that these taxes are indistinguishable from general property taxes and should as a matter of policy be deductible as such.

It may be that you will receive testimony on this provision in the course of your hearings. In any case, if you would like any further information concerning that provision, we will be happy to supply it.

Sincerely yours,

GORDON ALLOTT, *U.S. Senator.*
PETER H. DOMINICK, *U.S. Senator.*

THE CHASE MANHATTAN BANK,
New York, N.Y., October 18, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We are writing to bring to your attention problems created by section 203 of H.R. 8363, now pending before your committee. Reversing a policy of many years' standing, section 203 of the bill will tax to an employee the cost of group term life insurance provided by his employer to the extent that the insurance coverage exceeds $30,000. We respectfully suggest that the reasons given by the House Ways and Means Committee for the limitation on exclusion of costs of group term life insurance, as proposed in section 203, are not persuasive (H.R. No. 749 at p. 39). The committee points out that the provision of up to $30,000 of such insurance "does much to keep together family units where the principal breadwinner dies prematurely." We believe that this same reasoning applies equally where the amount of such insurance exceeds $30,000. There are, moreover, additional objections:

1. Under the proposal an individual's taxable income would increase with advancing age without regard to whether or not his income increased.

2. The proposed limitation, if enacted, would tend to limit the amounts of group life insurance that employers would make available to their employees, because employers would be encouraged to select other types of employee benefits that would spare employees additional taxes, even though such other types might be less satisfactory, over the long run, from the viewpoint of employees and of their families.

Apart from the policy considerations involved in the proposed, we think it is very important to bring to your attention that, if the provision is enacted in its present form, it will prove both expensive and difficult to administer. Our concern in this regard arises out of the requirement imposed by section 203 that the cost of this insurance shall be subject to regular income tax withholding.

Having in mind that the persons to whom this new provision would be applicable are for the most part individuals who are more highly paid, who normally report their incomes in full and are subject to annual audits, there is not the same compelling necessity for tax exaction through withholding as may exist with respect to other wage earners. We feel certain that the full amount of the tax on income arising from such group insurance costs would be recovered if the employer merely had to report such "income" in the W-2 form required to be filed annually by all employers with respect to wages paid their employees.

The determination of the cost of the group insurance on which an employee would be taxed under section 203 is not a simple matter. In most instances it will necessitate recourse to a Treasury prescribed table of costs averaged out on the basis of 5-year age brackets, with such tables to be changed from time to time based on mortality experience. To determine the amount to be withheld on the basis of these costs requires coupling the information so arrived at with the various other items presently subject to payroll withholding.

In the case of this bank, as in the case of many other corporations, payrolls and computations necessary in connection with the administration of employee pension, profit-sharing and other employee benefit programs are maintained by electronic computers. The requirement of withholding on the cost of group insurance even to the limited extent required by section 203 would require major changes in our present computer programs. Briefly summarized, we would need to take the following steps at an estimated initial cost of $34,000 and an estimated additional $3,000 each year thereafter:

1. Incorporate in the recordkeeping program of each payroll the tables containing the group life insurance premium amounts of each age group.

2. The electronic tape on which records are stored would need to be expanded to add an additional field containing the amount of group life insurance premium in excess of the premium on $30,000 of coverage paid by the bank.

3. Programs would need to be altered in order that this amount could be reported separately as income and as tax withheld. Since gross salary is used for several purposes, the additional amount taxed to the individual could not be combined with salary.

4. A number of basic forms would need to be changed to reflect the additional items of information both in the bank's records and any information given to employees.

5. The steps required to accomplish the provisions of the proposed law would mean the design of significantly different recordkeeping and operating programs.

This simply strikes us as asking for an unreasonable expenditure of time, money, and effort under all the circumstances in contrast to the comparatively easy alternative of requiring that such group insurance costs be included on the W-2 report of wages paid which the employer would compile manually at the end of the year at much less cost.

For these reasons we respectfully urge that section 203 of H.R. 8363 be deleted, and if that is not acceptable, that subsection (c) thereof be deleted.

Sincerely,

GEORGE CHAMPION.

LONGMEADOW, MASS., *October 15, 1963.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Your committee is presently holding hearings on the Revenue Act of 1963 as recently passed by the House of Representatives.

This letter is to call your attention to a provision which works unfairly when a corporation has a long-term capital gain and a loss from operations in the same year. The provision is section 1201, IRC 1954 which reads in part as follows:

"SEC. 1201. ALTERNATIVE TAX. (a) CORPORATIONS.—If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 11, 511, 802 (a) or (b) and 831(a), there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

"(1) a partial tax computed on the taxable income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and

"(2) an amount equal to 25 percent of such excess * * *"

As an illustration, (using present rates of tax), if a corporation has a long-term capital gain of $60,000 and an operating loss of $20,000 in the same year, its tax is $15,000 (25 percent of $60,000). The tax under section 11 is $7,500 on $25,000, plus 25 percent of $15,000, or $7,800, making a total tax of $15,300, on $40,000 of income ($60,000 minus $20,000).

The result is that the $20,000 of operating loss is wasted, i.e., has no effect upon tax liability. There is no net loss to be carried back or over because there is no net loss for the year.

It seems to me, in such a case, the $20,000 should be treated as a deduction from long-term capital gain, and the net amount taxed at 25 percent, in this case $10,000. This was the law many years ago.

Or the $20,000 might be treated as a net loss carryback. However, this approach would require extensive changes in the statute. The loss to the revenue would probably be greater, because the net loss would then be applied to ordinary net income.

May I suggest the insertion of subparagraph (3) in section 1201(a) to read as follows:

"(3) An amount equal to 25 percent of the excess of long-term capital gain over short-term capital loss reduced by the operating loss of the current year, if any."

Rate of alternative tax

The Revenue Act of 1963 proposes to retain the 25 percent rate for net long-term capital gains realized by a corporation, while it proposes to reduce the normal tax to 22 percent. This seems illogical, and means the alternative tax computation cannot reduce the tax of a corporation unless it has total income for a year somewhat in excess of $25,000.

I suggest that the alternative tax rate for corporations be reduced to 22 percent or less.

Very truly yours,

WILLIAM W. JOHNSTON, C.P.A.

HAVERTOWN, PA., *October 20, 1963.*

Hon. HARRY BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR: I hope you will make the following thoughts part of your record on the tax "reform" bill.

First, the measure is self-defeating, since instead of freeing tax dollars for investment or to enlarge or expand industry, these tax dollars will have to be invested at once into bonds to pay for the deficit. Actually, since in inflationary times bonds are a poor investment, the bonds may be hard to sell. I personally would rather invest in good common stocks. Therefor the tax break will only help industry if the Government expenditure is cut equally, so that the budget is in balance. Then it will help.

Second, the cut is made at the expense of those least able to pay for it. Removing the tax break on dividends means higher taxes for (1) all retired persons, whose life savings are in stocks and bonds, (2) all widows, orphans, or others without wage earners, since they rely on investments of deceased persons for their support, (3) on the persons who are self-employed, or trying to build a retirement fund, since they are taxed on their savings, invested in stocks and bonds. Instead of taxing these investments more (which are already taxed at source before they ever reach the investor) they should give an exclusion, say $5,000, below which there is no taxation whatever, just to protect these retired or dependant persons. The cut also drops exclusion of medical costs. Actually the original deduction on this was inadequate. As an example, an old person, living on accumulated and invested funds, too weak to take care of herself or himself, living in a nursing home, cannot deduct the full cost of this medical or hospital service, and ends up paying income taxes on income never received, which went straight to medical services, result: must cash an investment to pay income taxes. So the old person instead of being a self-supporting member of the community becomes a charge on it due to the taxes removing the principal. If my mother had not died unexpectedly, this would have happened to her. The administration is quite keen on medical assistance to the old, but instead of removing taxes on medical expenses (the quickest, cheapest way to accomplish this) it increases these taxes, then hands it back as a dole to those who have a social security account. (My mother did not.)

I see no excuse either for spending money we have not got, nor for double taxation. I hope, most earnestly, that your committee will only approve a cut in revenue if it is balanced against an equal cut in expenditure, and that it will reverse the bill on the dividend and medical deductions, providing complete deductions for medical, unlimited, and a high, say $5,000 exclusion on dividends, prior to tax.

Respectfully,

WALTER LEE SHEPPARD, Jr.

GREENBRAE, CALIF., *October 18, 1963.*

Senator HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SIR: For those classified as senior citizens, the art of living becomes more complicated with each passing day. Those of us who are retired, living on pensions, savings in the bank, social security and perhaps some dividends from the investment of savings put away during our working years, are facing now, and will confront graver problems of living if some curbs are not placed on currency inflation that threatens to drop the purchasing power of the dollar to 25 cents within 10 years.

I belong to an organization in this State named the SIRS, a contraction of Sons In Retirement. We are a social group composed of retired men. In the short span of 3½ years SIRS has grown from 4 men to a group of over 4,000 members. The groups so far organized are restricted to an area in and around San Francisco, with one additional branch in the city of Sacramento. Each week requests come from other parts of the State seeking information on the establishment of new branches, and one has been received from Oregon. It is evident and easy to appreciate that as word spreads about the SIRS such an organization could become a great force throughout the country.

There has been considerable talk of late among members of this group, having to do with taxes, Government spending and balance-of-payment deficits. Undoubtedly more Members of the Congress will be hearing from other individual members in other branches of this organization.

Through the press, and by comments of the President, we have been informed of the need to reduce taxes, and a bill of such a nature has already passed the House. To those of us living on fixed incomes, and with inflation on the rise, there is little comfort in the crumbs to be thrown to the senior citizen in the present form of the bill now before the Senate.

On the plus side there are perhaps these tidbits:

(*a*) Two exemptions for persons 65 years of age or over. (Retained from the present law.)

(*b*) Retention from the present law of the retirement income credit.

(*c*) Reduction in the capital gains tax for securities held 2 or more years. (Threatened by a new attack by Secretary Dillon.)

(*d*) Easing of the capital gains tax on homes owned more than 5 years by citizens 65 years old or over.

(*e*) Reduction in the overall tax rate.

Three of these benefits are new and are meaningful to retired citizens, however there are features of the proposed tax bill that tend to offset and nullify benefits that might accrue from these changes. Before going into that let's look more closely at the new features, as they apply to retired people.

Many of us 65 years old and over sold the homes in which we raised our families when we retired. Many of us reinvested the proceeds in smaller homes within 1 year as provided in the law, paid the gains tax on the balance, or perhaps moved into rented quarters and paid the gains tax on the entire profit. Therefore this offer while appearing generous to older people can only affect those who might retire in the future, or those few who still retain the old homestead and wish to dispose of it.

The reduction in the capital gains tax for securities held over 2 years is a fine gesture, but now I see that Secretary Dillon is trying to have this removed. There are minus qualities that must also be considered, most of which I maintain will offest advantages, particularly with respect to its impact on senior retired citizens. For example:

(*a*) Reduction of the dividend credit from $100 to $50 unless securities are jointly owned, a practice frowned upon by every security adviser, and not generally practiced by most investors.

(*b*) Withdrawal of the 4-percent dividend credit and the substitution of a sliding rate and final elimination of this feature by 1965.

(*c*) Withdrawal of certain presently allowable deductions for those who itemize their deductions; State gasoline and other taxes.

The first two are obviously objectionable. As to the third this strikes me as definitely a tax on tax, and could lead ultimately to the elimination of all State taxes, city taxes, and other burdens now carried by the taxpayer, but more so by those of limited income, or fixed income.

My gasoline consumption for the year, according to records I have kept will be about 1,400 gallons. This is true of people who live in States where long distances are the rule, like California and Texas. At 7 cents per gallon State tax, this means I cannot deduct $98 from my tax liability. I also purchased a new automobile during the year, the registration of which cost $88 in the State of California and which will continue to be high until the car is 5 years old. I will be unable to deduct this fee from my tax liability.

The tax experts might argue that the average citizen is not concerned with itemizing his deductions, and therefore whether or not State gasoline taxes, automobile registration fees, and other currently allowed deductions are dropped from the bill is no concern of his. I submit all these matters are of concern to the retired citizen, for if he owns property, pays taxes on it, drives an automobile, he is indeed very much interested in all the deductions that can possibly be allowed to enable him to meet the present high cost of just living. The retired citizen has lost the extra dependent deductions for his children have grown, whereas the younger man, who without itemization of his deductions, has no concern with these taxes, or dividend credits, usually has at least three, often times more dependents, if he is married and is raising a family. The retired citizen, on the other hand, who may find it advantageous to itemize his deductions, not only loses extra exemptions but is now to lose other benefits now allowable under the law.

All of the benefits of the new act, with one exception are for the benefit of people gainfully employed, those who are compensated from time to time by their employer for the increasing impact of higher living costs. The retired citizen is being penalized for being retired, and could very well pay higher taxes as time goes on.

Returning to the matter of inflation, here also the retired citizen is penalized. As inflation increases the salaried man's salary is raised to compensate. The retired citizen receives no such treatment, as a matter of fact, if he is receiving social security payments, he cannot work to increase his income, except under certain circumstances, and he may not be able to work under any conditions. His only chance for the supplementing of his income is by capital gains on investments or by increased interest on his savings or increased dividends, if he is fortunate enough to have investments. Now it is proposed to confiscate more of this source of income by a decrease in the dividend credit and to eliminate another credit against income entirely.

There would be less protest in these changes if it were evident that Congress means to reduce the cost of Government. Nothing is being done in that direction, rather there is increased evidence that expenditures will go even higher. How many of the economies proposed by the Hoover Commission have been put into practice? Why must we spend billions to go to the moon, except some nebulous idea of national prestige?

Better to allocate some of these billions to establish a scientific investigation into what can be done with surplus agricultural products. Better to use a part of those billions to help educate our children, by providing better classrooms and teachers. Better to use some of those billions to improve and eliminate slum conditions. Better to use some of those billions to strengthen our roadways, and provide roads where they are sorely needed. Better still to use some of those billions to finance a commission of hardheaded businessmen for the purpose of finding ways to cut the cost of Government.

Couldn't our balance-of-payment deficit be cured, or at least medicated if the Government would curb its lavish spending abroad and tighten up on its loose fiscal policy at home? Finally, a cutback on the heavy Government spending would certainly lessen the Government's need for such high taxes on the American people.

When these things are accomplished then, perhaps, we can take another hard look at taxes. Possibly then, we could come up with a tax bill that would actually reduce taxes, not shuffle them about like chessmen, giving the idea that tax relief is being extended to all by a benevolent Government administration, when actually there is little or no tax relief, and the older retired portion of the citizenry is being sorely discriminated against.

Very truly yours,

R. A. MILLARD.

WOODHAVEN, N.Y., *October 18, 1963*.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: I am taking the liberty by means of these lines to present my views and comments on the tax bill H.R. 8363 now under consideration by your committee.

Among the more objectionable features contained in this bill are the so-called structural changes calling for—

(*a*) Eventual total repeal of the 4-percent dividends credit;
(*b*) Reduction in amount of individual exemptions;
(*c*) Limitation of allowable deductions, both if itemized or unitemized:
(*d*) Lets off scot free, by the terms of revised rate scale, estimated 1½ million persons from tax rolls.

Of the above the first three fall most heavily on that segment of taxpayers comprising the aged and retired citizens whose main source of income is from dividend payments.

This dividend credit was originally made a part of the 1954 tax law in partial recognition of the gross inequity of double-taxing shareowners, since dividend payments are in effect only a partial distribution of the residual earnings on which the respective corporations previously paid a tax of 52 percent. This 4-percent credit should most certainly be retained in any new tax measure, since it is not, as erroneously charged by its opponents both in and out of Congress, a boon for the favored few. It is of vital importance to some 17½ million American shareowners who have placed their accumulated surplus funds in stock investments in order to provide risk capital to both American industry and labor.

As for item (*d*), I am sure that it is unnecessary to point out that such action runs counter to the very concept of just and equitable tax principles, namely that all should contribute a proportionate share, be it large or small, of the Government's functional expenses. It does not require expert tax opinion to discern that this group of citizens so liberally treated by the terms of the new measure, will contribute very little to the country's economic growth in any shape or form. They are gratuitously made a group of "freeloaders."

In addition to the foregoing, a most strenuous objection should be directed against the proposal advanced by the Treasury Department that the bill include also a capital-gains tax on estate assets passing at death of originl owner. This last-named proposal is more glaring in its unfairness because of being based on the premise of levying a tax upon tax, for as you are well aware, the Federal inheritance tax now in effect already amply covers this phase of taxation.

In conclusion I would say that it is doubtful that the bill can achieve the objectives claimed for it, namely to spur the Nation's economy, reduce unemployment; and produce additional utopian results. Certainly it is difficult to understand how such benefits can be attained while no serious effort is being made to balance the budget and bring large-scale government spending under control.

In these circumstances I sincerely trust your committee after due deliberation will not concur in the proposed legislation as embodied in H.R. 8363, but rather will give most serious consideration to the correction or elimination of the many defects now present in it.

Sincerely yours,

THEODOR WERNER.

(Whereupon, at 5:05 p.m., the committee adjourned to reconvene at 10 a.m., Tuesday, October 22, 1963.)

REVENUE ACT OF 1963

TUESDAY, OCTOBER 22, 1963

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, Smathers, Douglas, Gore, Talmadge, Ribicoff, Williams, Carlson, Bennett, and Curtis.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Leon H. Keyserling.

Mr. Keyserling, we are glad to welcome you once again before the committee. Please proceed.

STATEMENT OF LEON H. KEYSERLING, CONSULTING ECONOMIST AND ATTORNEY

Mr. KEYSERLING. Mr. Chairman and members of the committee, I have a comprehensive statement with charts, which is in your hands. I would like in order to save your time, to ask permission to have this statement inserted in the record, and then I will attempt a reasonably brief oral summary of the main content.

The CHAIRMAN. Without objection.

(The statement referred to follows:)

STATEMENT OF LEON H. KEYSERLING, CONSULTING ECONOMIST AND ATTORNEY

Mr. Chairman and members of the committee; I deeply appreciate the opportunity to testify on the momentous tax proposal. And doubly so, because you have scheduled my appearance so early in these hearings, although I represent no organized group nor powerful interest, but speak only to make known the results of my own studies and the dictates of my own conscience. I cannot help believing that the courtesy which this committee is now extending to me reflects the fact that I have tried to be helpful and objective on the many occasions when I have appeared before you.

Still another reason why I am appreciative of the willingness of this committee to hear me is that a majority of the committee, albeit for varying reasons, may not agree with some of my views on economic matters. Yet I hope that my efforts here today will help to develop a common ground on many points, thus enabling this committee to report for consideration by the Senate a better tax bill than the one now before you.

First of all, before getting into the details of the particular measure now before you, I owe it to the committee and to myself to state that I strongly favor a large and immediate tax reduction, and that this position is entirely consistent with my sense of obligation to be severely critical here today of some of the major provisions of the current tax proposal in its present form.

I admire and support the bold and persistent efforts of the President to achieve a large tax reduction now, and want to do all that I can to help advance this objective.

I heartily favor, at this time, a tax reduction at least as large as that embodied in the current bill. I believe such action long overdue, and have advocated it for a long time. Indeed, I believe that the whole tax reduction should be made effective at once, and not be spread over a number of years.

I do not believe that tax cuts should be balanced by cuts in Federal spending. My views on this issue, entirely to the contrary, will be stated toward the end of my testimony.

I am wholly in favor of the deliberate immediate enlargement of the Federal deficit, now, to help stimulate an American economy which is so far short of reasonably full levels of production and employment. And although I believe a balanced national economy far more important than a balanced Federal budget, I am also firmly convinced that only by balancing the national economy can we avoid repeating indefinitely the large Federal deficits of recent years and move toward a balanced Federal budget. I shall in due course present factual analyses bearing upon this point.

The reason why I believe the current economic situation calls for large and immediate tax reduction is mainly this: Current tax rates are highly repressive of our entire economic performance, in that these rates are so high that they would balance the Federal budget, and even yield a surplus, at levels of economic activity far short of reasonably full economic activity.

Under these circumstances, the question naturally arises as to whether my views as just stated are based upon the assumption that we will have an economic recession next year if we do not undertake large tax reduction now. My record before this committee and elsewhere makes it clear that I do not believe that changes in fiscal policy as profound and enduring as those embodied in the pending measure should be based upon hazardous attempts at precise short-range forecasting. I do not think that the sound case for tax reduction has been furthered by those who on one day have warned us that we are likely to have a recession next year if the pending measure is not enacted promptly, and who on another day have said that the economic outlook is good for the near future and that the main reason for the pending measure is to accelerate our long-range rate of economic growth. Nor have the forecasts of some of these people been sufficiently accurate in recent years to add much to their persuasiveness when they use these forecasts in support of the pending measure. While some will admit that my own forecasts have tended to be more accurate, I do not place much store in the ability of anyone—including myself—to make these short-range forecasts with any degree of accuracy.

Instead, my position in favor of a large and immediate tax cut is founded upon the chronically rising tide of idle manpower and plant which has afflicted the American economy for a decade or so, and upon the dangerously low rate of economic growth which correlates with this highly unsatisfactory performance. It is toward remedying these chronic conditions, which as yet show no real signs of abatement, that fundamental national economic policies should now be directed vigorously and promptly.

Having said all this, I must say also that I believe there is great need for basic change, not in minor details, but in large ways involving economic substance and social principles, in many major provisions of the current measure, although I agree with some of the other provisions and would like to see them carried further. These changes seem to me immensely important, even though I might rather see them bypassed than see anything interfere with enactment of the measure this year.

My general support of large and prompt tax reduction has led some of my friends, in the Government and elsewhere, to question why, at this late date, I raise these criticisms of the current tax proposal, when in their view the choice is between this measure in substantially its present form and no measure at this session of the Congress. My first answer to these questions is that I would not so denigrate this committee and the Senate of the United States as to accept the viewpoint that they have no important role to perform in considering his measure, except to rubberstamp a proposal which has come over from the House Ways and Means Committee and the House of Representatives, whose views and responsibilities I also respect.

And while the hour is late, it is not too late to look before we leap, especially with respect to a tax proposal which will profoundly affect the American economy for many years to come, and which to a substantial degree will even set an irreversible course, because the history thus far of this very proposal shows how hard it is to alter or reverse our fiscal policies once written into law. And even if it were too late for my single voice or others added to mine to change in any respect the momentum of support which this measure has already acquired in exactly its current form, it is never too late to honor the principle that there is always need for some critical evaluation of our national economic policies. This is true of policies already on the statute books; it must certainly be true of those still in process of enactment. The very idea that it is obstreperous or obstructionist to express one's views frankly and fully with respect to our great national economic policies, simply because the hour is late or momentum has been acquired, would if accepted rob a free society of one of its most precious assets.

So I cannot accept the view, pressed upon me by some of my most valued friends, that there are reasons of political strategy and practicality which should preclude me from speaking my mind fully at this late date. In the first place, I do not so overestimate my influence as to believe that anything I may say here will change the time at which this tax bill in some form becomes law. And second I believe that, if anything I say here may persuade this committee to change any portions of the bill in line with my suggestions, the changes will be in the national interest. Further, I am not at all certain that those who have advised me to cease and desist have had more political seasoning and practical experience than I have had during the past 30 years, as to the best ways to serve this national interest. So far as self-interest is concerned, I would be much better off, if I avoided by one means or another the course I am taking here today. It is hard to be in fact critical of policies advanced by an administration to which one is generally committed.

Now, let me get on with my comments about the pending measure in detail, in the setting of the chronic economic situation now confronting our country.

(1) My first basic proposition is that the current economic situation, viewed in sufficiently broad perspective to make the examination meaningful, calls for large and prompt fiscal measures, including tax reduction, to stimulate economic activity.

My first chart indicates that the long-term historic growth rate of the U.S. economy during the period 1922–62, excluding periods of depression and the war eras, averaged annually 3.7 percent. It also indicates that, in view of the rising trend in productivity and technology, an average annual growth rate of between 4 and 5 percent has occurred during those periods since World War I when our productive resources have been in reasonably full use.

My second chart illustrates that, in vivid contrast with these growth requirements, our average annual growth rate during the period 1953–62 was only 2.8 percent, and that this average has been compounded of a fairly rhythmic pattern of recessions, inadequate upturns, and periods of stagnation or of abnormally low economic growth leading into the next recession. The second sector of this same chart, tracing the quarterly record from first quarter of 1961 through second quarter of 1963, shows in the main a clear trend toward a declining rate of economic growth. And the third sector of the same chart, depicting consecutive 12-month trends from first quarter of 1961 through second quarter of 1963, shows a steadily and considerably dwindling rate of economic growth for each and every succeeding 12-month period. The growth rate of only 3.3 percent during the 12-month period from second quarter 1962 to second quarter 1963, should be contrasted, not with the growth rate of about 5 percent needed to maintain full prosperity after it is attained, but rather with the growth rate of 8 to 9 percent needed annually for about 2 years to restore reasonably full production and employment. And we all know, the trends during the third quarter of 1963 have at best been no better than during the second quarter, as is evidenced by the assertions of some very capable people that we are on our way toward another recession come 1964 if this tax measure is not enacted. Actually, while the economic upturn which started in early 1961 now gives indications of lasting longer than previous upturns during the past decade, one of the reasons is that the latest upturn has been of smaller relative magnitude, has converted more quickly to stagnation, and has not brought us as far back to reasonably full use of our resources as of the earlier upturns. We are thus extending the period of economic stagnation, not really making gains.

My third chart shows the chronic rise in the true level of unemployment, from 4.9 percent of the civilian labor force in 1953 despite a recession commencing in the middle of that year to 9.3 percent, seasonally adjusted, during the first 6 months of 1963. Even excluding the full-time equivalent of part-time unemployment, and the concealed unemployment resulting from the repressed growth of the labor force due to inadequacy of job opportunity, full-time unemployment as customarily recorded rose from 2.9 percent of the civilian labor force in 1953 to 5.7 percent during the first 6 months of 1963. The situation has not improved in any significant degree, during the most recent months, and it is noteworthy that unemployment thus far in 1963 has been higher than in 1962 despite the continuation of the economic upturn.

My fourth chart shows the chronic rise of our unused productive powers measured by GNP. My estimate is that, by fourth quarter 1962, the gap between actual national production and reasonably full production was in the neighborhood of $80 billion, and I estimate this gap to be about the same now. The reasons why my estimate of the size of the production gap is so much larger than that of some other competent analysts has been detailed on other occasions. Here I shall say only that my past estimates of the size of this gap have correlated much more closely than their's with the growth rate needed under the new technology, and this explains in part why my forecast as to how high unemployment would remain have come much closer to the mark than their's.

My fifth chart depicts the enormous losses which we have suffered, during the period from the beginning of 1953 through the first quarter of 1963, in consequence of the chronically poor economic performance, coming in the aggregate to a forfeiture of about $440 billion worth of total national production (measured in 1962 dollars) and about 27½ million man-years of employment opportunity.

It should be noted in passing that these very unfavorable economic trends have had a most damaging effect upon the condition of the Federal budget. My sixth chart shows how, comparing estimated fiscal 1964 with fiscal 1954, total outlays in the Federal budget have declined, when measured on a per capita basis related to our total population, and when measured as a percent of our total national production. Despite this, the Federal deficits have grown because, in view of our inescapable Federal responsibilities such as national defense, interest payments, and payments fixed under existing statutes, it has become virtually impossible to balance the Federal budget in a stagnating economy. As the deficits in our national economic performance have risen, as measured by the gap in our total national production, the Federal deficits have grown accordingly, as shown on my seventh chart. And as shown on my eighth chart, if we had enjoyed reasonably full economic performance from 1953 through 1962, the Federal budget on a calendar year basis would have shown an aggregate surplus of $17 billion, contrasted with the actual deficit of about $37 billion—a net difference of about $54 billion—even though my estimates are based upon some tax reduction beyond that which actually took place during this period, and somewhat higher levels of expenditures than actually occurred. This history is highly relevant to the point that properly devised stimulative measures now, including properly devised tax reduction, can help to balance the Federal budget.

My main concern, however, is not with the past but with the future. On the basis of methods of analysis which have turned out to be quite accurate during the past decade, I do not see under current national economic policies the prospect of substantial improvement in our longrun economic growth rate, and this conclusion is certainly strengthened by the actual developments during the past 3 years to date which I have already detailed. If I am anywhere near correct in this, my ninth chart indicates that we could by 1966 be confronted by a level of unemployment, as conventionally measured, about 3.7 million higher than the level of unemployment which would be consistent with reasonably full employment. This would mean conventional unemployment in the neighborhood of 6 million, and a true level of unemployment between 8 and 9 million. By the same methods, I estimate that the production gap by 1966 could rise to $107 billion. measured in uniform 1962 dollars. And these estimates do not include the possibility that we might happen to be in a recession in 1966, which naturally would make the picture much worse.

My 10th chart shows my estimates of the magnitudes of economic expansion which would need to take place in 1963 and 1964, to restore a reasonably full level of economic activity by early 1965, consistent with longer range goals through 1966. As we all know, nothing like this rate of expansion is occurring in 1963, and there is virtually no prospect for the needed rate of expansion in 1964 under current policies, as practically all observers now admit. To take one salient example: The Council of Economic Advisers is now hopeful that we may get down to a 5-percent unemployment rate by 1965 or 1966 if the current tax proposal becomes law, contrasted with the goal in early 1961 of reaching a 4 percent "interim" objective by 1963 without benefit of this tax reduction.

For the foregoing reasons, I urge upon this committee the absolute necessity of large and immediate efforts to inject new stimuli into the American economy. In this effort, properly devised tax reduction would play a vital role.

But the inadequacies of the current tax proposal in its current form are very serious, and this I shall attempt to demonstrate in detail later on in my testimony.

CHART 1

GROWTH RATES, U.S. ECONOMY, 1922-1962

Average Annual Rates of Change in Gross National Product
In Uniform 1962 Dollars

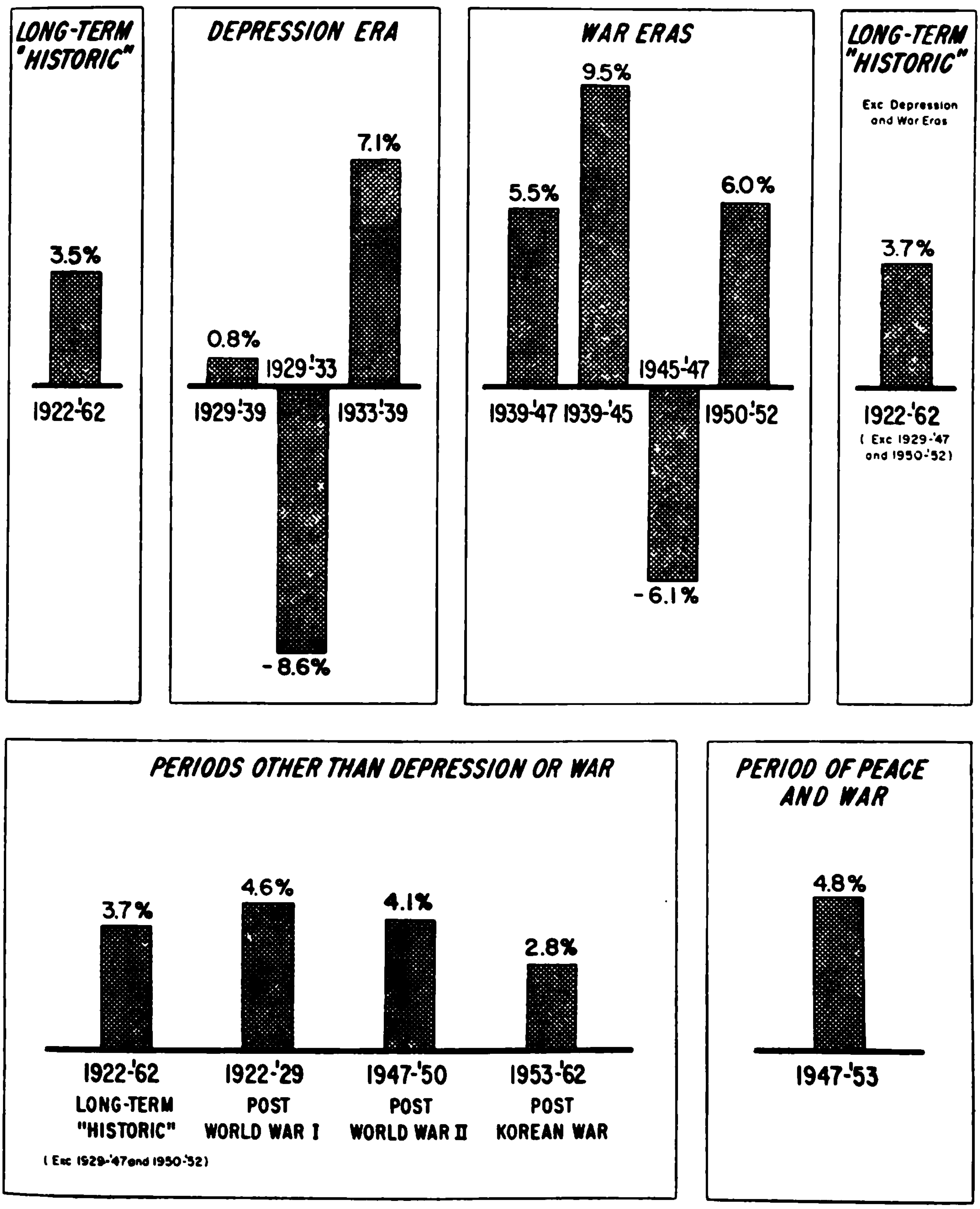
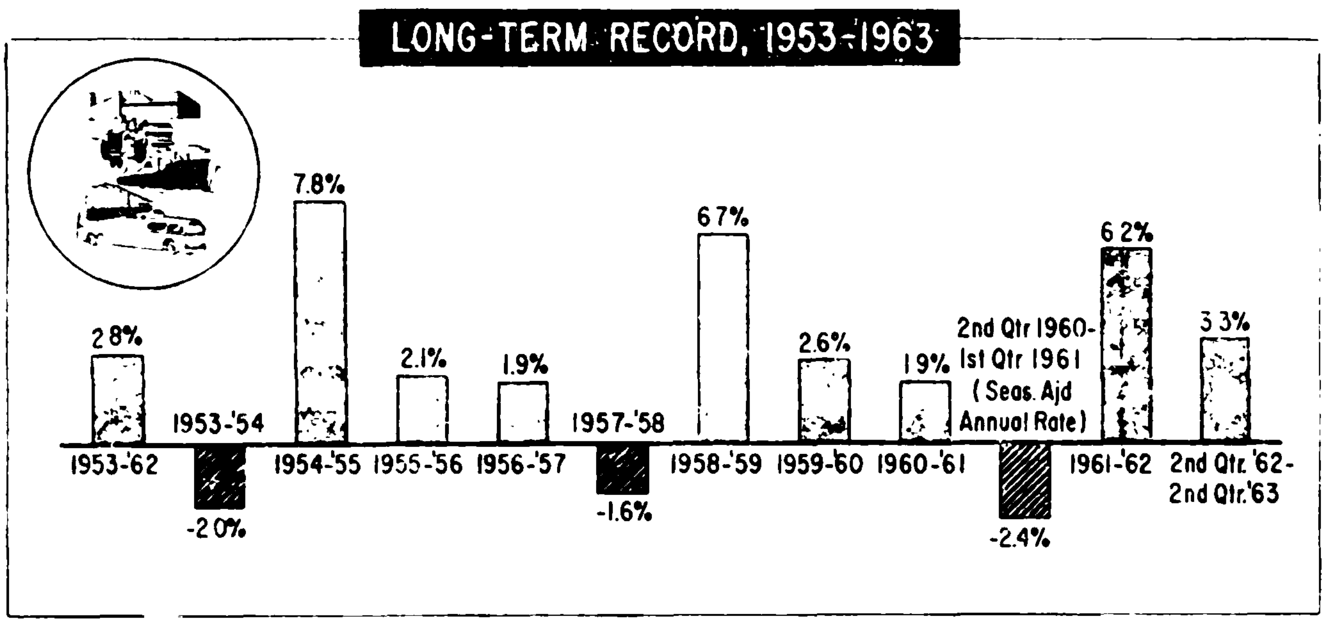
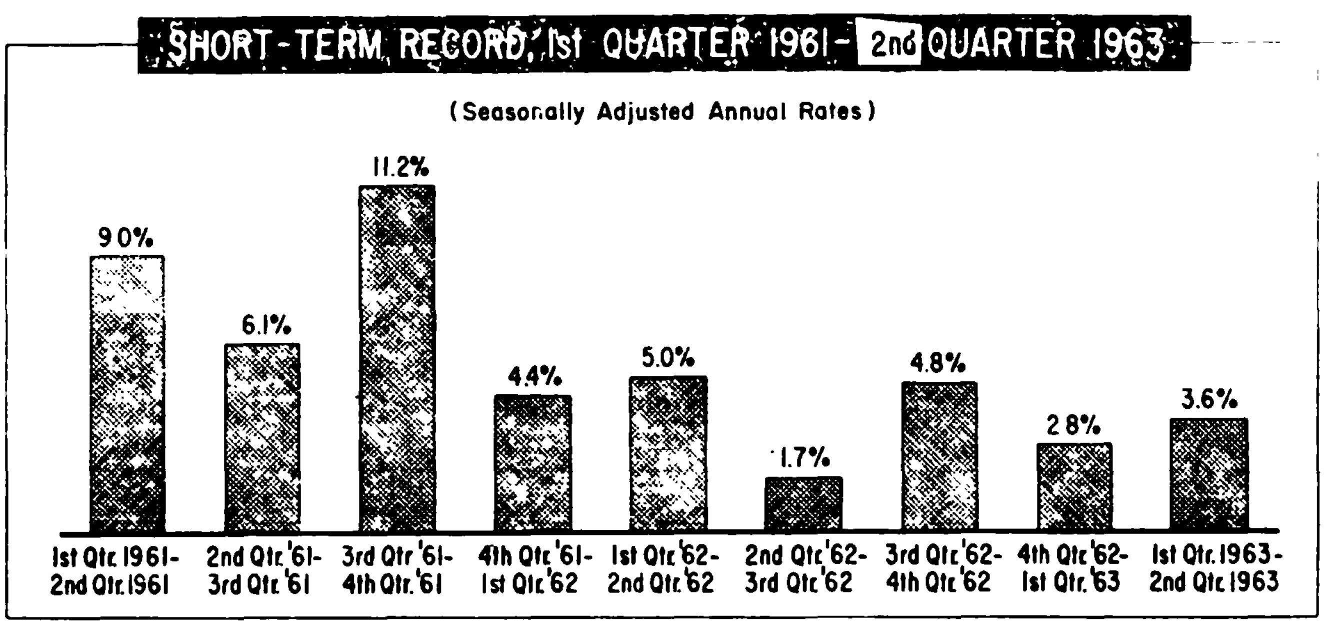


CHART 2

RECESSIONS, BOOMS, STAGNATIONS, 1953 - '63: RATES OF CHANGE IN G.N.P.

In 1962 Dollars





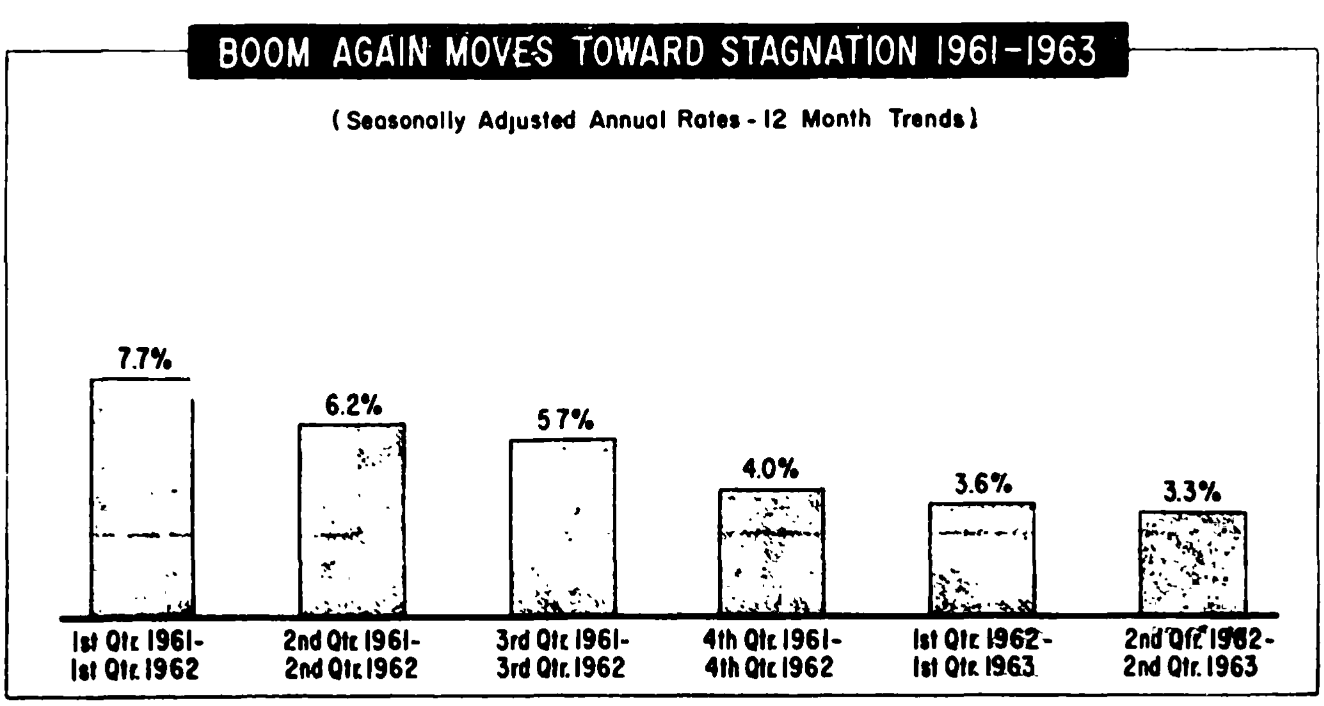
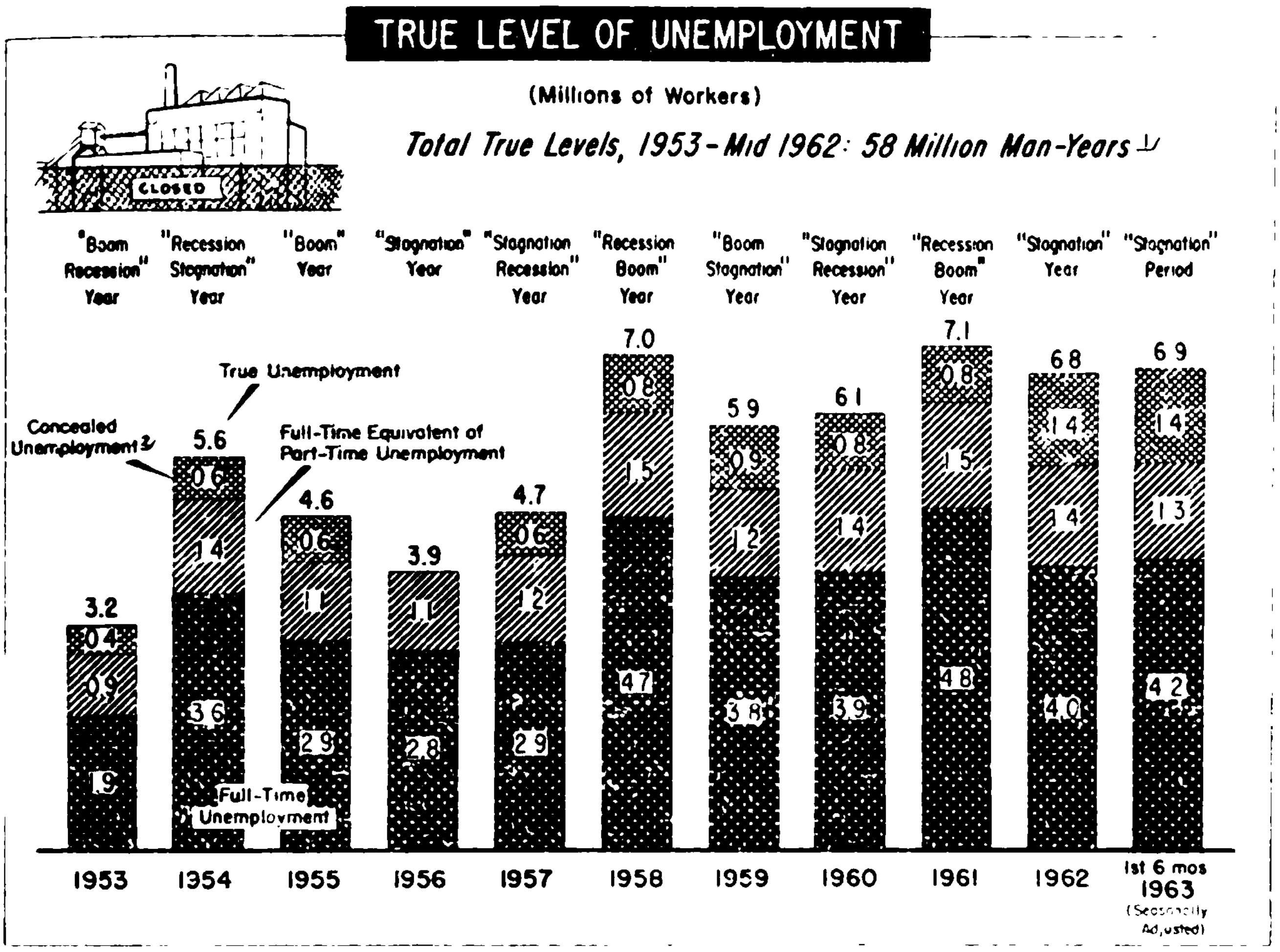
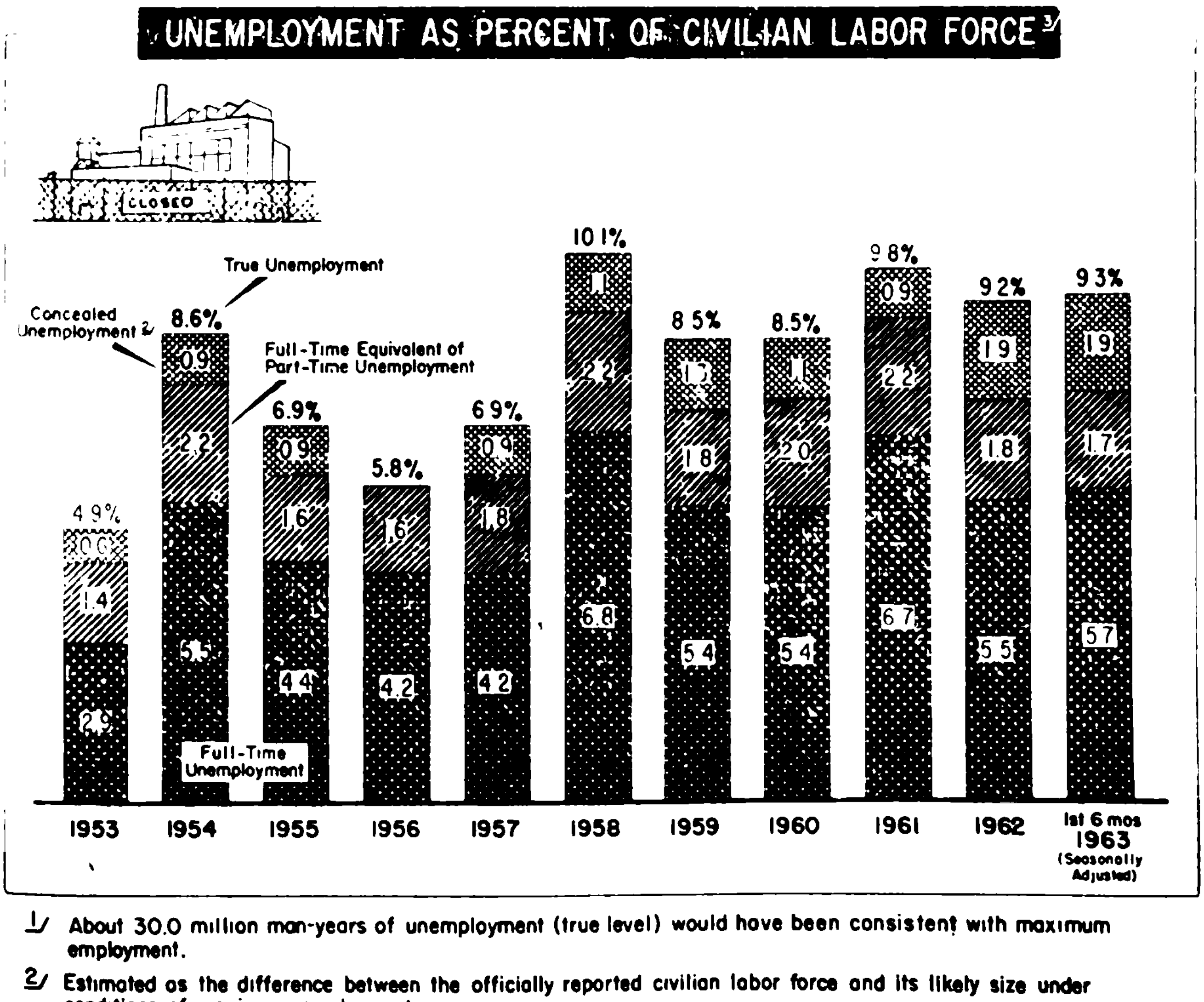


CHART 3

CHRONIC RISE OF UNEMPLOYMENT, 1953-1963





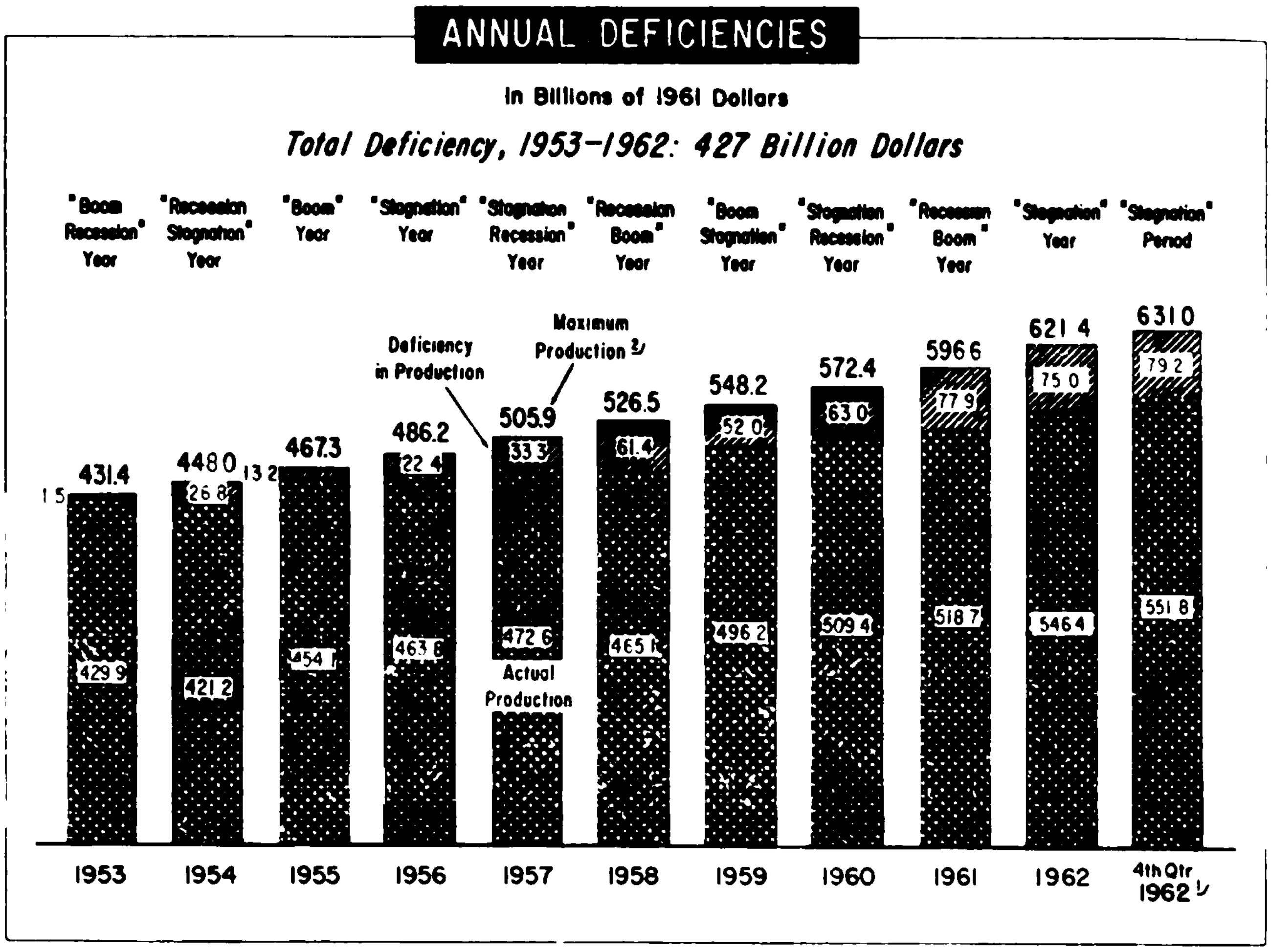
1/ About 30.0 million man-years of unemployment (true level) would have been consistent with maximum employment.

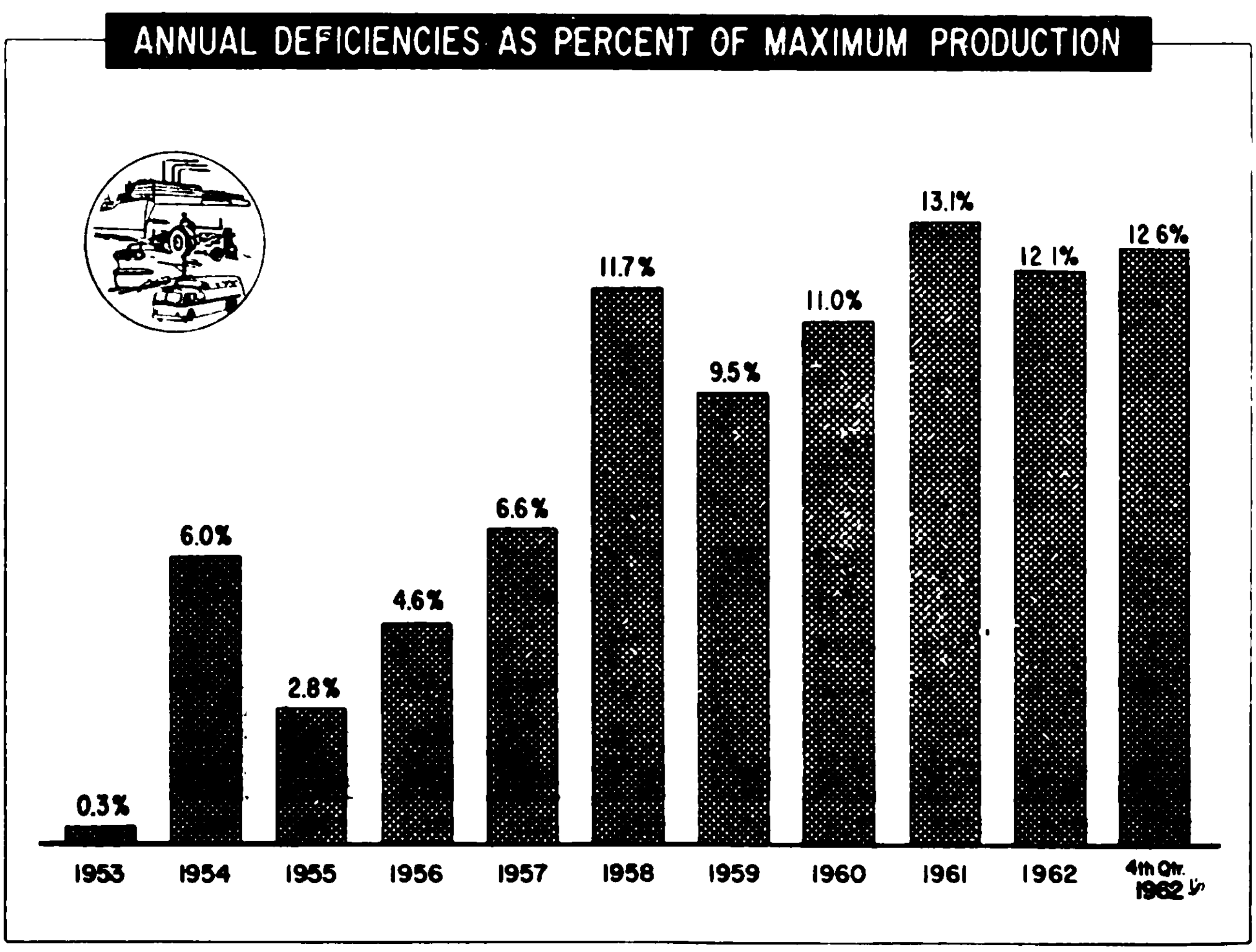
2/ Estimated as the difference between the officially reported civilian labor force and its likely size under conditions of maximum employment.

3/ In deriving these percentages, the civilian labor force is estimated as the officially reported civilian labor force plus concealed unemployment.

CHART 4

CHRONIC RISE OF OUR UNUSED PRODUCTIVE POWERS (G.N.P.), 1953-1962





1/ Seasonally adjusted annual rate.

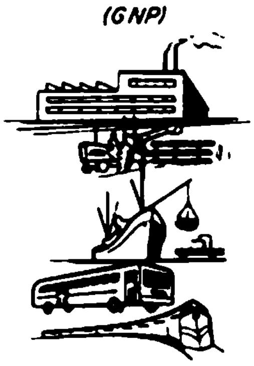
2/ Based upon sufficient annual rate of growth in G.N.P. to provide full use of growth in labor force, plant and productivity under conditions of maximum employment and production.

CHART 5

LARGE NATIONAL ECONOMIC DEFICITS DURING PERIOD 1953–1st QUARTER 1963

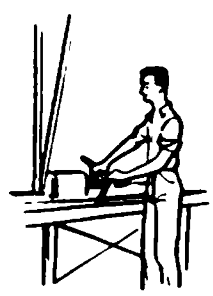
Dollar Items in 1962 Dollars

TOTAL NATIONAL PRODUCTION *(GNP)*



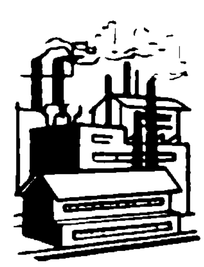
$439 Billion Too Low

MAN YEARS OF EMPLOYMENT



27.5 Million Too Low

PRIVATE BUSINESS INVESTMENT *(Incl Net Foreign)*



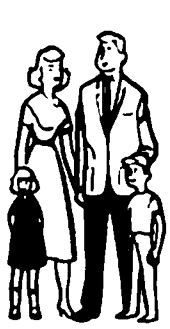
$110 Billion Too Low

PRIVATE AND PUBLIC CONSUMPTION [1]

$329 Billion Too Low

. . .THESE HAVE LED TO LARGE LOSSES TO ALL ECONOMIC GROUPS

AVERAGE FAMILY INCOME *(Multiple-Person Families)*



$6,800 Too Low

FARM OPERATORS' NET INCOME

$66 Billion Too Low

WAGES AND SALARIES

$283 Billion Too Low

UNINCORPORATED BUSINESS AND PROFESSIONAL INCOME

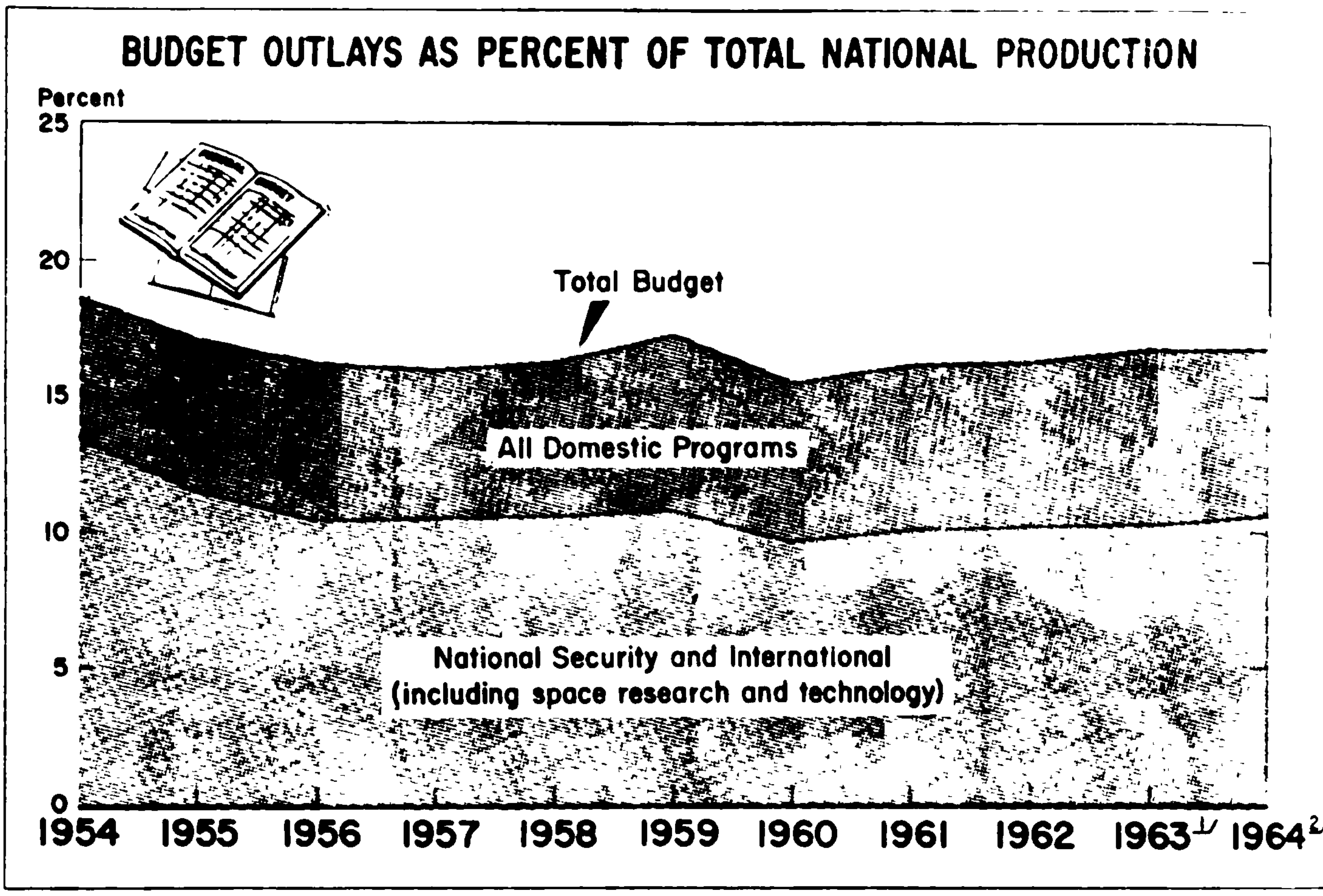
$30 Billion Too Low

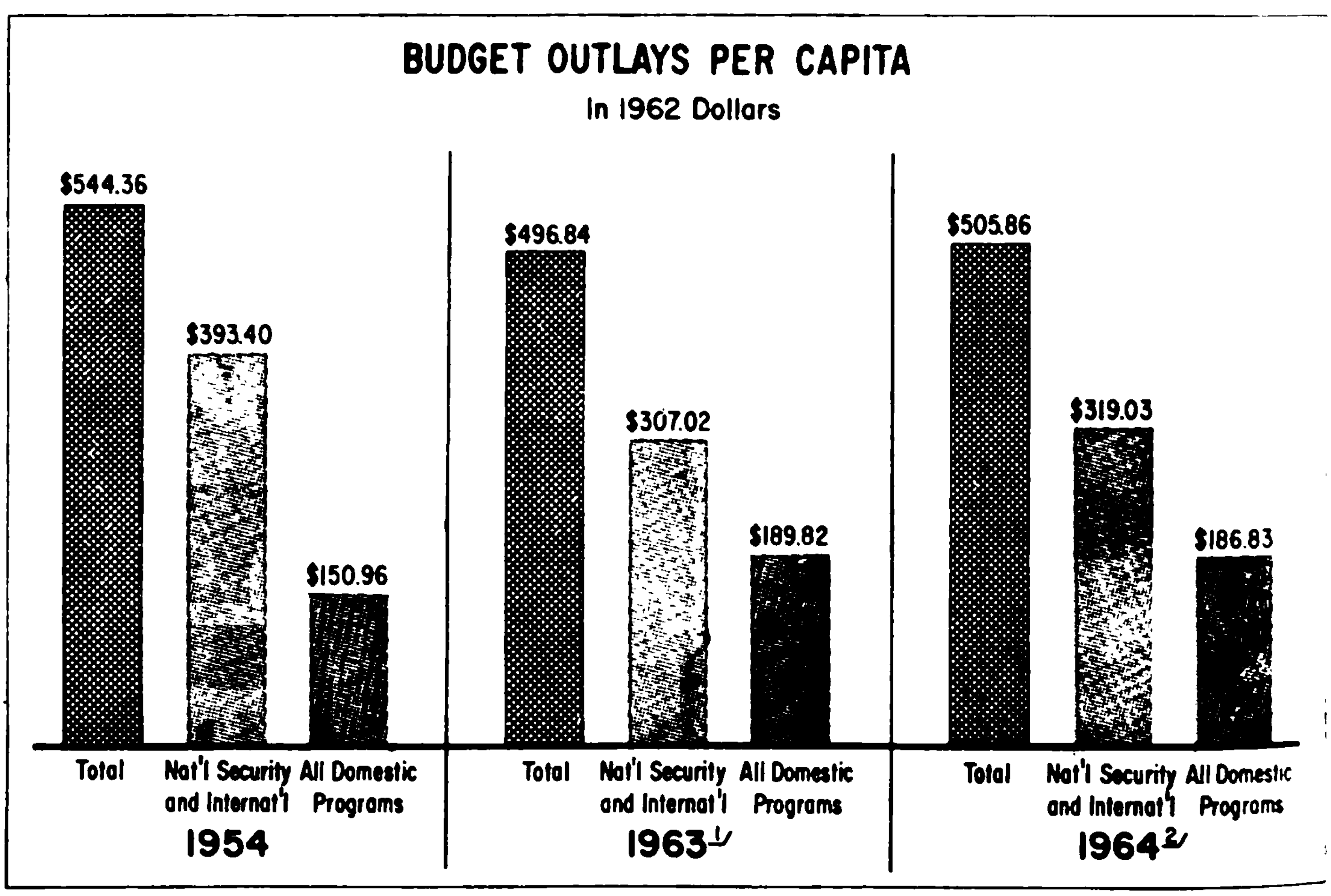
[1] Includes personal consumption expenditures plus government (Federal, state, and local) expenditures (286 and 43 billions, respectively)

CHART 6

FEDERAL BUDGET HAS SHRUNK RELATIVE TO SIZE OF ECONOMY AND NEEDS, 1954–'64

Fiscal Years





1/ Preliminary G.N.P. estimated at $565 billion, CEP.

2/ Administration's proposed Budget as of Jan. 17, 1963, G.N.P. estimated at $588 billion, CEP.

CHART 7

THE FEDERAL BUDGET REFLECTS NATIONAL ECONOMIC DEFICIENCIES

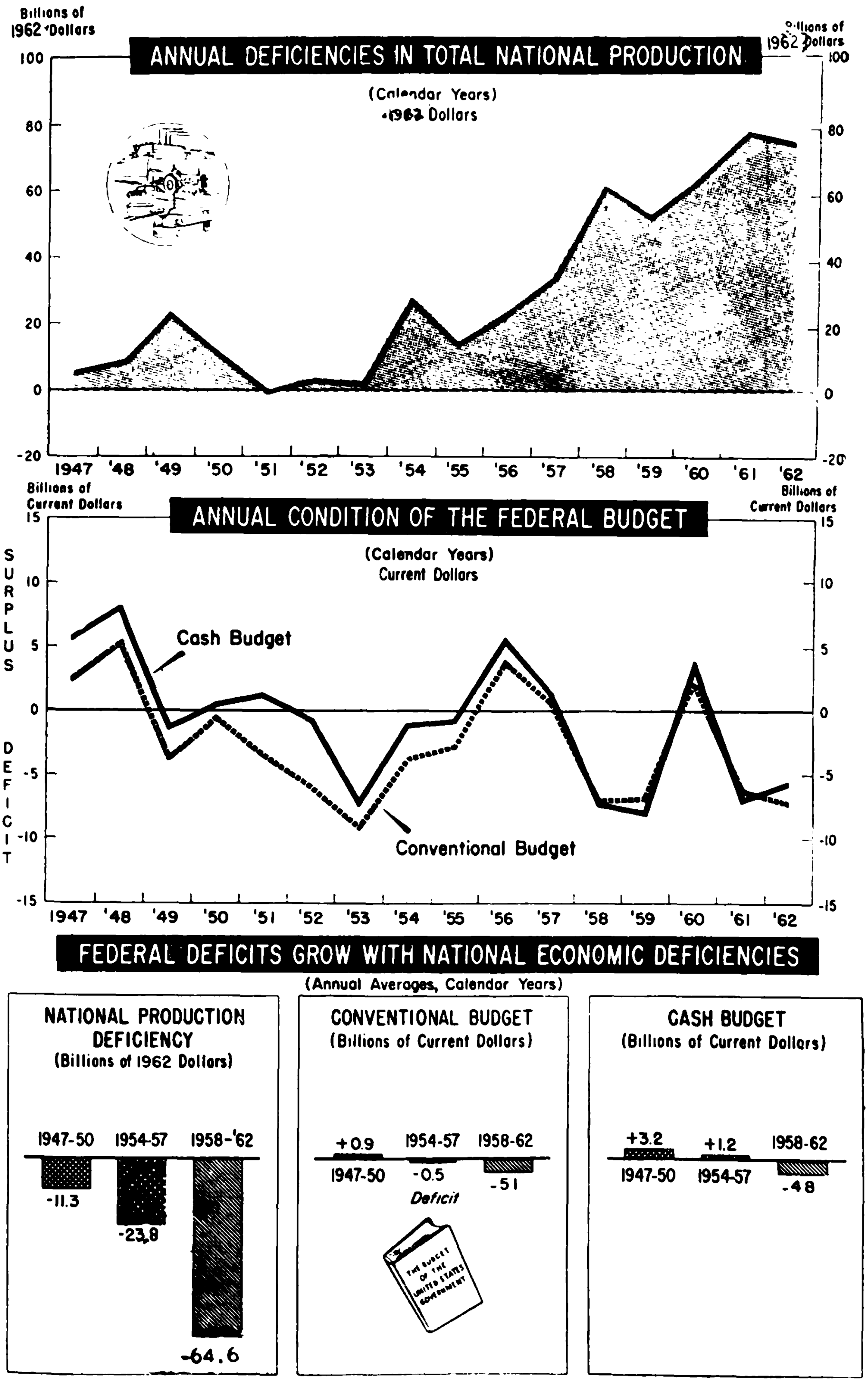
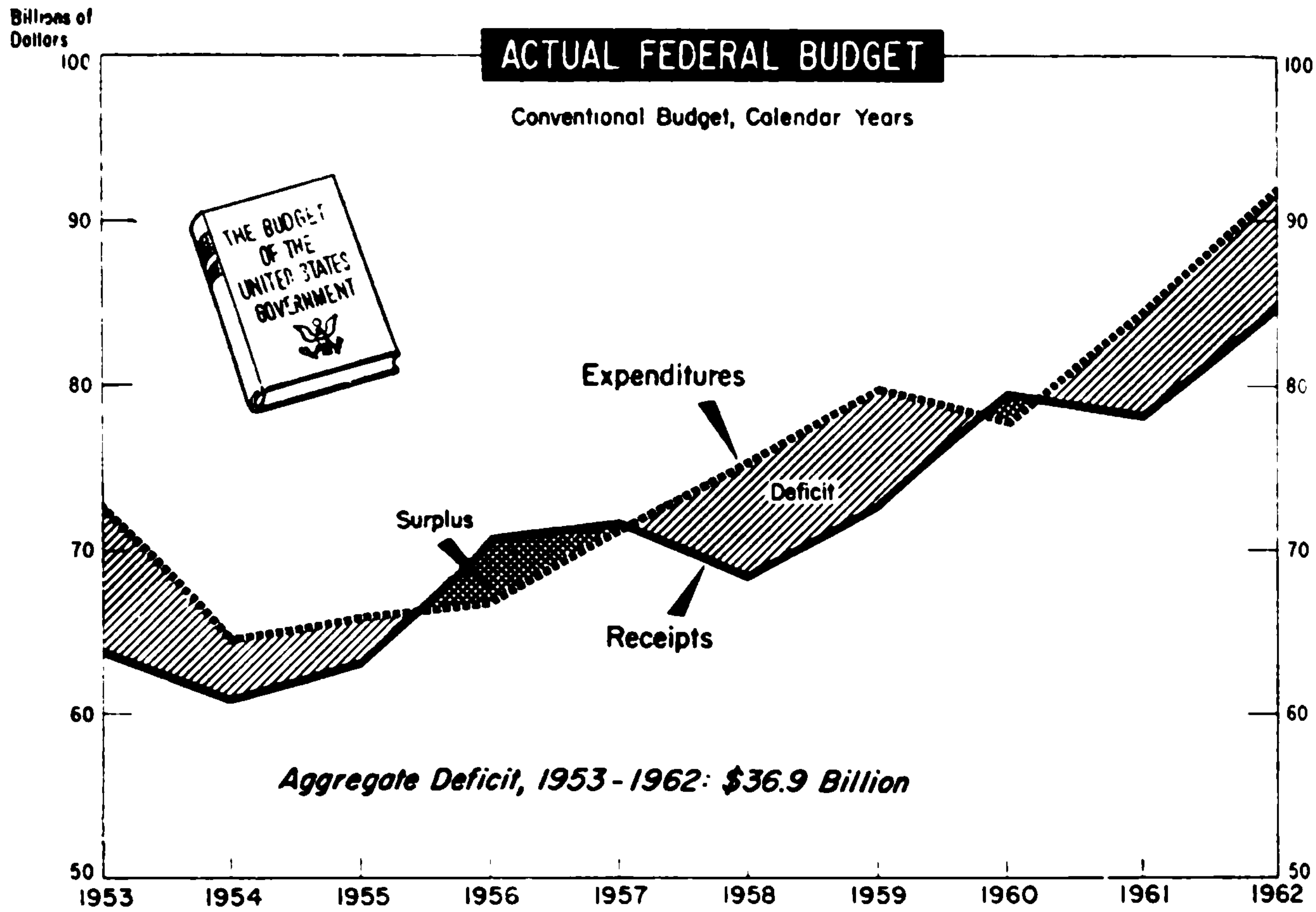
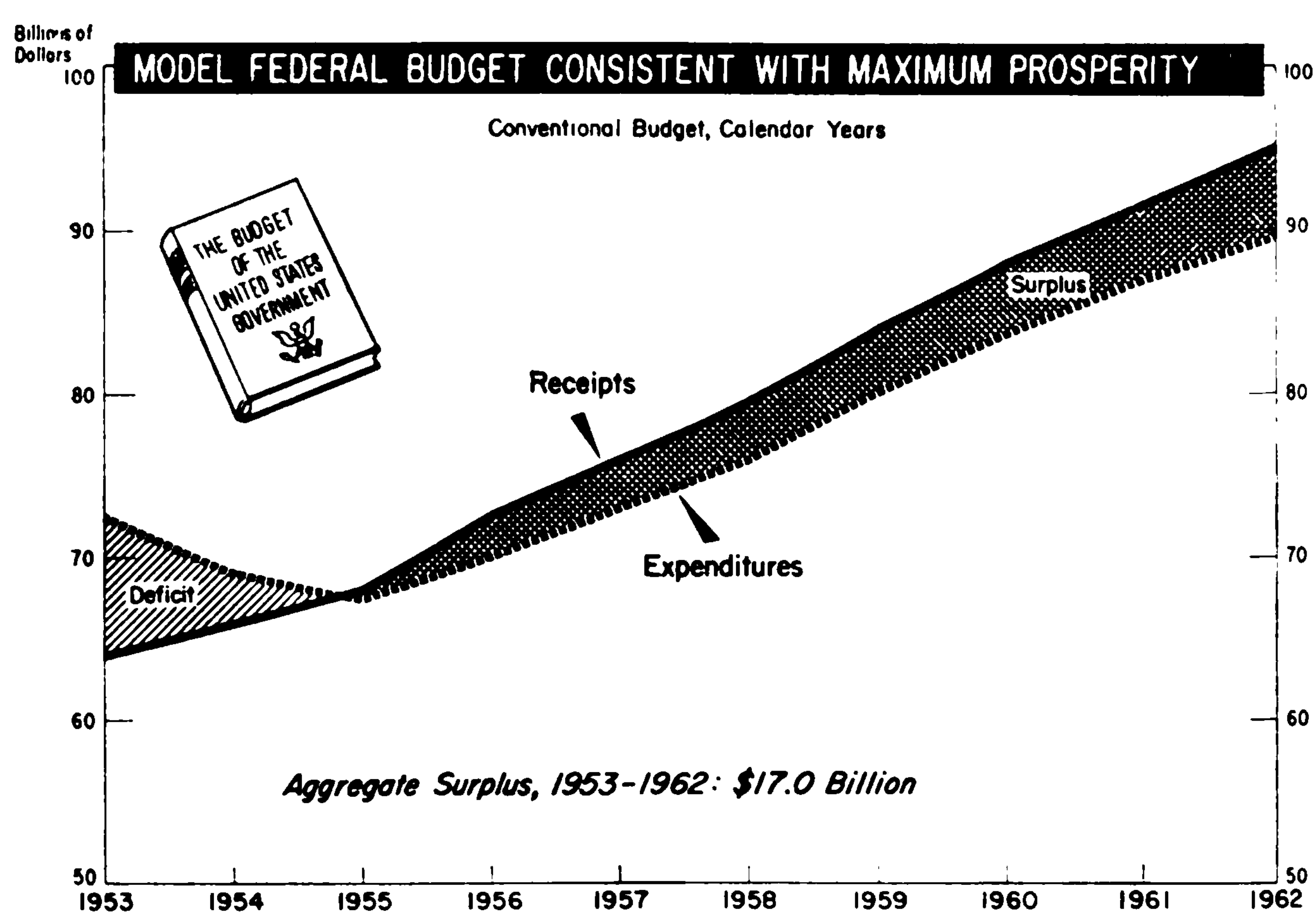


CHART 8

A BALANCED FEDERAL BUDGET DEPENDS UPON A MAXIMUM PROSPERITY ECONOMY



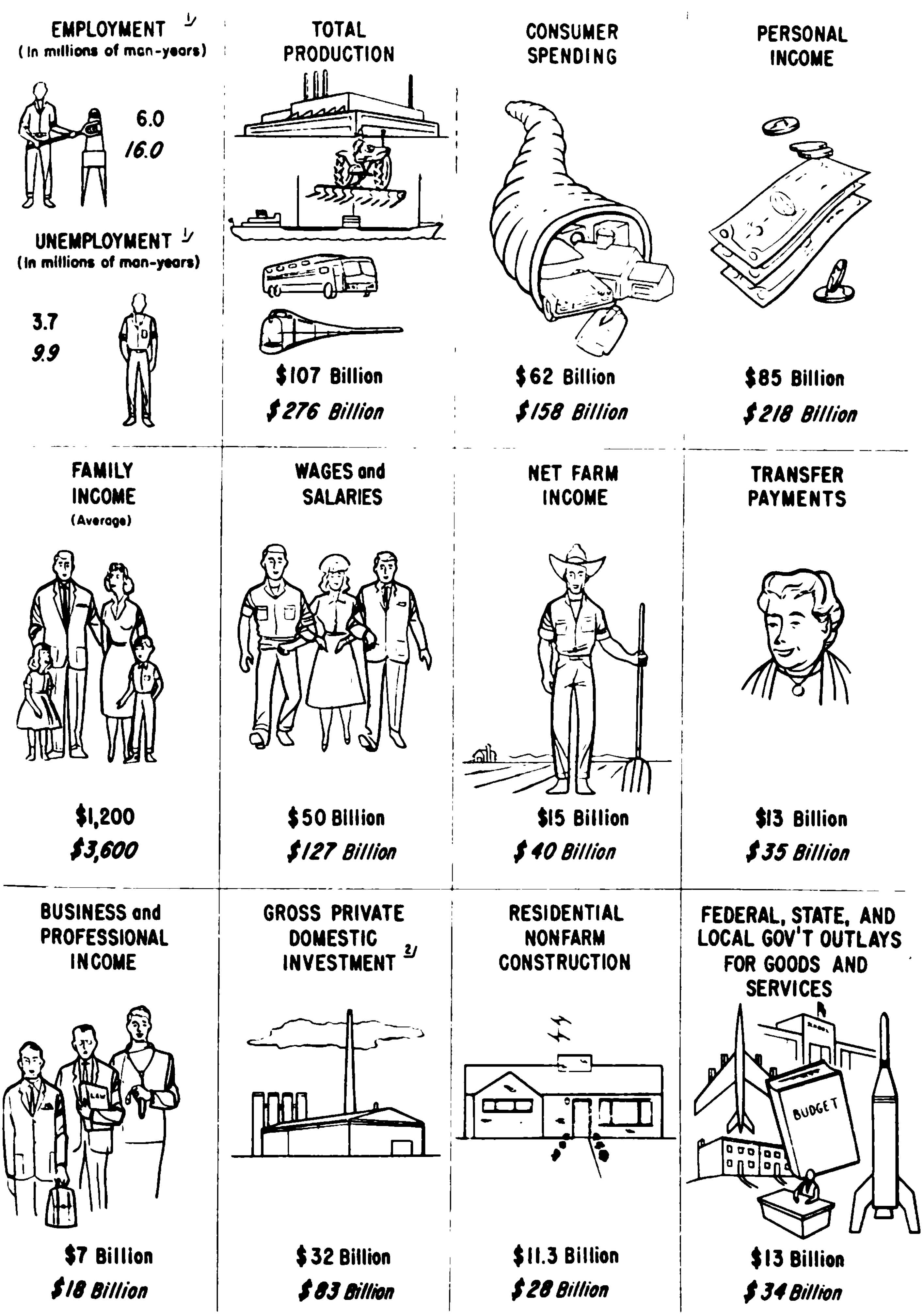


1/ Expenditures are shown as actual expenditures plus estimated deficiencies in expenditures during the period. Receipts are estimated by applying actual tax rates to maximum prosperity levels of economic activity.

CHART 9

DIFFERENCES IN RESULTS OF HIGH AND LOW ECONOMIC GROWTH RATES, 1963-1966

Bold face - Difference in 1966; *Italics - Difference for four year period as a whole*
Dollar figures in 1962 dollars

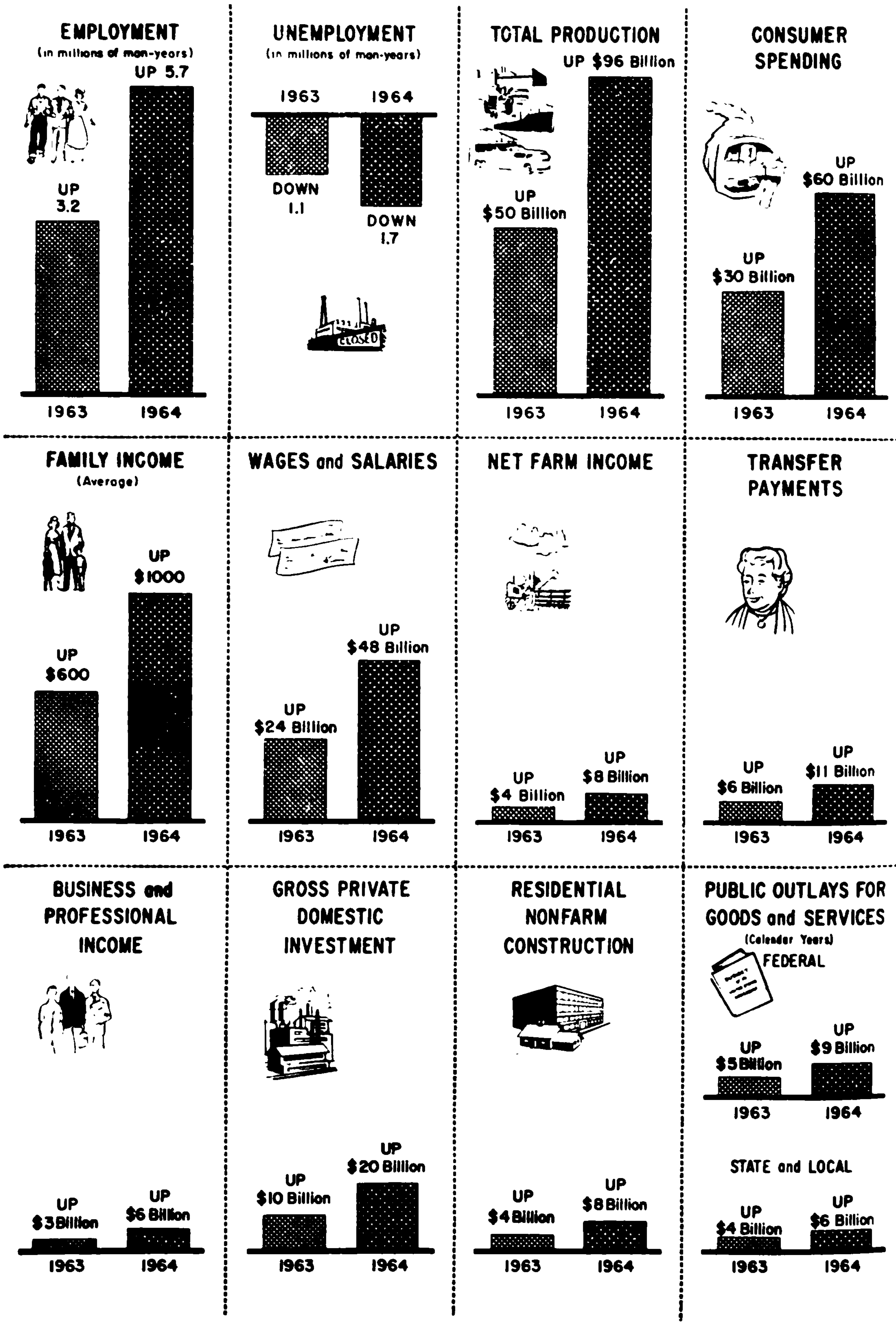


1/ High growth rate would draw more persons into the labor market than low growth rate
2/ Including net exports of goods and services

CHART 10

GOALS FOR 1963 AND 1964, CONSISTENT WITH LONG-RANGE GOALS THROUGH 1966

1963 and 1964 Goals Compared with Estimated 1962
Dollar Figures in 1961 Dollars



(2) My second basic proposition is that devising the proper kind of tax reduction depends upon correct analysis of the type of disequilibrium which has occurred in the U.S. economy during the past and is still present.

My 11th chart translates my estimates of the deficits in total national production from the beginning of 1953 through the second quarter of 1963 into my estimates of the deficits in the three main components of total national production or GNP—private consumer expenditures, gross private investment, and public outlays at all levels of Government for goods and services. The main purport of the chart is to show that by far the largest deficits have occurred with respect to private consumer expenditures. For the second quarter of 1963, I estimate a deficit of about $58 billion in these private consumer expenditures, measured against a GNP deficit or gap of about $78 billion.

My 12th chart shows that the deficient rate of growth in private consumer spending, 1953–63, has dominated in magnitudes the deficits in the total economy. And my 13th chart indicates that these deficits in private consumption have resulted, not primarily from a propensity of consumers as a whole to spend too small a part of their disposable incomes and to save too large a part, but rather from deficiencies in the total expansion of disposable incomes. The distribution of income has also tended to encourage oversaving and underconsumption. All this, as I shall disclose in due course, has a powerful bearing upon the whole issue of appropriate and inappropriate changes in tax policy, and in other national economic policies also.

My 14th chart shows that gross private domestic investment and also investment in plant and equipment, during the period 1953–63 as a whole, was indeed deficient, as almost everything was deficient in an economy expanding at little better than half the needed rate. But during each period of economic upturn, as the chart shows, the expansion of investment in the plant and equipment which enlarge our productivity capabilities raced forward at a nonsustainable rate, very much more rapidly than the demand for ultimate products represented by the combination of private consumer outlays and public outlays at all levels for goods and services. To take the most recent illustration, from the first half of 1961 to the second half of 1962, this investment in plant and equipment rose 8.5 percent, while demand for ultimate products rose only 5.1 percent.

These nonsustainable upward surges in private investment in plant and equipment were supported by ample or more than ample after-tax profits, savings, credit, and other sources of funds for these purposes. The sharp investment downturns which occurred periodically, and which sparked the recessionary movements, were not occasioned by any shortages of such funds, but were occasioned by the excess plant capacity which had developed in consequence of the inadequate growth in demand for ultimate products.

This summary analysis of the disequilibriating factors during the past decade and even now indicate unanswerably that changes in tax policies and in other national economic policies should now be directed toward bringing the demand for ultimate products into better line with the growth in our productive capabilities. Before analyzing why the current tax bill in its present form is not adjusted to this purpose, I would like to bring before this committee in more detail the investment trends during the periods of economic upturn since 1953 to date, as these bear upon the whole problem of our U.S. economic performance, including the rate of economic growth and the levels of idle manpower and plant.

(3) My third basic proposition is that investment trends during the past decade, when compared with other trends, provide no justification for the proposition that large tax concessions are needed now for the purpose of stimulating investment, especially when the additional Federal deficits which these concessions would entail could be devoted to far more salutory programs in the interest of the national economy.

Before going into this subject in detail, I would like to dispose of the notion, urged upon me by some of my friends in the Government and elsewhere, that large deficits deliberately incurred to stimulate private investment are in accord with a "modern" or "progressive" economic philosophy, as represented for example by the teachings of Lord Keynes. Of course, the teachings of Lord Keynes, developed decades ago in the context of the depressionary worldwide situation then prevailing, and with particular reference to the Britain of that era, may not be entirely relevant today. In any event, the core of Lord Keynes' position was that, due to the unsatisfactory distribution of income, and its effect upon the propensity to consume, total private saving became too large to

CHART 11

DEFICIENT "DEMAND" OR SPENDING ACCOUNTS FOR DEFICIENT TOTAL PRODUCTION (GNP)

Billions of 1962 Dollars

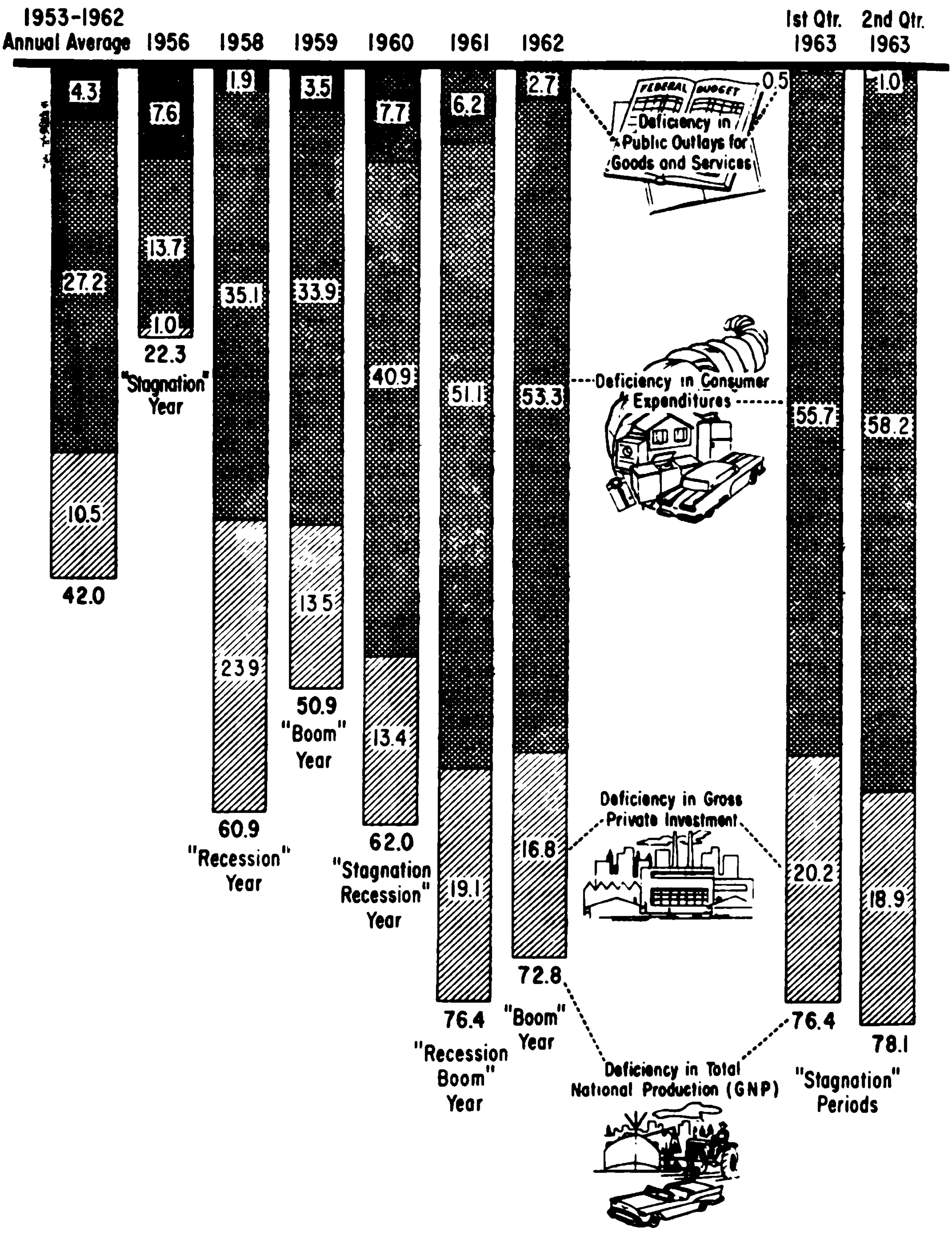
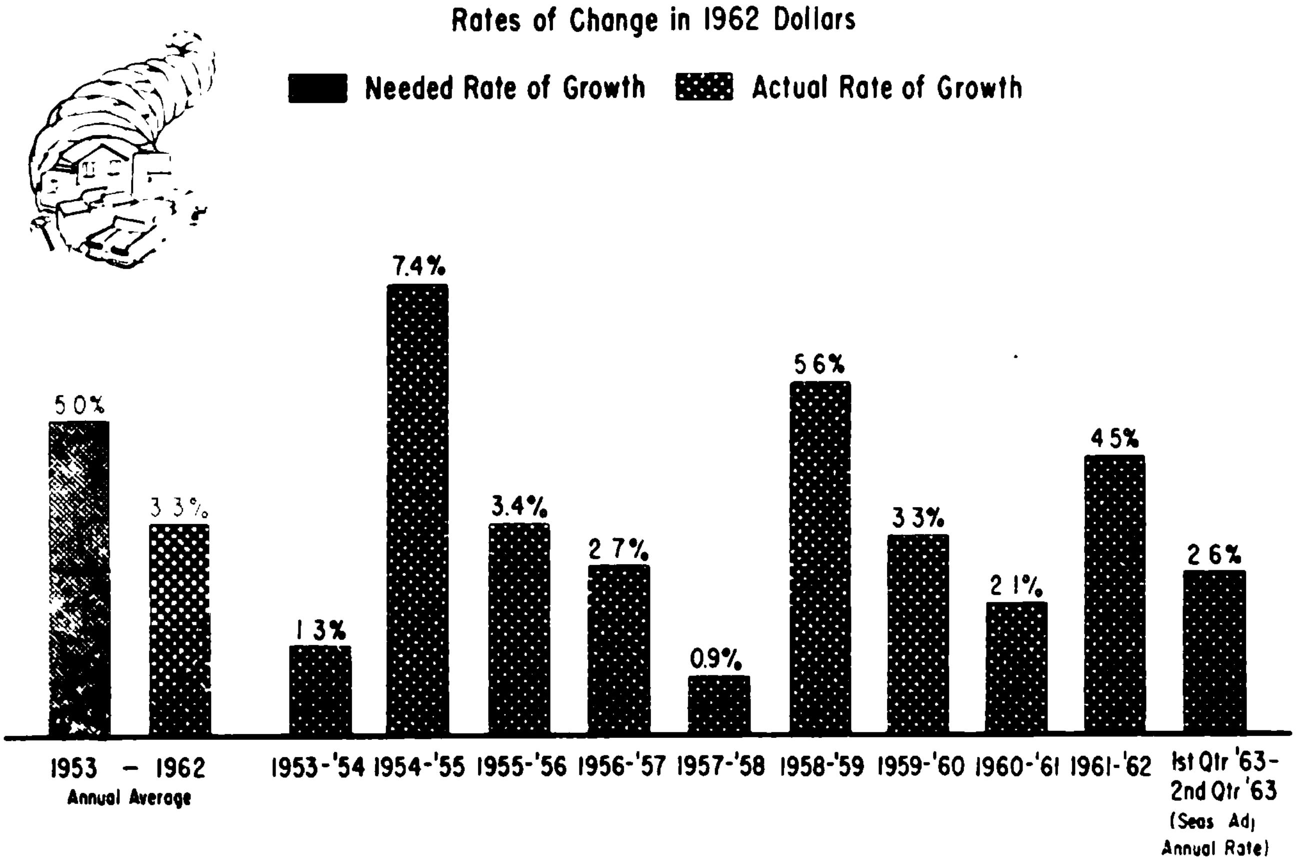


CHART 12

DEFICIENT RATE OF GROWTH IN PRIVATE CONSUMER SPENDING, 1953 - 1963

Rates of Change in 1962 Dollars



THE PRIVATE CONSUMPTION DEFICITS DOMINATE THE DEFICITS IN THE TOTAL ECONOMY

Billions of 1962 Dollars

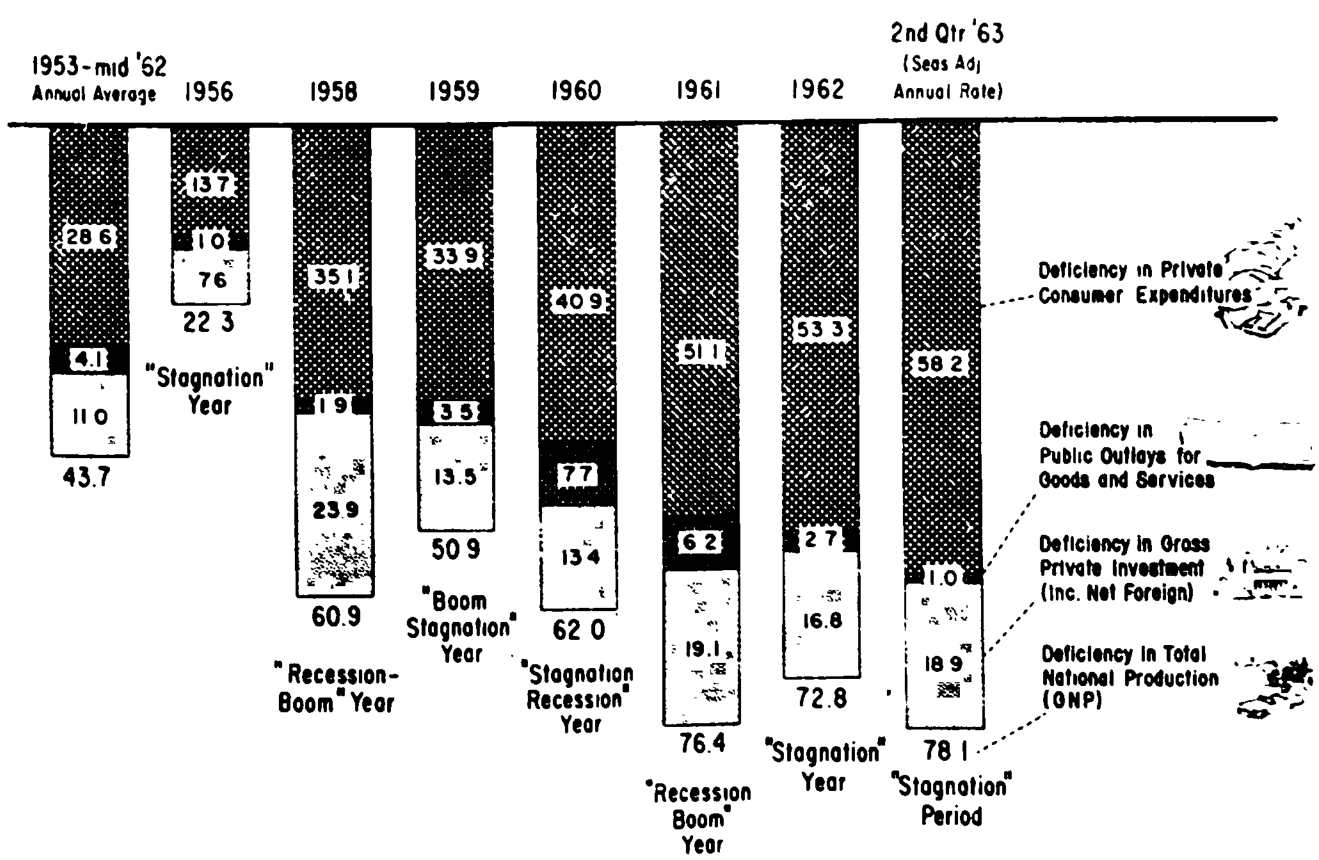
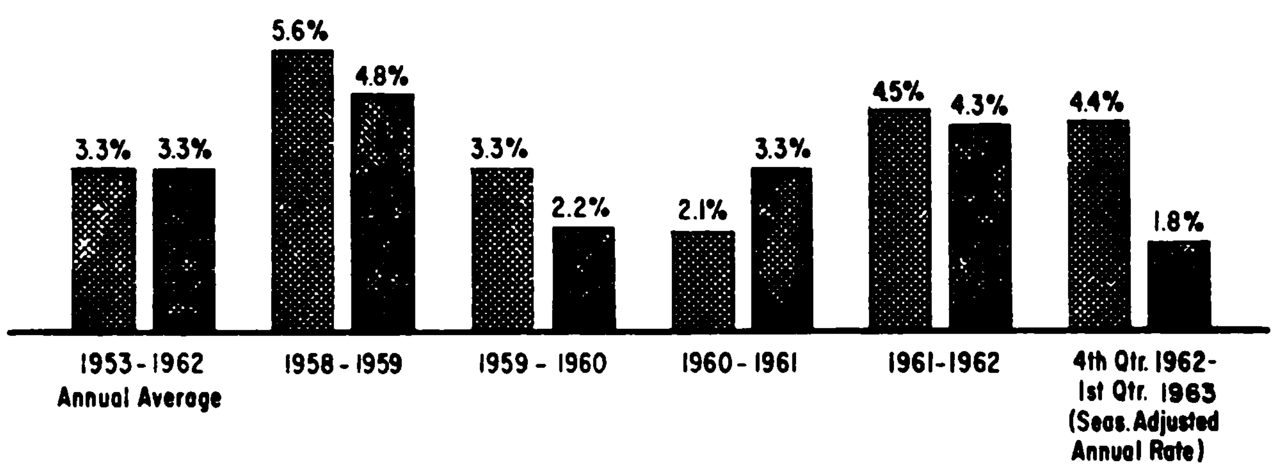


CHART 13

LOW GROWTH IN PRIVATE CONSUMPTION REFLECTS LOW GROWTH IN INCOMES

Rates of Change in 1962 Dollars



THE PRIVATE CONSUMPTION DEFICIENCY OF $286 BILLION, 1953-1st Qtr. 1963 REFLECTED A $375 BILLION INCOME DEFICIENCY

Billions of 1962 Dollars

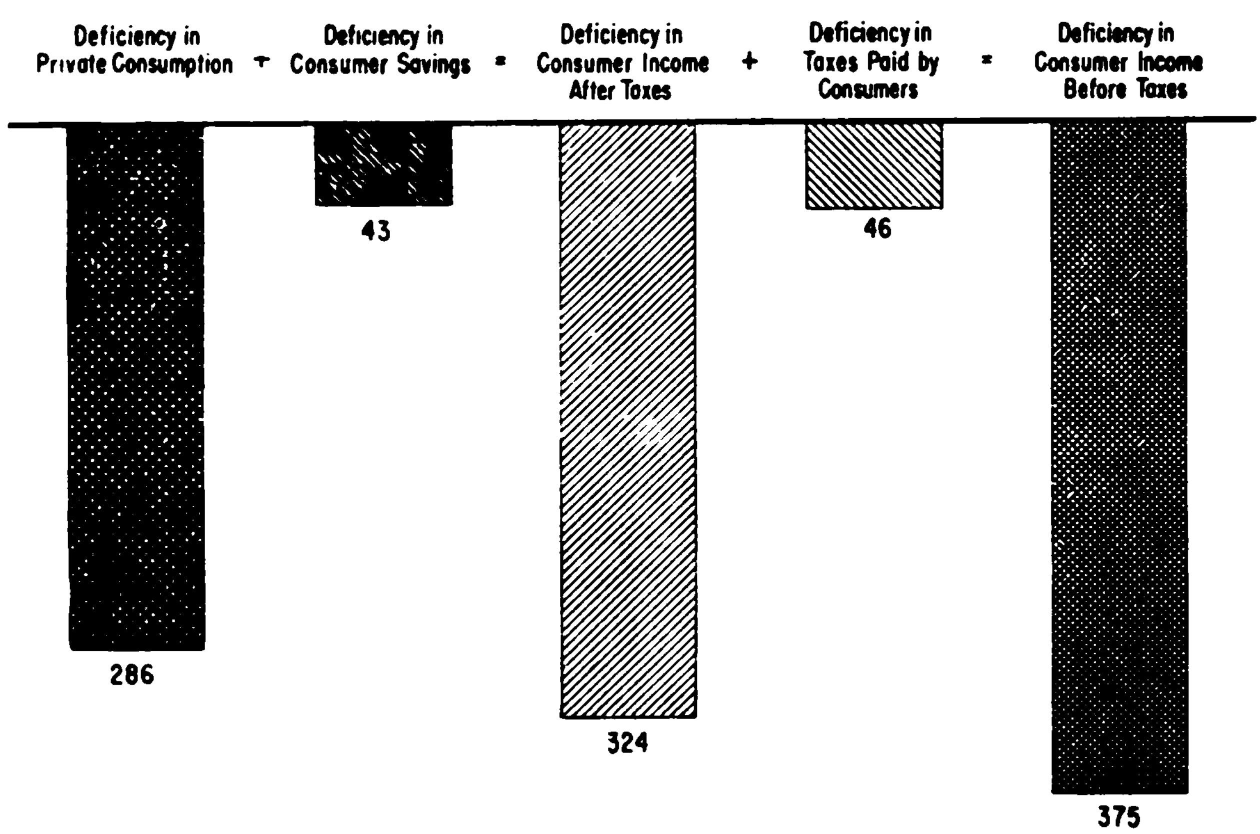
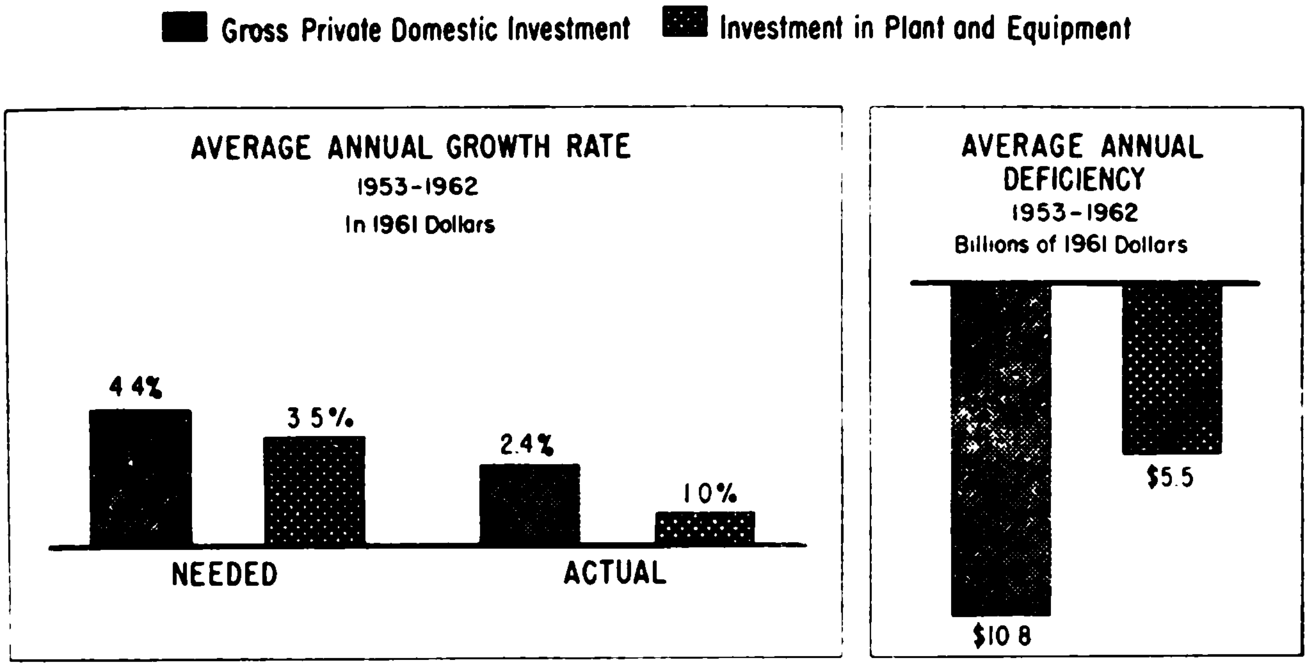
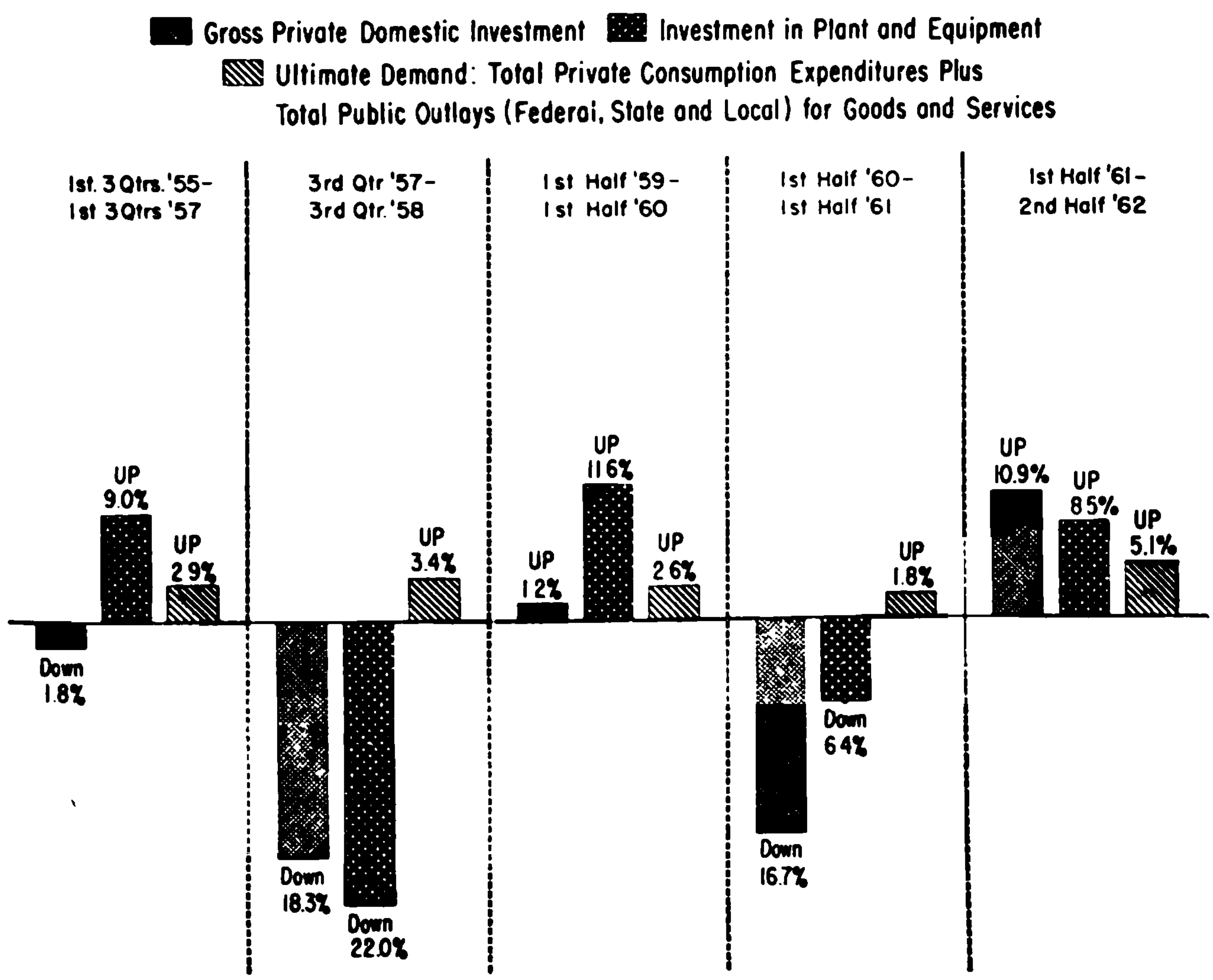


CHART 14

GROSS PRIVATE DOMESTIC INVESTMENT WAS DEFICIENT DURING 1953-1962 AS A WHOLE



BUT INVESTMENT IN MEANS OF PRODUCTION AT TIMES OUTRAN ULTIMATE DEMAND; HENCE INVESTMENT CUTS AND RECESSIONS



Average Annual Rates of Change, 1961 Dollars find its way promptly into private investment, so that investment plus consumption did not add up to full employment. His major remedy for this was increased public outlays of an investment nature, incurred by deficit financing, which would bring total saving into line with total investment at full employment. But I can hardly imagine, viewing the situation in the United States during the past 10 years, when the distribution of income has led to private saving in excess of private investment and consequent unemployment, that the great and perceptive John Maynard Keynes if alive today would recommend the handout of tax concessions to private investors whose savings are already redundant in terms of any investment programs which current of foreseeable levels of ultimate demand would justify at this time. Instead, Lord Keynes I am sure, would if here now recommend increases in public investment, combined with measures to stimulate private consumption. This, indeed, is what the best economic brains in the Government now were urging a few years ago, before they were overpowered and outmaneuvered by the Secretary of the Treasury and the Chairman of the Federal Reserve System.

It is interesting to note that, a few years ago, the then Secretary of the Treasury and the then Chairman of the Federal Reserve System were advocating tax concessions to stimulate investment, on the ground that there was a shortage of savings available for investment purposes. While I did not agree at the time that there was any such shortage of savings, which they later confessed, there was at least logic in their remedies, assuming their set of facts. But very recently, when spokesmen for the Treasury were asked why the increase in short-term interest rates would not drive up long-term interest rates, their answer was that this would not happen because of the oversupply or redundancy of saving available for investment purposes. So it would seem that the Treasury wants tax concessions to stimulate investment both when saving is alleged to be too low and when saving is admitted to be too high. This I cannot understand.

With these introductory comments, I turn to my more detailed analysis of investment trends compared with other relevant trends. My 15th chart shows that, during the 2 years preceding the 1957–58 recession, investment in the plant and equipment which add to our productive capacities rose with enormous rapidity in key areas of industrial activity. This investment splurge was supported in the main by very large increases in prices and in profits after taxes.

My 16th chart portrays the enormous upsurge in investment in plant and equipment during the year preceding the 1960–61 recession, despite a generally downward movement in prices and profits. This indicates that investment trends in the short run are governed, not so much by the trends in prices and profits, as by the expectancies of investors with respect to the prospective demand for their products. In this period, as in the earlier period just discussed, the expectancies were not justified by the actual trends in consumer incomes and in consumption.

My 17th chart, dealing with the upturn period from first quarter 1961 right down through second quarter 1963, shows in the majority of cases a recurrence of the nonsustainable investment splurge. In two of the cases, it shows that increases in profits after taxes have been accompanied either by a very moderate upturn in investment or by a downturn in investment where excess capacities are very extreme, thus indicating again that it is the demand for ultimate products relative to capacity which is the controlling factor in determining the level of investment. In all of these three upturn periods just examined, as I disclosed earlier, the upturn in investment in plant and equipment was very much more rapid than the rate of expansion in the demand for ultimate products comprising both private consumer expenditures and public outlays for goods and services at all levels.

Because investment in plant and equipment adds to our productive capabilities and is supported substantially by profits after taxes, and as wages are a main factor in the expansion of private consumer incomes and outlays, it is essential to look also at the relative trends in these areas during the three periods of economic upturn since 1953.

My chart 18 shows that, during the 2 years preceding the 1957–58 recession, profits after taxes and investment far outran the expansion in wage rates which is an important component in the expansion of total wages. My 19th chart shows that, even with reduced profits from excessively high levels, the expansion of investment in plant and equipment enormously outran the expansion of wage rates during the year preceding the 1960–61 recession. And my 20th chart shows an expansion in profits after taxes at a tremendously faster pace than the expansion in wage rates during the current economic upturn from early 1961 through mid-1963. In view of the extraordinary amount of unused plant capacity, the expansion in profits after taxes has not been accompanied during this current upturn by any comparable expansion of investment in plant and equipment, which shows once again that more after-tax profits will not spark optimistic investment when idle plant capacity is much too high and demand for ultimate products much too low. In some cases, the investment in plant and equipment has been faster (in the case of motor vehicles and equipment, more than six times as fast) as the expansion in wage rates; in other cases, the investment in plant and equipment has lagged behind the expansion in wage rates. But this last-mentioned phenomenon must be viewed in the perspective that we still have a great gap in wage payments as a factor in the great gap in consumer incomes, while the rate of expansion in investment in these cases is repressed not by any inadequacy of profits after taxes or other available funds, but rather by the deficiencies in ultimate demand.

Actually, despite much misguided propaganda to the contrary, the increases in wage and salary rates during the most recent years have lagged very far behind the increases in productivity, and this of course has an important bearing upon the proper distribution of tax cuts. Thus, as shown by my 21st chart, during the most recent 5-year period 1957–62, productivity per employee-hour in the whole nonfarm economy rose in an average annual rate of 3.1 percent, while the average annual increase in wage and salary rates was only 2.7 percent. And in manufacturing during this 5-year period, as shown by my 22d chart the average annual increase in output per man-hour was 3.4 percent, while the average annual increase in wages and salaries was only 2.2 percent. It is only very recently that these alarmingly disparate trends have begun to receive the notice they deserve.

These comparisons reinforce mightily my proposition that there is now no justification for tax concessions to investors in order to speed up the rate of productivity growth. The real problem is to bring the expansion of consumption into line with actual trends in productivity growth. Moreover, as I have been stressing for a number of years, the inefficiencies resulting from very large economic slack have resulted in an actual growth in productivity as conventionally measured far below the technological growth in our productivity potentials as affected by improved machinery and automation. Very recent studies put out by the Department of Labor confirm me fully on this vital point. And indeed, as my 23d chart shows, the long-range trends in our output per man-hour or productivity have tended through the decades to accelerate greatly, except when artificially repressed by large economic slack.

Therefore, the situation we confront now is this: With the economy moving upward, the rate of productivity growth tends to increase rapidly, so that the economic upturn results in a decreasing ratio of the expansion of employment to the expansion of output. Second, the economic upturn results in more hours of work per week. In consequence, the current upturn has been very unsatisfactory from the viewpoint of reducing unemployment. The ultimate meaning of this is that, in view of the rapidly accelerating productivity potentials due to technology and automation, a very much higher growth rate than that set by the Council of Economic Advisers is needed to reduce unemployment. To state this in another way, we will be hard put to achieve increases in ultimate demand large enough to bring us toward reasonably full utilization of plant and manpower.

The last thing in the world that we need, under such circumstances, are large tax concessions to the investment process, on the ground that these are required to speed up productivity growth, to enlarge our economic growth rate at home, to make us more competitive overseas, and to improve our balance-of-payments and gold position. Insofar as unbalanced tax concessions would increase the disequilibrium between productivity growth and idle plant capacity on the one hand, and inadequate ultimate demand on the other hand, such tax concessions would be self-defeating on all scores. In the longer run, they would even repress the rate of productivity growth (as in recent years past), in consequence of the inefficiencies resulting from high economic slack.

All of these conclusions are fortified by further examination of profit trends. My 24th chart presents the commonly known fact that after-tax profits in key industries by second quarter 1963 were soaring far above any previous peaks, despite large unused capacities. A very prominent business magazine declared recently that "the profit squeeze is off"—if one ever really existed in recent years. My 25th chart shows that, in key industries, profit sales ratios are very rewarding and generally are reaching new peaks, despite substantial idle capacities. My 26th chart shows that, during the past decade, the portion of total funds available to corporations used for plant and equipment investment has grown considerably, and that the portion of these corporate funds drawn from internal sources has also grown considerably.

I therefore submit, Mr. Chairman, and members of the committee, that large tax concessions now to stimulate investment would be largely wasted, and would do much less to stimulate investment than would be accomplished by measures designed to expand the demand for ultimate products. In the alternative, even if these tax concessions to stimulate investment should result in sustaining and prolonging a rate of investment which even now is moving forward more rapidly than the expansion of demand for ultimate products, this would only increase the disequilibriums within the economy and make the bitter harvest in due course even more severe.

We are now in danger of repeating some of the very errors which were committed in early 1957, when I protested before this committee and elsewhere the official proposition that, through tax amortization concessions and in other ways, we should seek to enlarge the rate of saving and thereby to stimulate investment. This was at a time when it was abundantly apparent that excess plant capacity was everywhere, and when I foretold another recession just around the corner. A year later, some of the very same officials who had been urging this policy came back before this very committee, which was then investigating the financial condition of the United States, and confessed that they had been wrong a year earlier when they had mistaken a growing deficiency in consumption for a deficiency in investment.

(4) My fourth basic proposition is that the specifics of the current tax bill, in its present form, provide excessive and substantially wasteful stimulants to investment, and far too little stimulation of consumption.

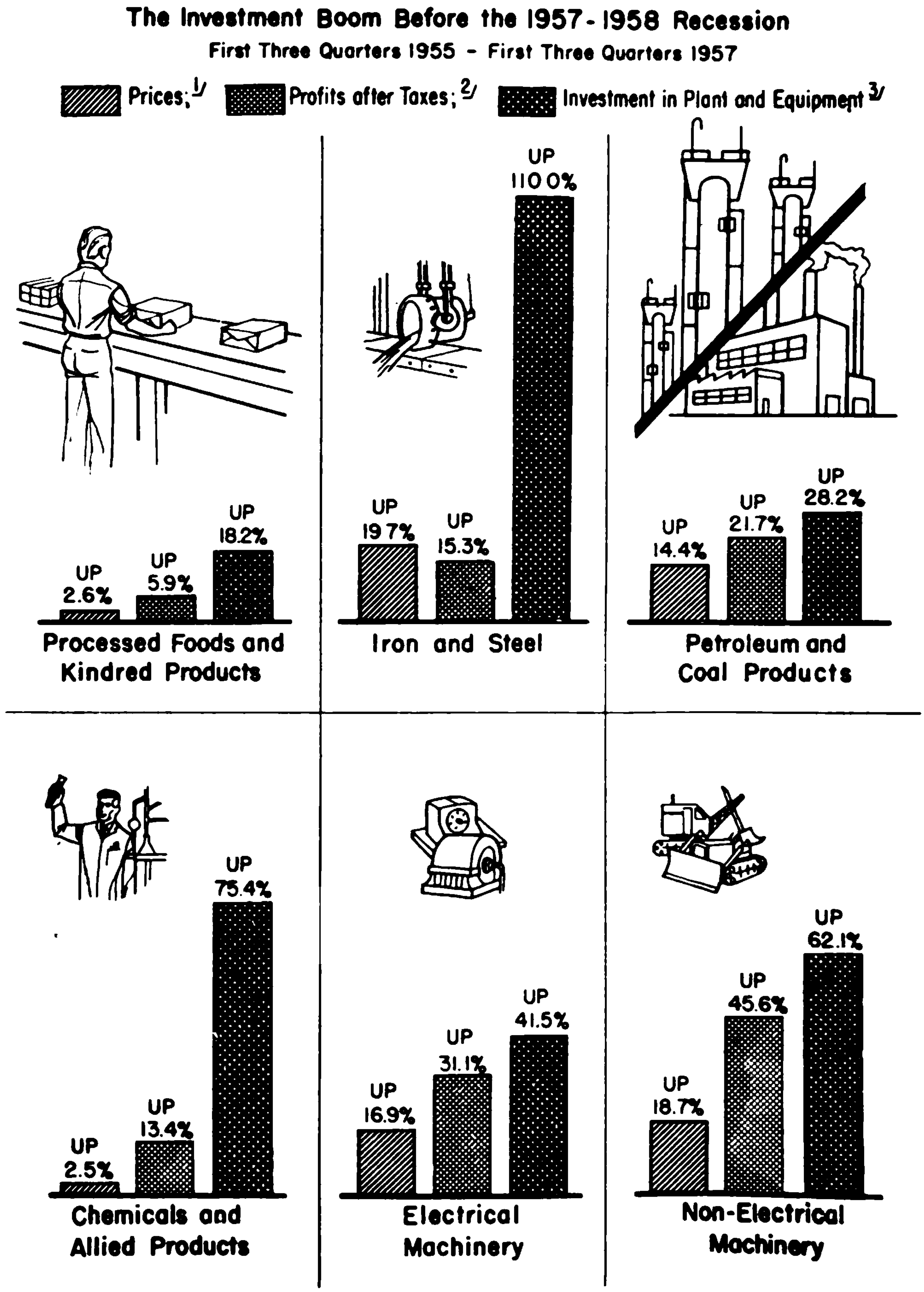
Coming now to the specifics of the current tax proposal, my 27th chart contains my estimates as to how the proposed tax cuts would divide between cuts for investment purposes and cuts for consumption purposes. In making these estimates, I have added to the $11.1 billion tax cut now proposed the $2 billion in tax concessions made to corporate investors in 1962 by legislation and by Treasury action, bringing the total to $13.1 billion. I think that this inclusion is entirely appropriate for purposes of economic analysis, and Secretary Dillon evidently agrees; in a very recent speech, as reported in the press, he estimated rather gleefully that the 1962 action, plus the corporate tax reductions in the current proposal, would increase the after tax profits on new investments by about 35 percent. In addition to this $2 billion, the current measure involves a proposed corporate tax cut in the neighborhood of $2.2 billion, and a proposed personal tax cut in the neighborhood of $8.9 billion—bringing the total to $13.1 billion.

Of this $13.1 billion amount, $4.2 billion are directly allocated to investment purposes, counting the $2 billion in 1962 and the $2.2 billion corporate tax cut in the current proposal. In addition, it is my estimate that $2.8 billion of the proposed personal tax cuts of $8.9 billion would be saved for investment purposes. I derive this by estimating what portion of the personal tax cuts of $4 billion for taxpayers with incomes of $10,000 and over would be saved for investment purposes rather than spent for additional consumption. This estimate in its very nature cannot be exact, although I think it is reasonable. But even if we were to assume that a larger portion of the proposed personal tax cuts for taxpayers with incomes of $10,000 and over would be used to add to their immediate consumption, then the comments which I make later with respect to the impropriety, on equitable and social grounds, of adding so much to the immediate consumption of the higher income people as against additions to the consumption of lower income people become even more telling. Thus, my estimate is that about $7 billion of the $13.1 billion tax concession, including the 1962 concession, are allocated to investment purposes.

As against this, I estimate that the $4.9 billion in proposed personal tax cuts for taxpayers with incomes under $10,000 would flow almost entirely into immediate consumption, and that $1.2 billion of the $4 billion personal tax cuts for taxpayers with incomes of $10,000 and over would flow into immediate consumption. Thus, my estimate is that $6.1 billion of the $13.1 billion total are allocated to consumption purposes.

CHART 15

RISING PRICES, PROFITS, AND INVESTMENT BEFORE THE 1957-1958 RECESSION

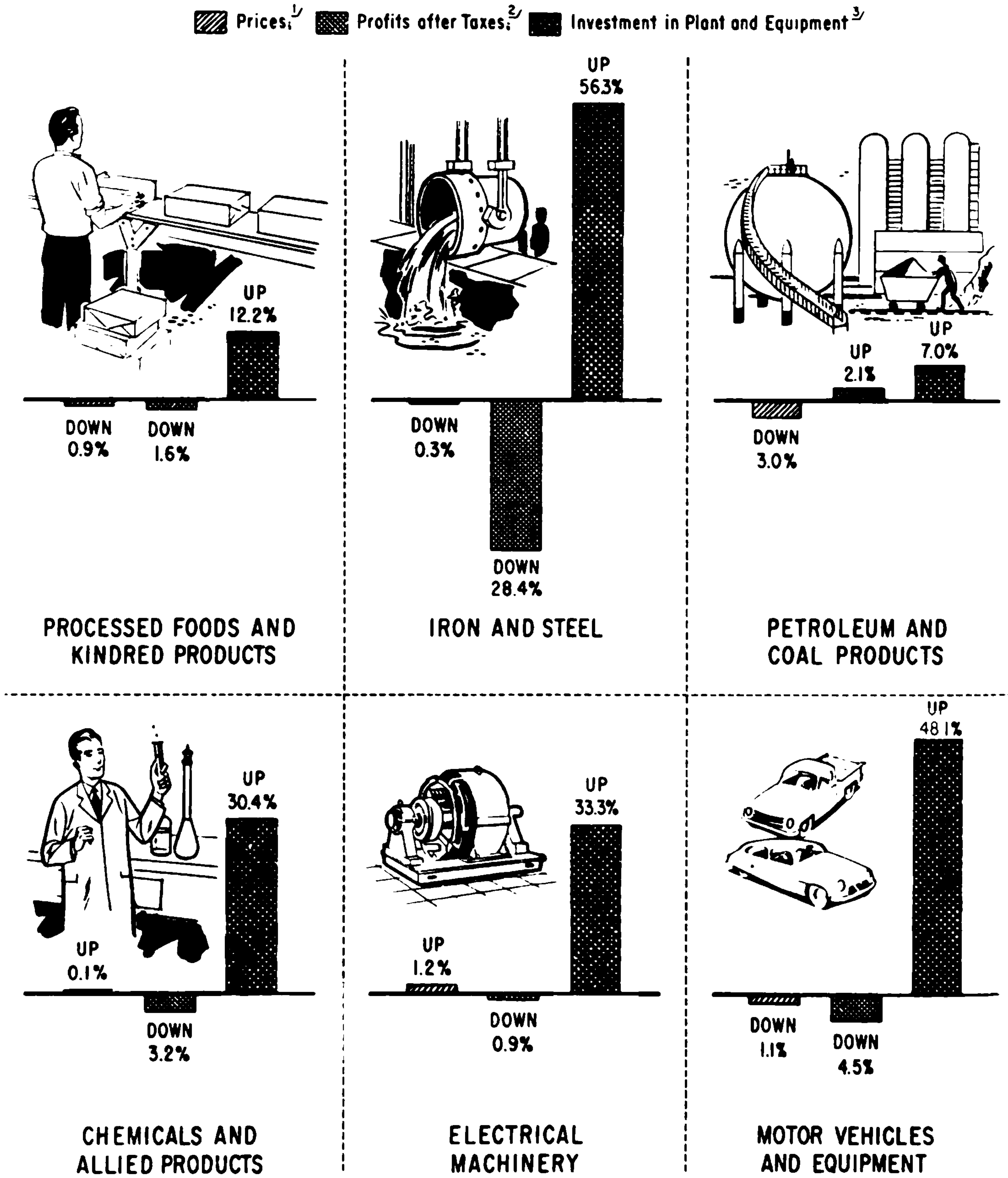


1/ Bureau of Labor Statistics, (U S. Dept. of Labor), Commodity Wholesale Price Indexes.
2/ Securities and Exchange Commission, Profit Estimates
3/ Securities and Exchange Commission estimates of expenditures for plant and equipment.

CHART 16

INVESTMENT BOOM OCCURRED AGAIN BEFORE THE 1960-1961 RECESSION DESPITE REDUCED PRICES AND PROFITS

First Half 1959 – First Half 1960

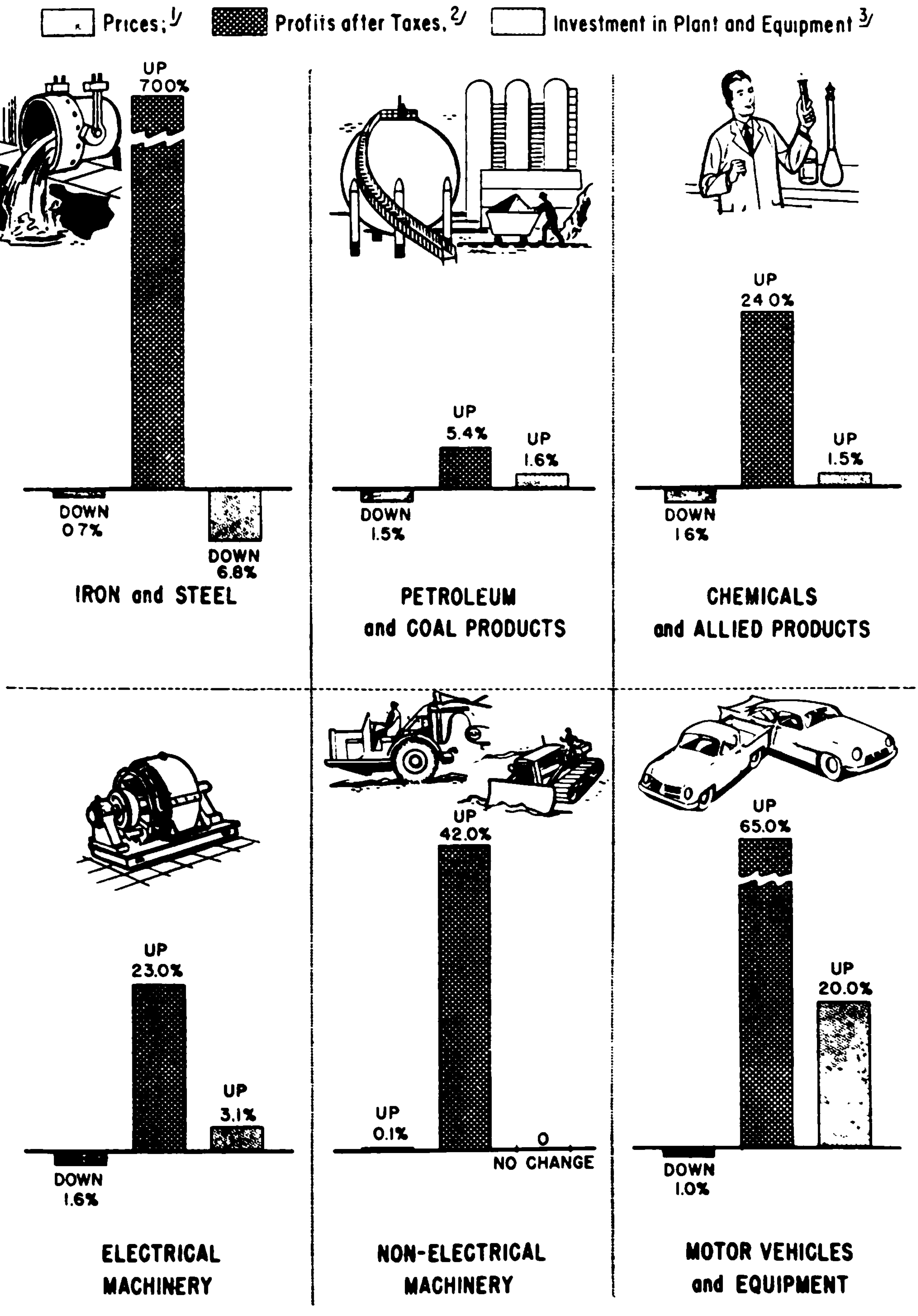


[1] U. S. Dept. of Labor, Bureau of Labor Statistics, commodity wholesale price indexes.
[2] Securities and Exchange Commission, profit estimates.
[3] Securities and Exchange Commission, estimates of expenditures for plant and equipment.

CHART 17

PRICE, PROFIT AND INVESTMENT TRENDS DURING CURRENT ECONOMIC UPTURN

Annual Rates 1st Quarter 1961 - 2nd Quarter 1963

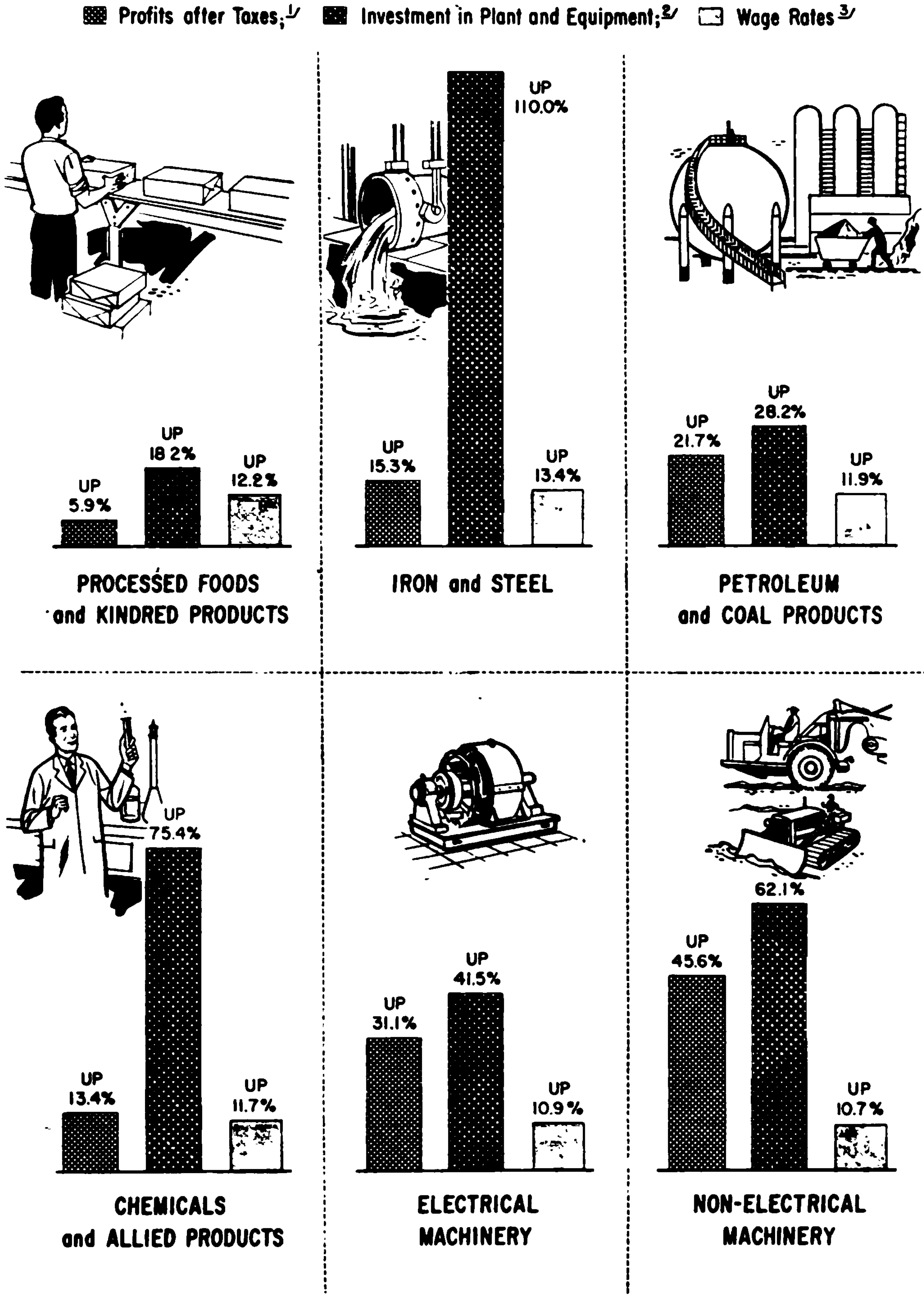


1/ Data: U.S. Dept of Labor, wholesale commodity price indexes
2/ Data: Federal Trade Commission-Securities and Exchange Commission.
3/ Data: U.S. Dept. of Commerce and Securities and Exchange Commission; seasonally adjusted.

CHART 18

BEFORE THE 1957-1958 RECESSION, PROFITS AND INVESTMENT OUTRAN WAGES-BASIC TO CONSUMPTION

First Three Quarters 1955 – First Three Quarters 1957

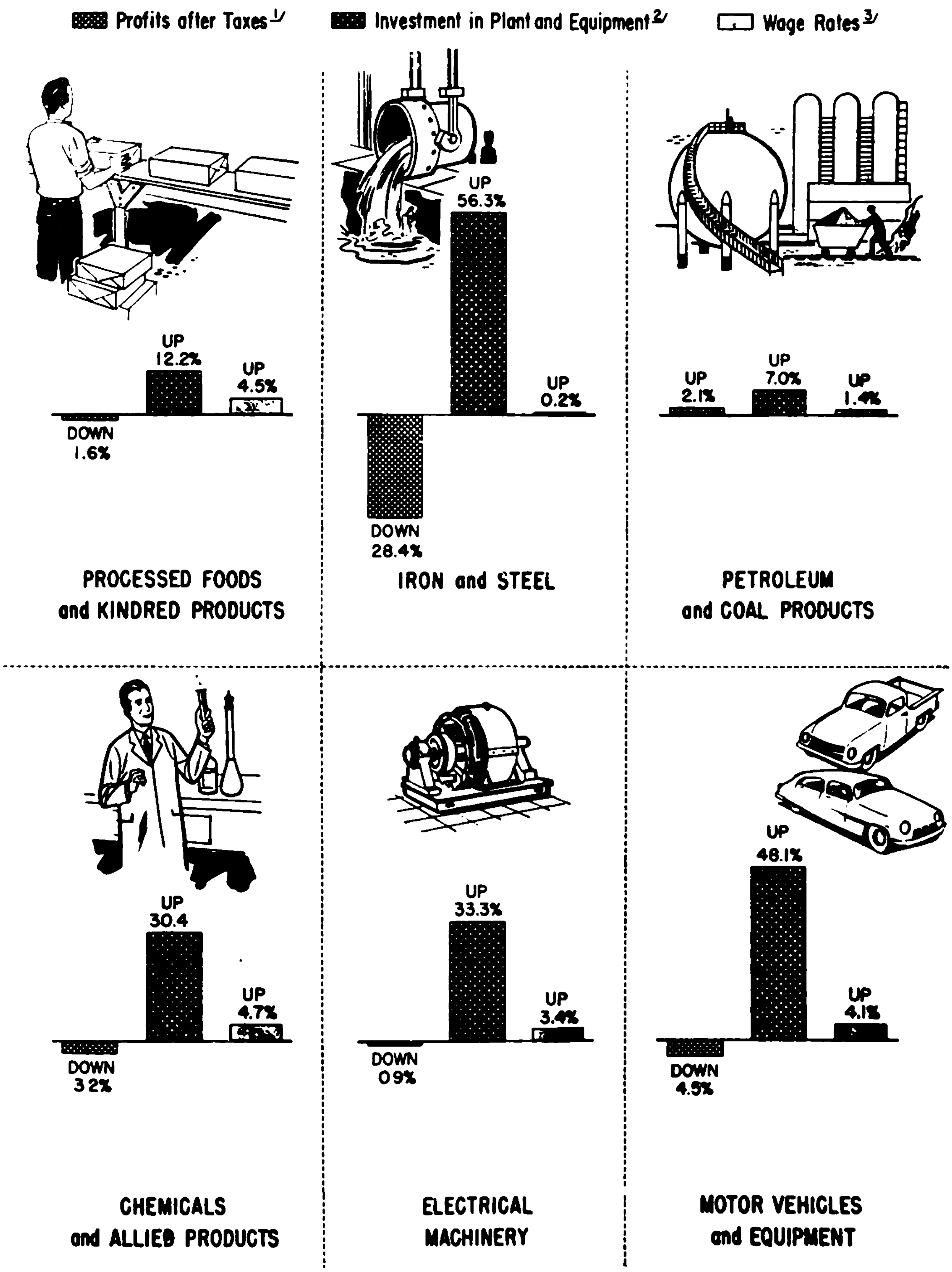


[1] Data: Securities and Exchange Commission.
[2] Data: U.S. Dept. of Commerce and Securities and Exchange Commission.
[3] Average hourly earnings of production workers. Data: U S Dept. of Labor.

CHART 19

BEFORE THE 1960-1961 RECESSION, DESPITE REDUCED PROFITS, INVESTMENT OUTRAN WAGES-BASIC TO CONSUMPTION

First Half 1959 - First Half 1960

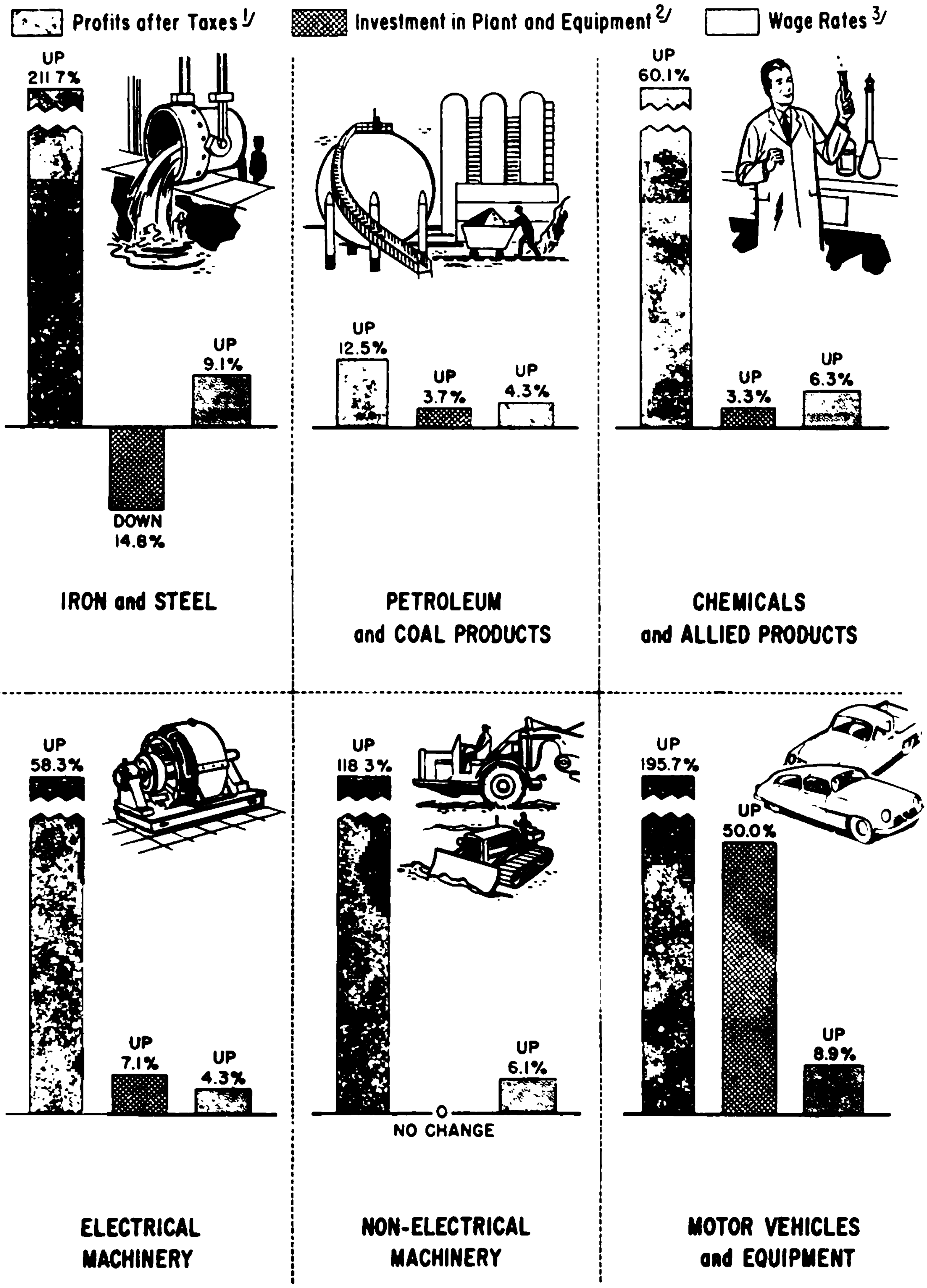


1/ Data Securities and Exchange Commission
2/ Data U S. Dept of Commerce and Securities and Exchange Commission
3/ Average hourly earnings of production workers Data: Dept of Labor

CHART 20

PROFITS AND INVESTMENT DURING CURRENT ECONOMIC UPTURN OUTRUN WAGES-BASIC TO CONSUMPTION

1st Quarter 1961-2nd Quarter 1963

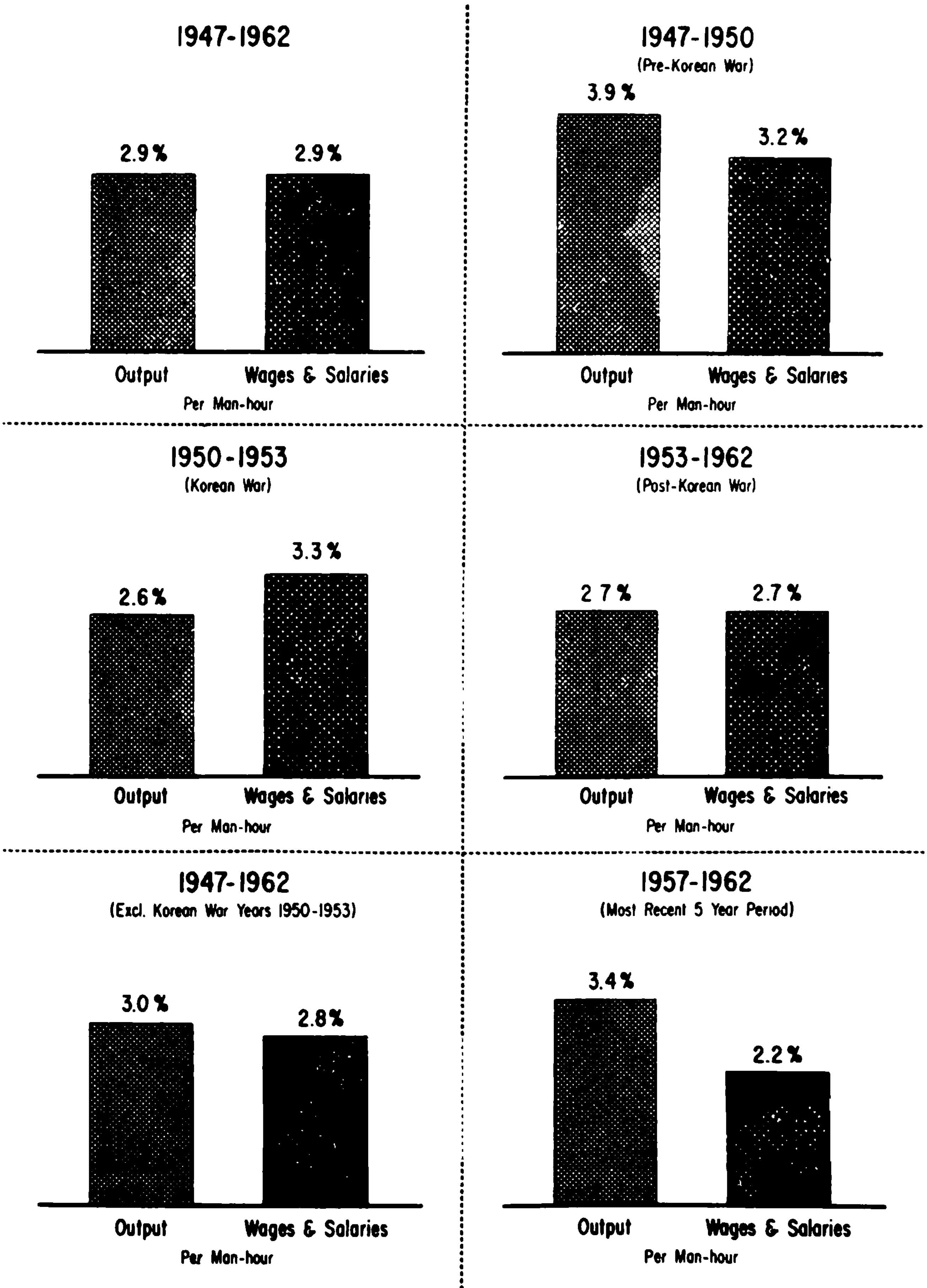


1/ Data. Federal Trade Commission–Securities and Exchange Commission.
2/ Data: U S Dept. of Commerce and Securities and Exchange Commission, seasonally adjusted
3/ Average hourly earnings of production workers. Data: U.S Dept of Labor.

CHART 21

RATES OF CHANGE PER MAN-HOUR IN MANUFACTURING OUTPUT AND WAGES AND SALARIES, 1947-1962[1]

Average Annual Rates of Change, Measured in Uniform Dollars

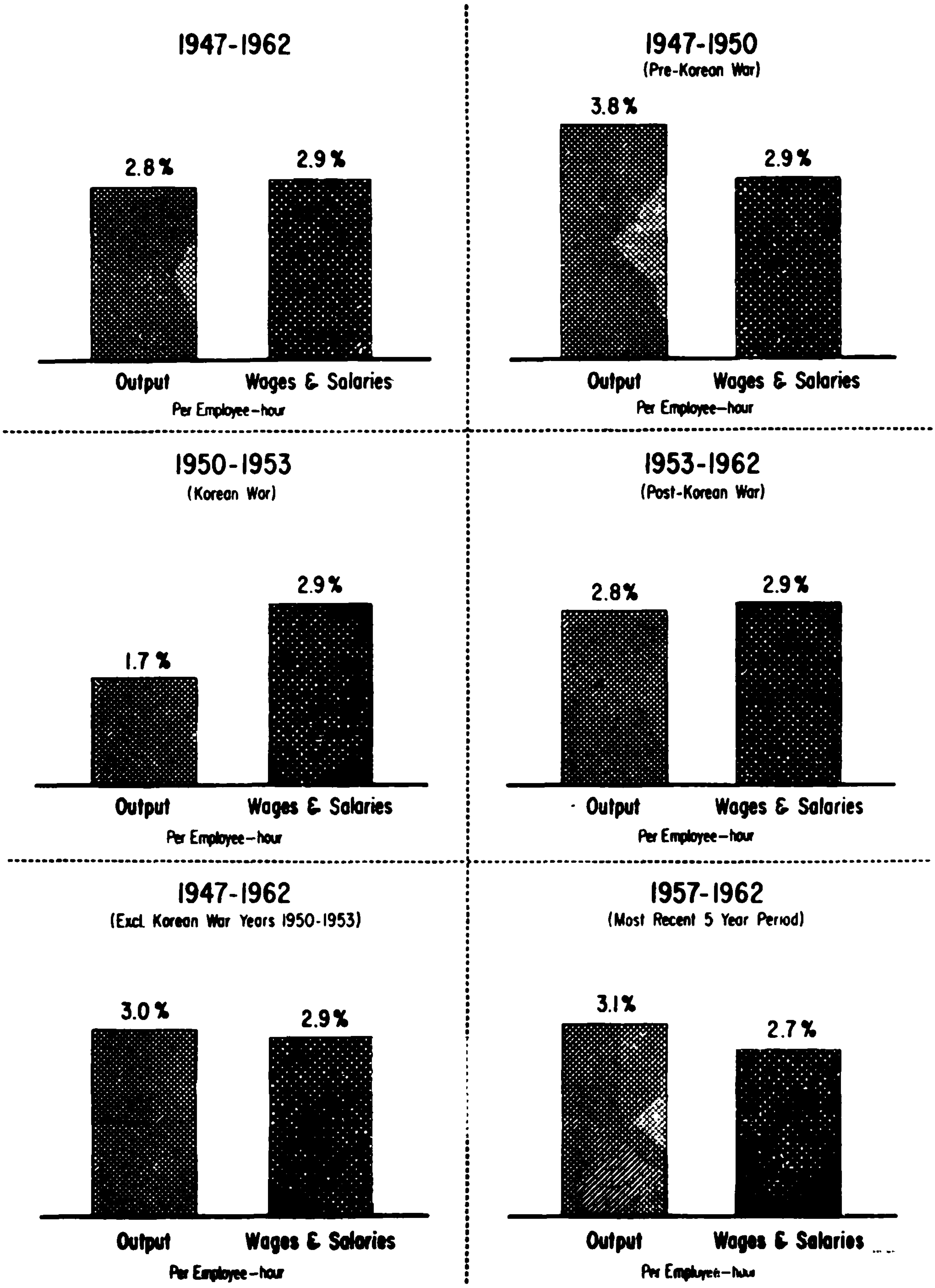


[1] 1962 estimated

CHART 22

RATES OF CHANGE PER EMPLOYEE-HOUR IN NONFARM OUTPUT AND WAGES AND SALARIES, 1947-1962 [1]

Annual Average Rates of Change, Measured in Uniform Dollars

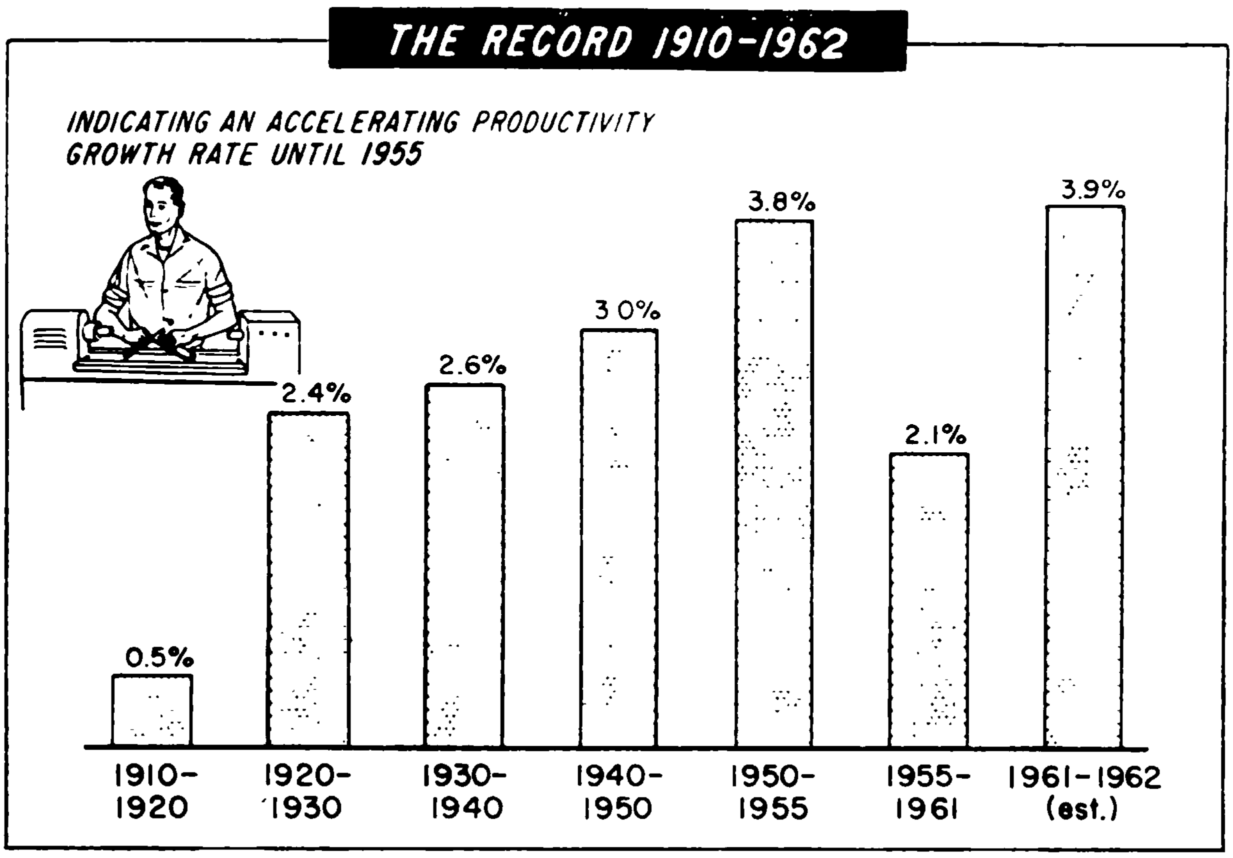


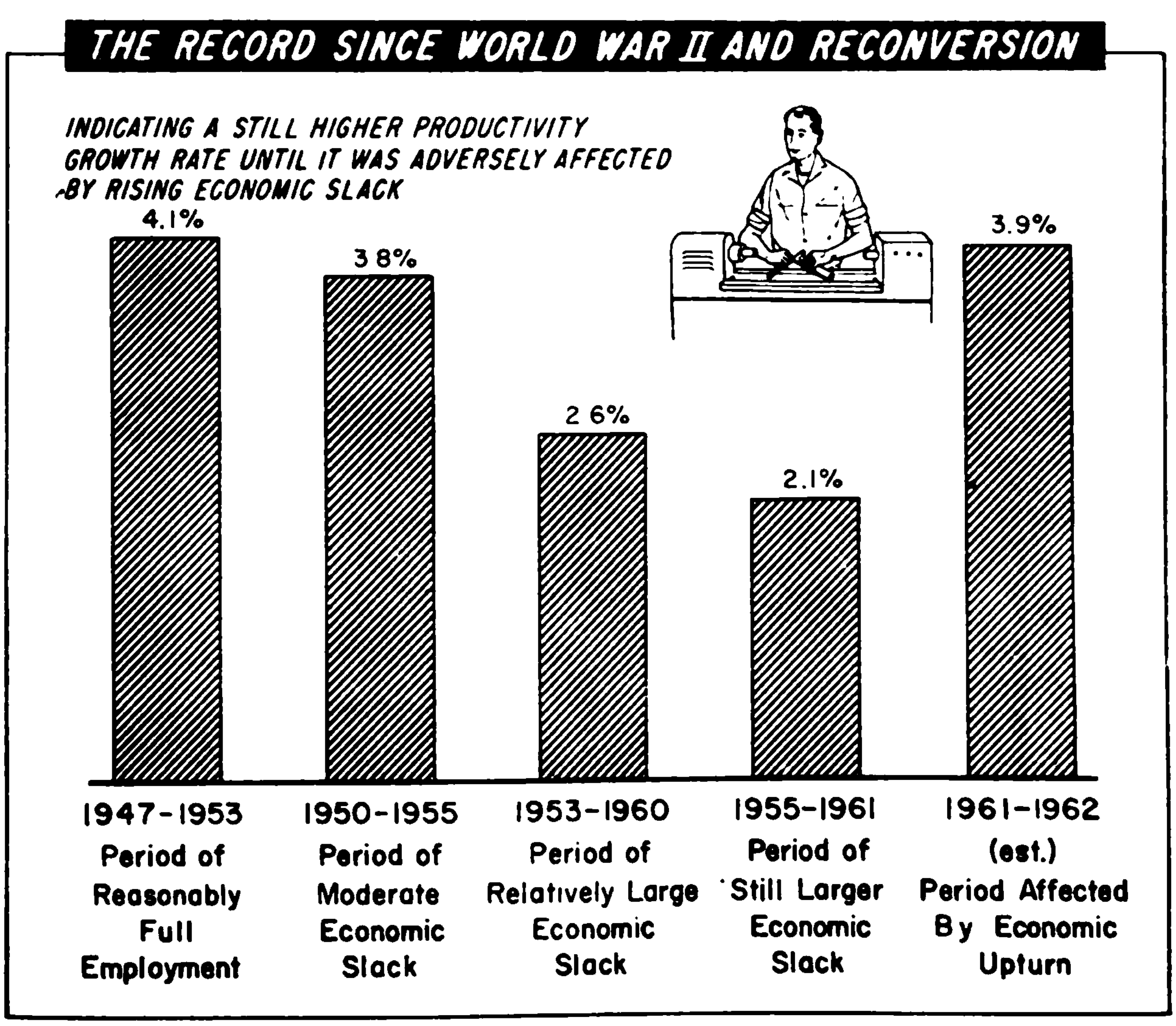
1/ 1962 estimated

CHART 23

TRENDS IN OUTPUT PER MAN-HOUR -OR PRODUCTIVITY-1910-1962

Average Annual Rate of Productivity Growth for the Entire Private Economy



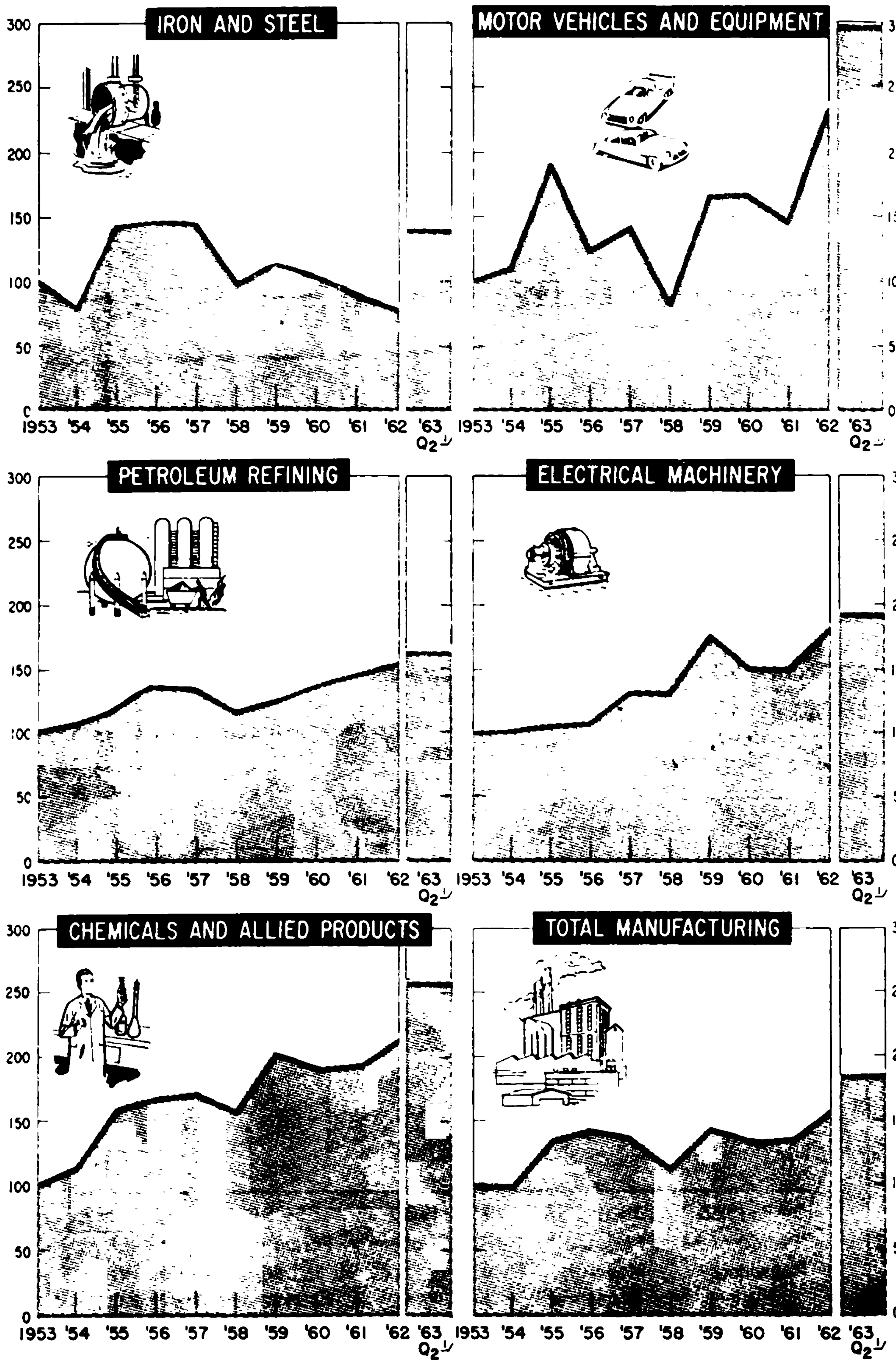


Note: Based on U S Department of Labor estimates, relating to man-hours worked.

CHART 24

KEY PROFITS AFTER TAXES ARE HIGH DESPITE LARGE UNUSED CAPACITIES

1953=100

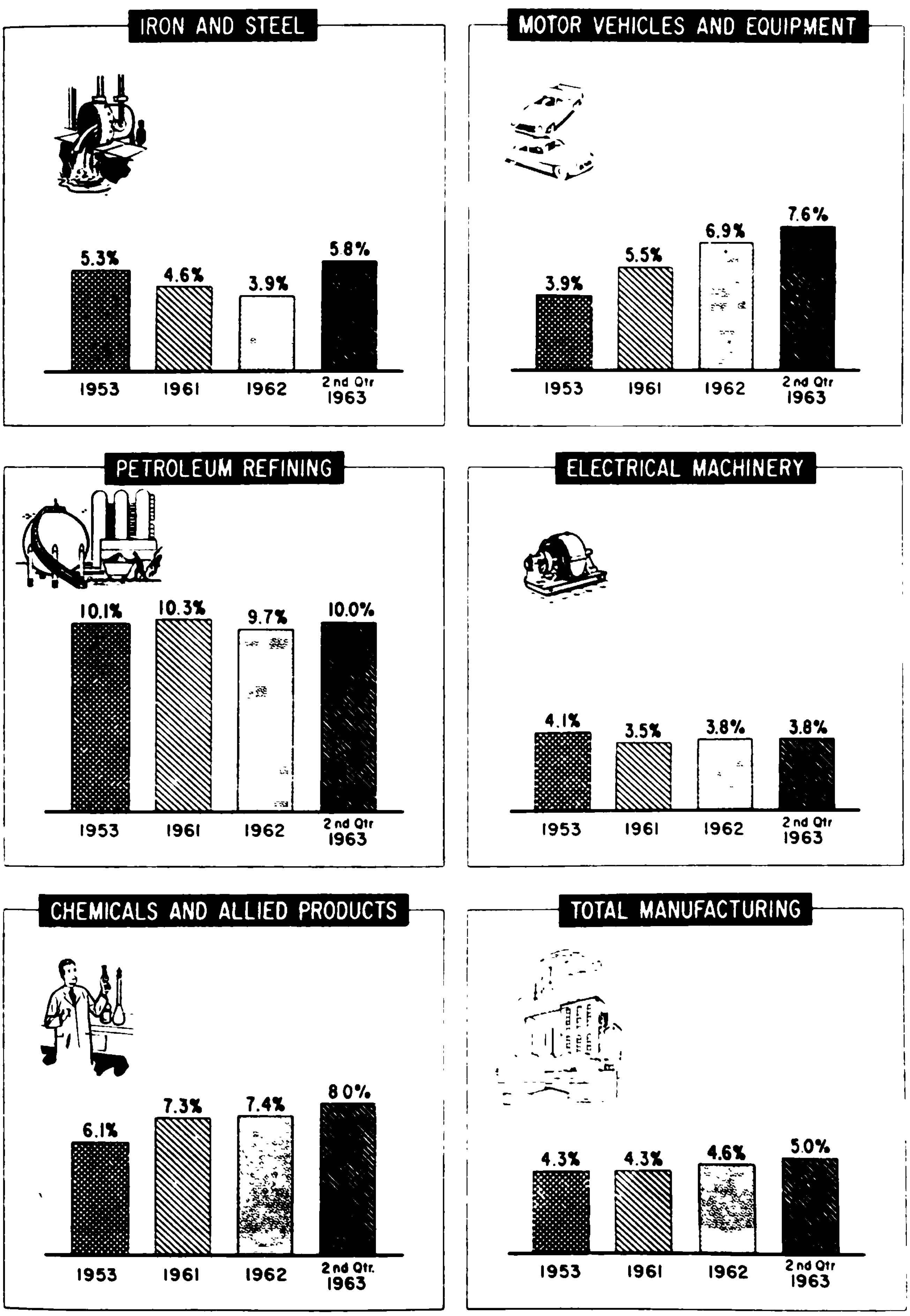


[1] Second Quarter of 1963 at an annual rate, not seasonally adjusted.
Data: Federal Trade Commission—Securities Exchange Commission.

CHART 25

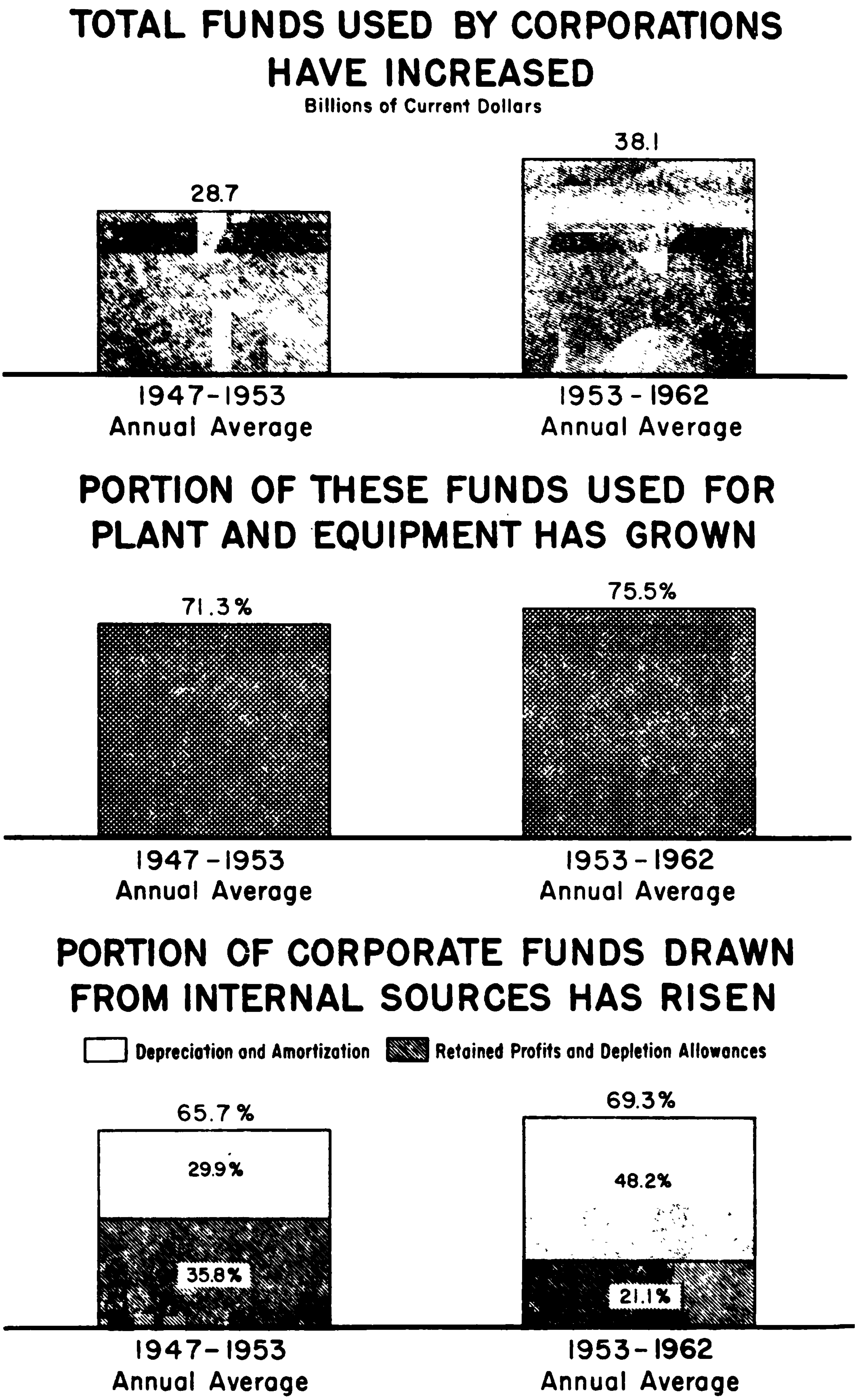
PROFITS-SALES RATIOS ARE GOOD AND GENERALLY ARE REACHING NEW PEAKS DESPITE SUBSTANTIAL IDLE CAPACITIES

Manufacturing Corporations' Profits after Taxes, as Percent of Net Sales



Data: Federal Trade Commission, Securities and Exchange Commission

CHART 26



Data Department of Commerce

This distribution—$7 billion allocated to investment purposes and $6.1 billion allocated to consumption purposes—seems to me palpably and egregiously maladjusted to the realities of the economic problems confronting us. As a matter of economic reality, I submit for the consideration of this committee that there is certainly no pressing need for a corporate tax cut of large size now, nor for several billion dollars in tax cuts for people in the higher income brackets, when measured against the competing utility of other ways of using the same amount of money, whether by way of other types of tax reduction or by way of increased public outlays. I shall discuss these alternatives subsequently in my testimony. About the only real argument I have heard for the currently proposed distribution of the tax cuts is that everybody must get some in order to make the proposition palatable.

Mr. Chairman and members of the committee, I am realistic enough to acknowledge, unfortunate though it may be, that maybe everybody needs to get something in order to facilitate the passage of this measure—but the question still remains: How much? This tax reduction would have exactly the same net effect as if tax rates were left just as they are now, and then corporations and individuals were mailed checks by the Government in exactly the same amounts, year after year without end, that they would receive by virtue of the proposed tax reductions. Would anybody, under this hypothesis, propose that now is the time when the Nation needs or the Government can afford to mail out these amount of bounties per annum to those who do not need them on any discernible economic grounds, and who on social grounds are not entitled to them at all? Can anybody really make an argument which will stand up, that this is the best way, or even a defensible way for the Government to pass out this amount of subsidies at this time?

I use the words "bounties" and "subsidies" advisedly. We are all too prone to think that, just because corporations and individuals pay taxes, the Government is not giving them anything when it cuts their taxes. But taxes ordinarily are supposed to cover the costs of what the Government is doing, and this has nothing to do with whether the Government is spending too much or too little. When the Government by cutting taxes deliberately contrives a larger deficit, even for the worthy purpose of stimulating the economy, the equivalent of a subsidy is involved, just as much so as if the Government left taxes just where they are now and mailed out checks as I have indicated just above.

As I said at the outset of my testimony, I am entirely in favor, under current economic conditions, of deliberately contrived increases in the Federal deficit—or subsidies—to stimulate the economy. But I think we should be reasonably confident, before we embark upon this course, that the subsidies are flowing to where they will do the most economic good, and to those who have at least some color of meriting them.

(5) My fifth basic proposition is that the personal tax cuts, under the current bill in its present form, would put disproportionately too much additional spending power where it is not needed, and not nearly enough where it is needed most. My objection here is on both economic and social grounds.

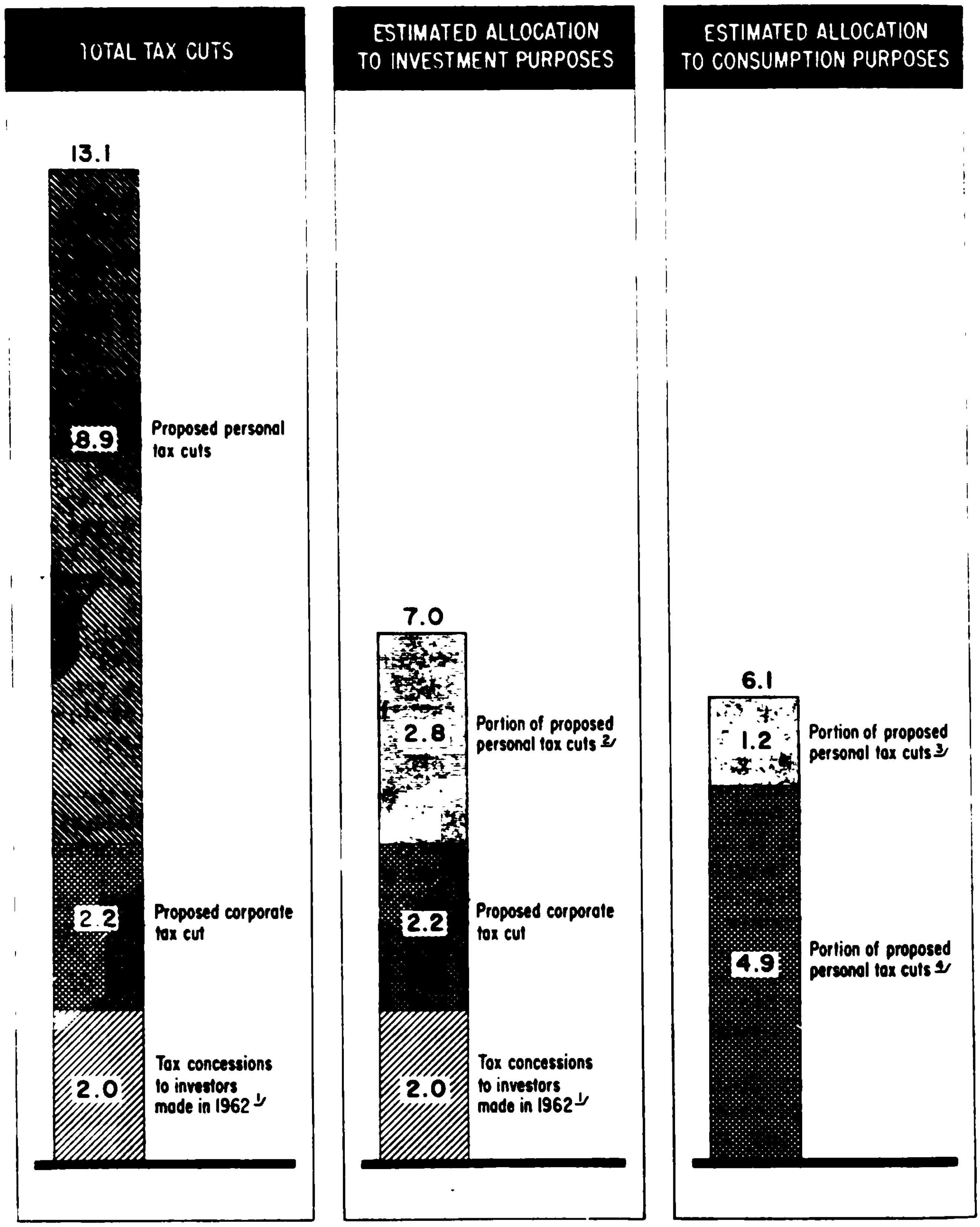
My foregoing discussion of the relative allocation of the proposed tax cuts to investment purposes and to consumption purposes, under the current measure in its present form, indicates fully why I object to the pattern of the distribution on grounds of economic effectiveness. I now turn to grounds of equity or social justice, which I most firmly insist are among the indispensable criteria to be taken into consideration in connection with the fiscal policy of a great and just Nation.

As shown by my 28th chart, one gets a very distorted impression of the distribution of the proposed personal tax cuts by looking at the percentage ratio of the proposed tax rate to the now existing tax rate. Looking at it this way, it appears that the $3,000-income family of four would get a 100 percent tax cut, while the $200,000-income family would get only a 16 percent cut. But the tax cut when measured this way is merely a mathematical formula; its only real significance is the effect which it has upon the after-tax or disposable income of the recipient. If the purposes of the tax cut are to stimulate the economy, or to improve the equitable imposition of the tax burden, or both, the only thing that counts is what happens to the disposable incomes of people when the cuts go into effect. By this test, which is the only appropriate test, the same chart shows that the $3,000-income family, under the current proposal, would have only a 2-percent increase in after-tax or disposable income, while the $200,000-income family would have a 16-percent

CHART 27

ESTIMATED DIVISION – PROPOSED TAX CUTS BETWEEN CUTS FOR INVESTMENT PURPOSES AND CUTS FOR CONSUMPTION PURPOSES

(Billions of Dollars)



1/ Through Congressional and Executive action.

2/ Estimated portion of personal tax cuts, for those with incomes of $10,000 and over, which they would save for investment purposes.

3/ Estimated portion of personal tax cuts, for those with incomes of $10,000 and over, which they would spend for consumption.

4/ Personal tax cuts for those with incomes under $10,000.

Note: Estimates of division, CEP.

increase in disposable income. In between these two extremes, the $5,000-income family would have an even smaller increase in disposable income than the $3,000-income family. And above this level, the higher the family income before taxes, the bigger would be the increase in disposable income by virtue of the tax proposal in its present form. The really big jump in disposable incomes, as shown by my chart, would be in the income levels above $25,000.

I am aware that the Secretary of the Treasury and others have made the argument that, in view of the progressively higher tax rates now paid by higher income families, any sizable program of tax reduction must add more to their disposable incomes percentagewise than it adds percentagewise to the disposable incomes of lower income families. If this were necessarily true, it would simply be an argument for finding some other route than tax reduction toward a more economically sound and more ethically justifiable result. There is nothing sacrosanct about tax reduction per se. If it were true that tax reduction in its very nature must do most for those who need it least, and least for those who need help most, I could readily suggest many better ways of using $13 billion, or $11 billion, than the ways embodied in the current tax proposal in its present form. But beyond this it is obvious that a tax reduction of the same size, or of any given size, can be so reconstructed as to be progressive rather than regressive in its consequences, and thus come closer to serving its avowed economic purposes and much closer to results which the average American would regard as fair.

There are other ways of analyzing the proposed personal tax cuts from the equitable and social viewpoint. As already indicated, about 45 percent of the total proposed personal tax cuts would go to taxpayers with incomes of $10,000 and over who comprise only about 12½ percent of all taxpayers; this means that only about 55 percent of the proposed personal tax cuts would go to taxpayers with incomes under $10,000, who comprise about 87½ percent of all taxpayers. I have been unable thus far to make refined estimates of other aspects of the proposed distribution of the personal tax cuts under the current measure. But a very rough indication of their consequences is indicated by my published study, "Taxes and the Public Interest," of the original proposal of the administration in early 1963. This study estimated that, excluding the then-proposed tax reforms, most of which have as of now been eliminated from the bill, only 3.7 percent of the total personal tax cuts would have gone under the original proposal to the 32.8 percent of all taxpayers whose incomes are below $3,000; 21.1 percent would have gone to the 1.9 percent of all taxpayers with incomes of $20,000 and over; and 8.3 percent would have gone to the 0.3 percent of all taxpayers with incomes of $50,000 and over.

While I did not agree in detail with the original tax proposal in early 1963, it did propose a large number of reforms to compensate in part for the nature of the proposed tax rate changes. With these reforms, my published study estimated that about 12½ percent of all taxpayers who have incomes of $10,000 and over would have received only 36.2 percent of the then proposed personal tax cuts, contrasted with about 45 percent under the current proposal in its present form. With these same reforms, those with incomes of $20,000 and over would have received 13.9 percent of the then poposed personal tax cuts, and those with incomes of $50,000 and over would have received 4.5 percent. Thus it is abundantly apparent, despite the lack of refinement in some of the data which I have presented in the preceding paragraph, that the current bill in its present form involves a much less defensible distribution of the personal income tax cuts than the original proposal.

My views in this regard are immensely strengthened when we come to consider that the Federal personal income tax is not the only tax which bears down upon the American people. Quite to the contrary, because of its relatively progressive nature, the Federal personal income tax has served, though in my view not served well enough, to redress in part the undesirable and inequitable imposition of the entire tax burden—Federal, State, and local, direct and indirect. Unfortunately, this aspect of the tax problem has been grossly neglected by economists. But my 29th chart shows the results of a competent study made in 1954, and these reults are very pertinent even today. When one looks at the Federal income tax alone, the $2,000 income-tax payer paid only 2.7 percent of his income in Federal personal income taxes in 1954, while the $10,000 and over income-tax payer paid 14 percent. This looks very progressive, indeed. But when one looks also at other types of taxes, the $2,000 income-tax payer paid out in taxes 23.4 percent of his income, while the $10,000 and over income-tax payer paid out only 39.2 percent, which is not nearly so progressive. If one looks only at State and local taxes, the $2,000 income-tax payer in 1954 paid out 9.8 percent of his income in such taxes, while the $10,000 over income-tax payer paid out only 7.4 percent. And the significance of the highly regressive nature of State and local taxation has been greatly augmented in the decade since 1954, responsive to the fact that since the outlays of the States and localities have risen many times as fast as the outlays of the Federal Government. This being the case, today is not the time to diminish the progressive nature of the Federal personal income tax, either on economic or social grounds.

If any further reinforcement is needed of this proposition, it may be obtained by looking at the current distribution of income in the United States. As shown by my 30th chart, among all multiple-person families in 1961, 10.4 million families, comprising 22.6 percent of all multiple-person families, had incomes under $4,000 and received only 7.2 percent of the total personal income of all multiple-person families. Under current conditions, taking into account our productive capabilities per capita and the standards which must rise as these productive capacities rise, an income of below $4,000 a year places the average multiple-person family in the poverty category. The chart also shows the number and percentages of multiple-person families at even much lower income levels than this.

With respect to unattached individuals, 4 million in 1961, or 35.7 percent of the total number, had incomes under $2,000 a year, and this placed them in the poverty category. These unattached individuals received only 11.1 percent of the total personal income of all unattached individuals.

The immediately foregoing data are a final reason why any tax proposal as gigantic and far reaching and long range as that now under consideration should not do relatively so much for those in the higher income brackets and relatively so little for those in the lower income brackets.

I want to make just one more point in this phase of my discussion. In my published study on the tax subject referred to above, I depicted the progressive nature of the changes in national tax policy during the period 1939–45, and the favorable impact of these progressive changes upon our general economic performance and upon our social progress. I also depicted the regressive trends in our national tax policies during the period 1945 to date, and the unfavorable consequence in terms both of economic performance and social justice. This whole analysis should be the answer to those who argue that, because of the intrinsic nature of our Federal tax structure now, it is fitting and proper that large-scale tax reduction should move in a regressive direction (i.e., reduce the current degree of progressiveness in this tax structure). I request the permission of the committee to insert at this point of my testimony the portion of my study which covers this subject, which runs only to five small printed pages and four charts.

[Excerpts from "Taxes and the Public Interest"]

III. THE PROGRESSIVE NATURE OF NATIONAL TAX POLICY, 1939–45

Distribution of increased personal tax burden, 1939–45

Due to World War II, the burden of Federal personal income taxes was very much higher in 1945 than in 1939. This increased burden (as the term "increased burden" is used in this discussion) is not measured by the total increase in taxes collected, much of which was due to the vast expansion of production, employment, and incomes. The increased burden is measured rather by the increases in tax collections due to higher tax rates.

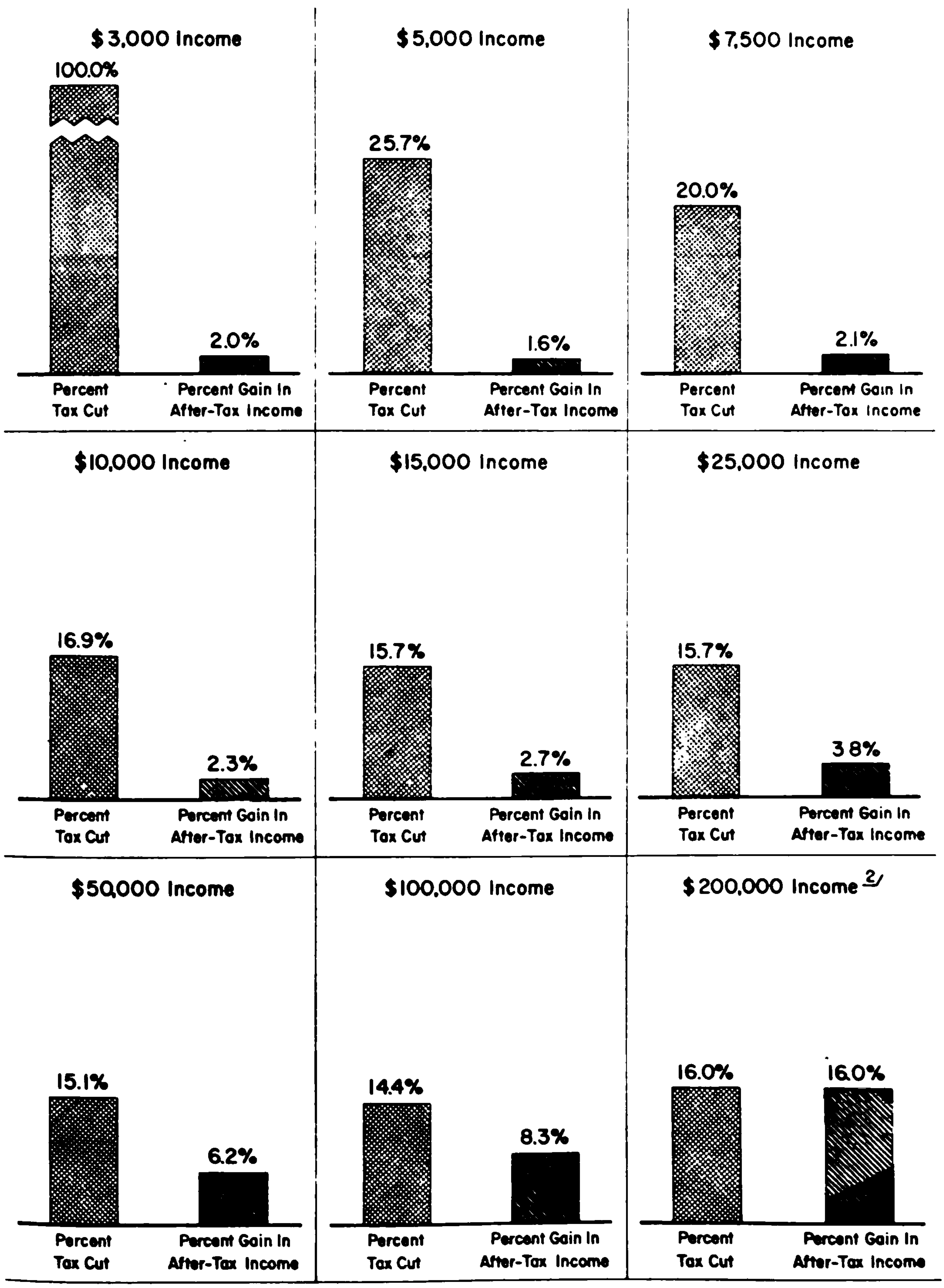
How was this increased burden distributed? This question may be answered by showing how much more taxes people in various income groups paid in 1945 than they would have paid in 1945 if effective tax rates had remained the same as they were in 1939.

In 1945, as shown by chart A, those with incomes under $3,000 comprised more 55 percent of all tax returns filed, but paid less than 32 percent of the total tax increase attributable to the increases in tax rates. The 2.8 percent of all those filing returns who had incomes of $10,000 and over paid 27.4 percent of the tax increase attributable to the tax rate increases; the 0.91 percent with incomes of $20,000 and over paid 17.2 percent; and the 0.16 percent with incomes of $50,000 and over paid 5.7 percent. This indicates that the higher income people, relative to their number, bore a larger share of the increase in the tax burden,

CHART 28

ADMINISTRATION PLAN, PERSONAL TAX CUTS

Percent Tax Cut And Percent Gain In After-Tax Income
Married Couple With Two Children At Various Income Levels [1]



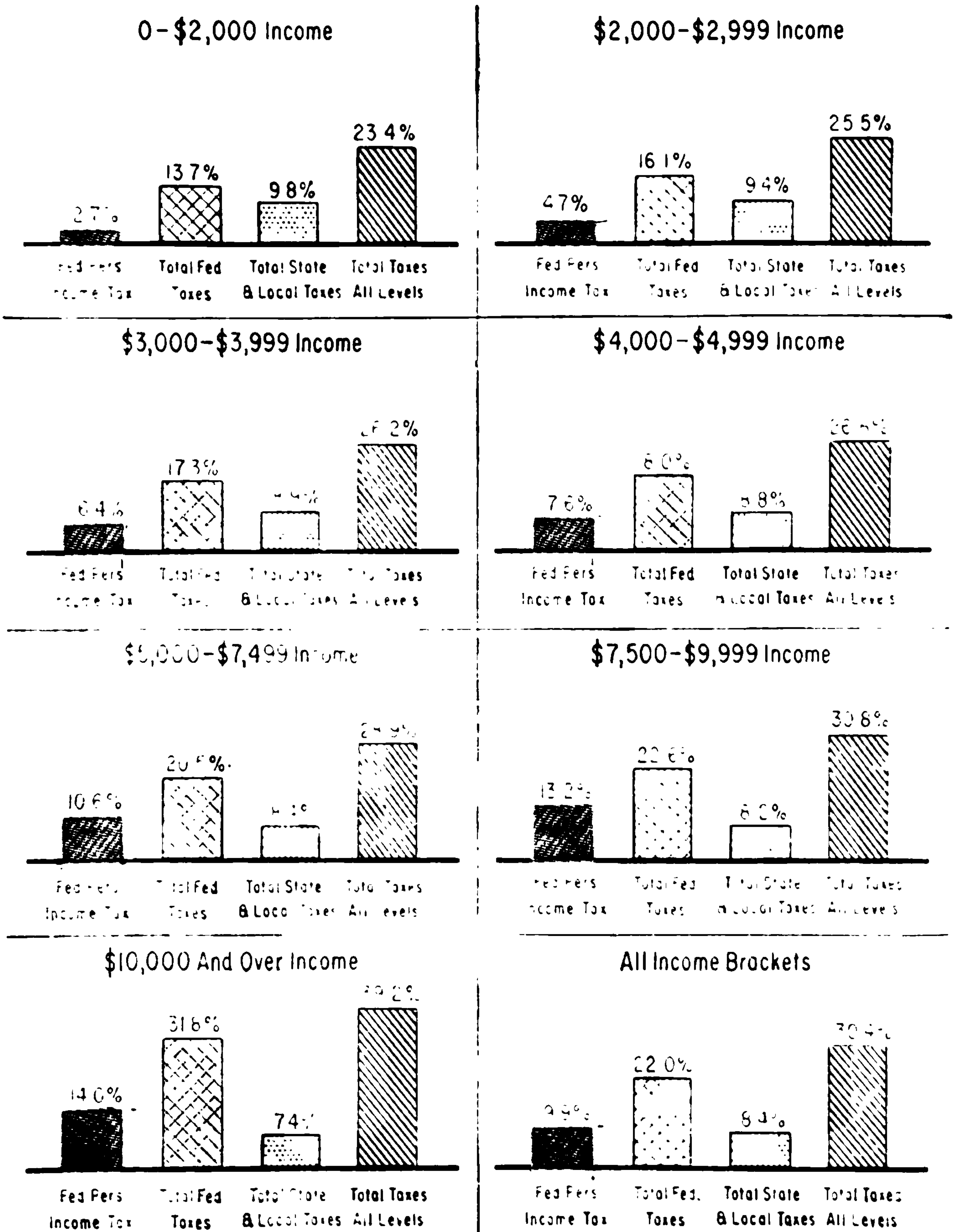
1/ Adjusted gross income levels. 2/ Estimated

Note: Standard deductions for $ 3,000 income level. Typical itemized deductions for other income levels.

CHART 29

TAXES PAID BY SPENDING UNITS[1] AT VARIOUS INCOME LEVELS, 1954

Taxes[2] Shown As Percent Of Income[3]



1/ Spending units include families plus unattached individuals

2/ Federal taxes include personal income, corporate profits, excises and social insurance taxes. State and local taxes include personal income, excise, sales, and property taxes.

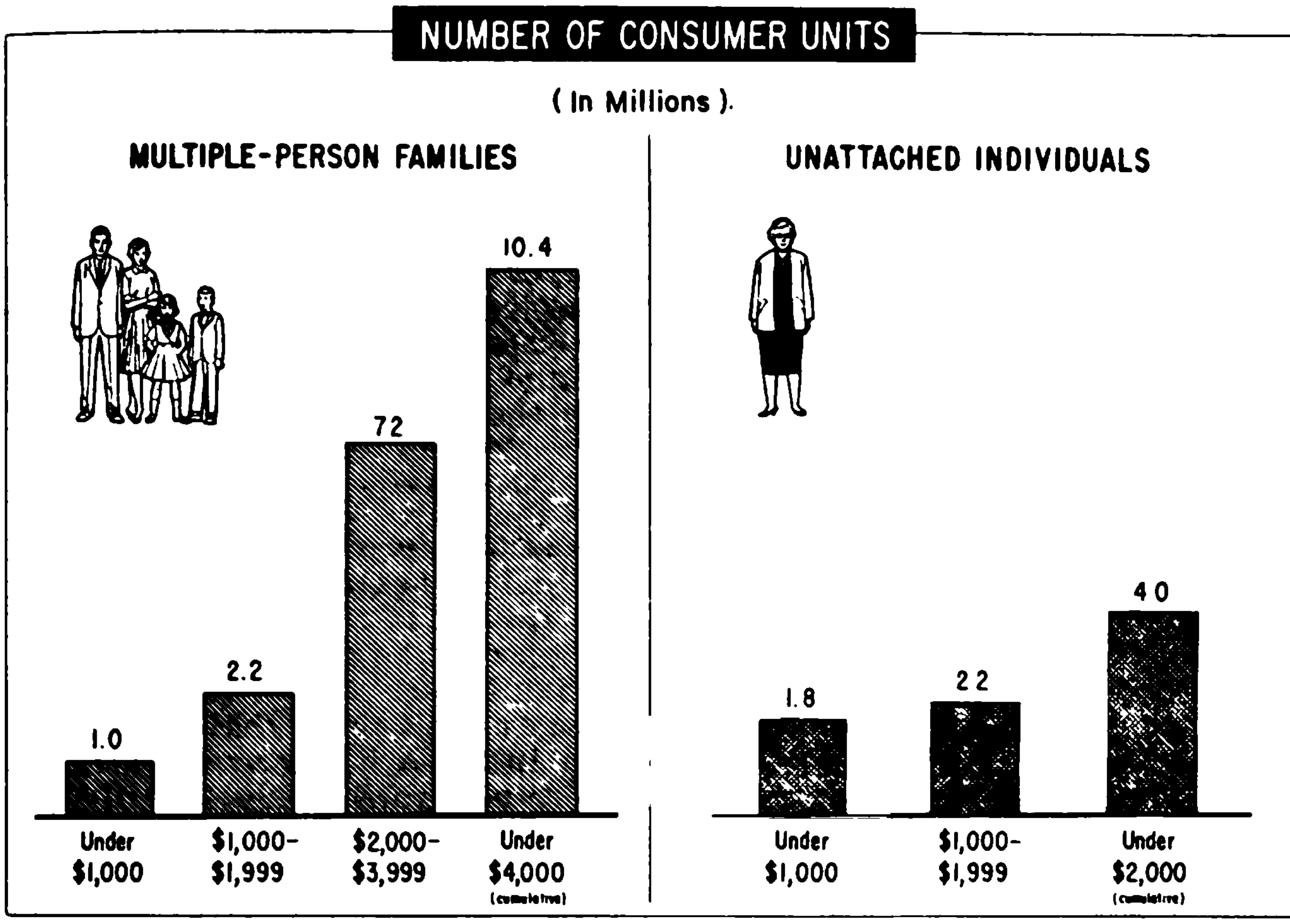
3/ Adjusted money income and non-money income

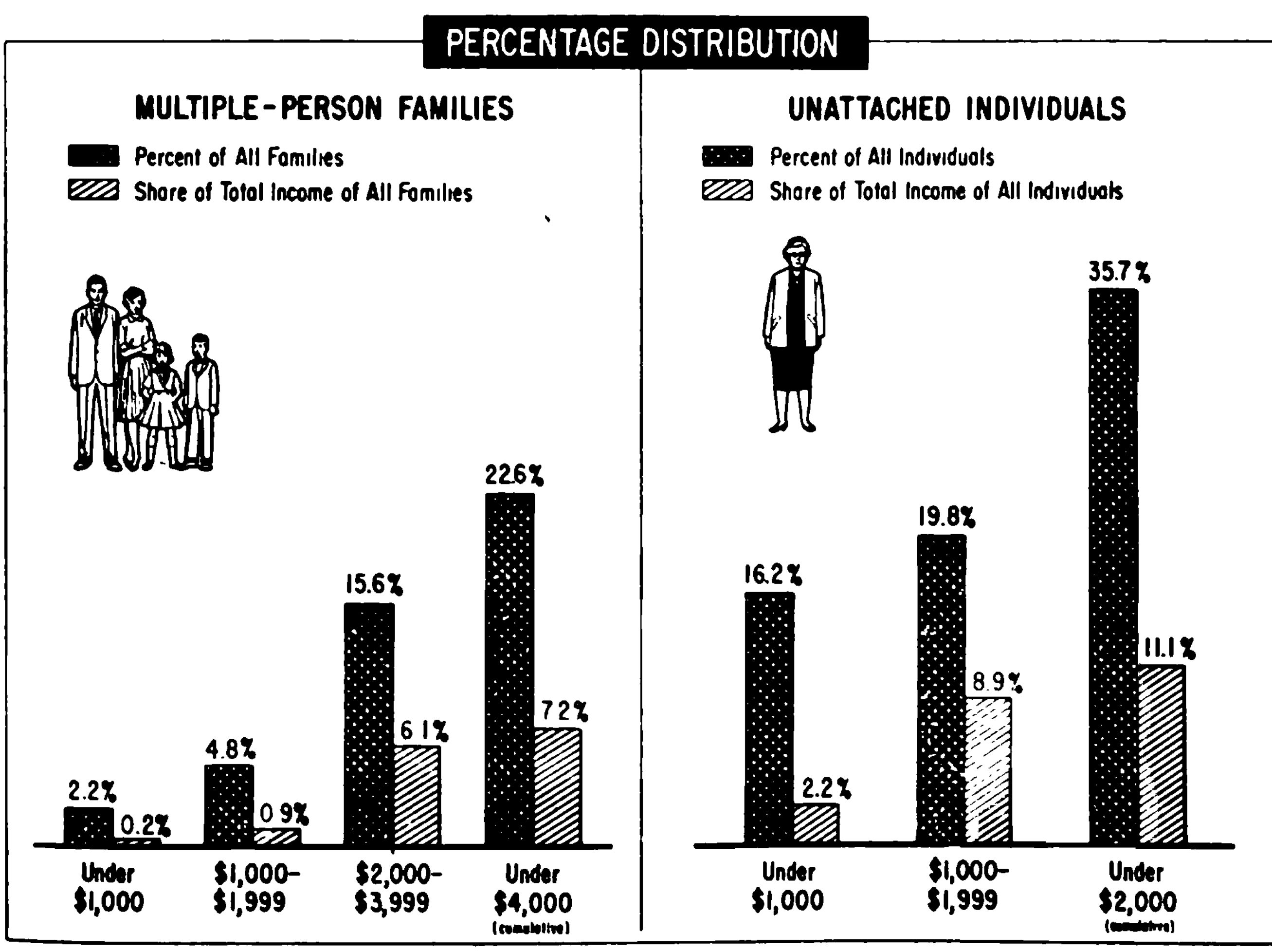
Data: Estimates by R. Musgrave in Nov. 9, 1955 publication of Joint Economic Committee.

CHART 30

AMERICANS LIVING IN POVERTY, 1961

Annual Incomes, Before Taxes, In 1961 Dollars[1]





[1] Includes, in addition to cash income, the monetary value of food and fuel produced by farm families for their own use, and other nonmoney income.

Data: Department of Commerce, except that numbers of consumer units in "under $1,000" and "$1,000-$1,999" groupings are estimated by CEP on basis of Commerce Department data for families and individuals with incomes "under $2,000"
CEP has also estimated shares of income for "under $1,000" and "$1,000-$1,999" groupings.

and the lower income people a smaller share. In other words, the distribution of the increase in the tax burden was progressive.

It is also revealing to look at the impact of the increased tax rates upon the disposable (after tax) incomes of taxpayers at various income levels. In this and similar discussions, the taxpayer is assumed to be married and have two children or other dependents; a flat 10-percent deduction is allowed for taxes, interest, contributions, etc. In this connection, a very erroneous impression results from focusing upon the percentage increases in tax rates; as shown on chart B, the $5,000-income taxpayer had a 2,000-percent increase in his tax rate, the increase in the tax rate of the $3,000-income taxpayer cannot be computed, because he paid no tax in 1939, while the $200,000-income taxpayer had only a 73.6-percent increase. But more realistically, in terms of the change in disposable income which is the ultimate economic and social result of any change in effective tax rates, the $3,000-income taxpayer suffered a disposable income decrease of only 6.9 percent; the $5,000-income taxpayer, 12.1 percent; the $10,000-income taxpayer, 17 percent; the $50,000-income taxpayer, 37.3 percent; the $100,000-income taxpayer, 45.3 percent; and the $200,000-income taxpayer, 51.2 percent. These data show more clearly that the tax rate changes had a progressive effect upon income distribution.

Changes in corporate and other tax rates, 1939–45

It is unnecessary, for the purposes of this study, to examine the changes in corporate and other nonpersonal tax rates in detail, because problems as to the distribution of the increased tax burden with respect to these types of taxes are not of significance comparable to the significance in the case of personal taxes. Subsequently in the discussion, the general significance of the changes in these types of taxes are dealt with. Suffice it to say at this point that corporate tax rates were immensely higher in 1945 than in 1939. A heavy excess profits tax was also imposed. Estate and gift taxes were also raised substantially.

Economic and social effects of 1939–45 tax changes

Although many other powerful factors influenced the economy, it is nonetheless feasible to evaluate the economic effects of these tax changes. Despite heavy increases in both personal and corporate tax rates, growth in total national production outdistanced the most optimistic expectations. Business and personal initiative was augmented, not repressed. High economic growth and full employment led generally to rising living standards, despite the extremely high allocation of output to direct war purposes. The numbers and percentages living in poverty were reduced at an unusually rapid rate. The progressive redistribution of after-tax income, through the changes in tax policy, abetted both economic growth and social progress.

Tax increases during World War II may have been too small

The only important criticism of our national tax policies from 1939 through 1945 might be that taxes were not lifted enough. About half of the increased public costs resulting from World War II was financed by borrowing rather than by the increased tax take. This built up huge wartime savings, which tended to increase inflationary pressures in the immediate postwar years when these savings mere injected into the spending stream too rapidly because of the premature abandonment of controls. But on balance, the utilization of these savings helped to prevent the kind of serious economic downturn which occurred during 1921–22 following World War I, and which many had expected after World War II.

IV. REGRESSIVE TRENDS IN NATIONAL TAX POLICY, 1945–63

Distribution of the decreased personal tax burden, 1945–63

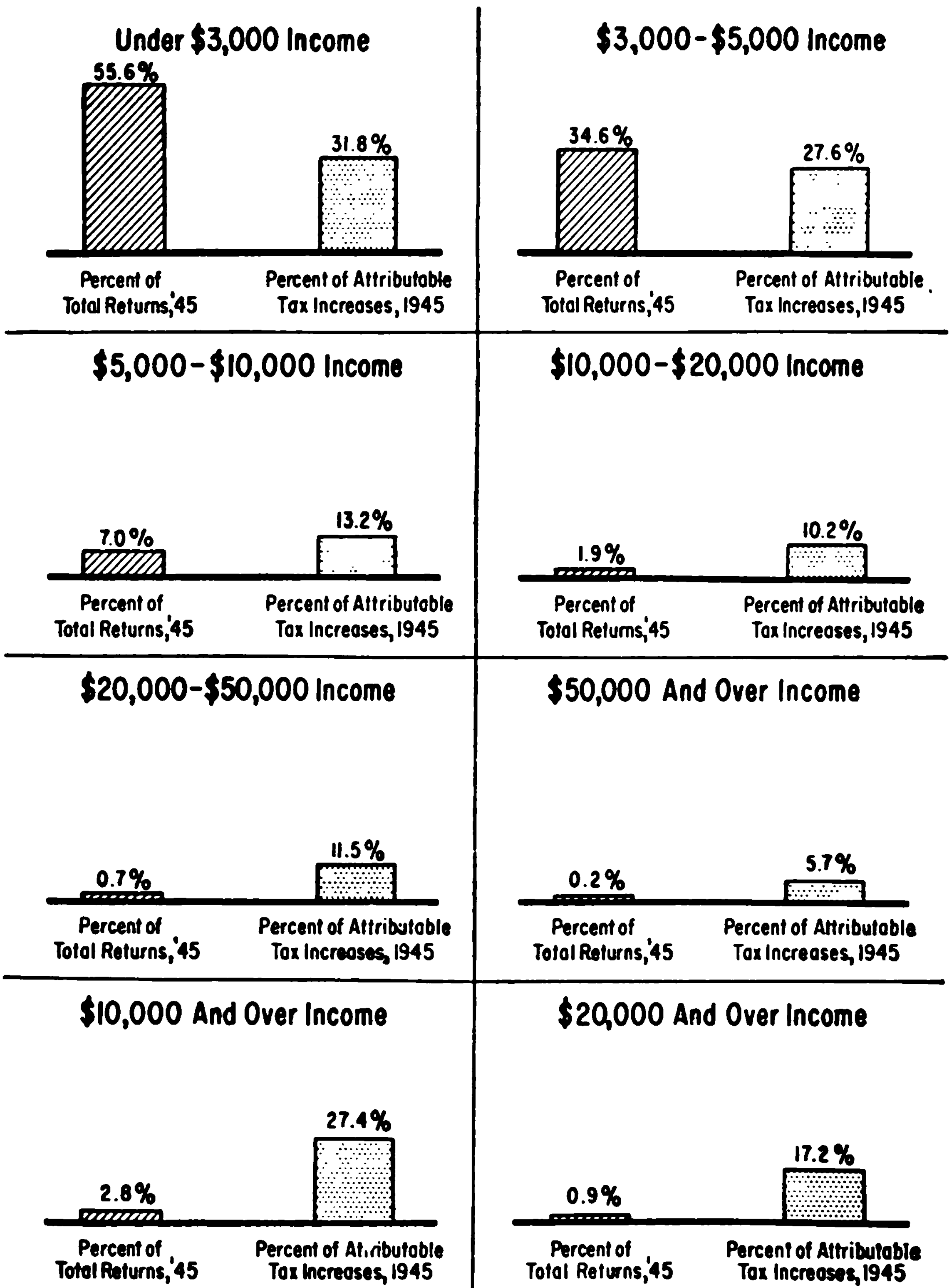
The end of World War II properly set in motion the trend toward tax reduction, and, despite a reversal of the trend during the Koren war, tax rates were very much lower by 1963 than in 1945. How the decrease in the tax burden due to lower tax rates was distributed may be shown by examining how much less taxes people in various income groups are estimated to pay in 1963 than they would pay in 1963 if tax rates had remained the same as they were in 1945.

For 1963, as shown by chart C, it is estimated that those with incomes under $3,000 would comprise almost 33 percent of all tax returns filed, but would receive only 3.4 percent of the total tax cut attributable to the decreases in effective tax rates (below the 1945 level). The 12.29 percent of all those

CHART A

PERSONAL TAX INCREASES, 1939-'45

Distribution In 1945 Of Total Tax Returns[1]
And Of Total Tax Increases Attributable To Tax Rate Increases[2]



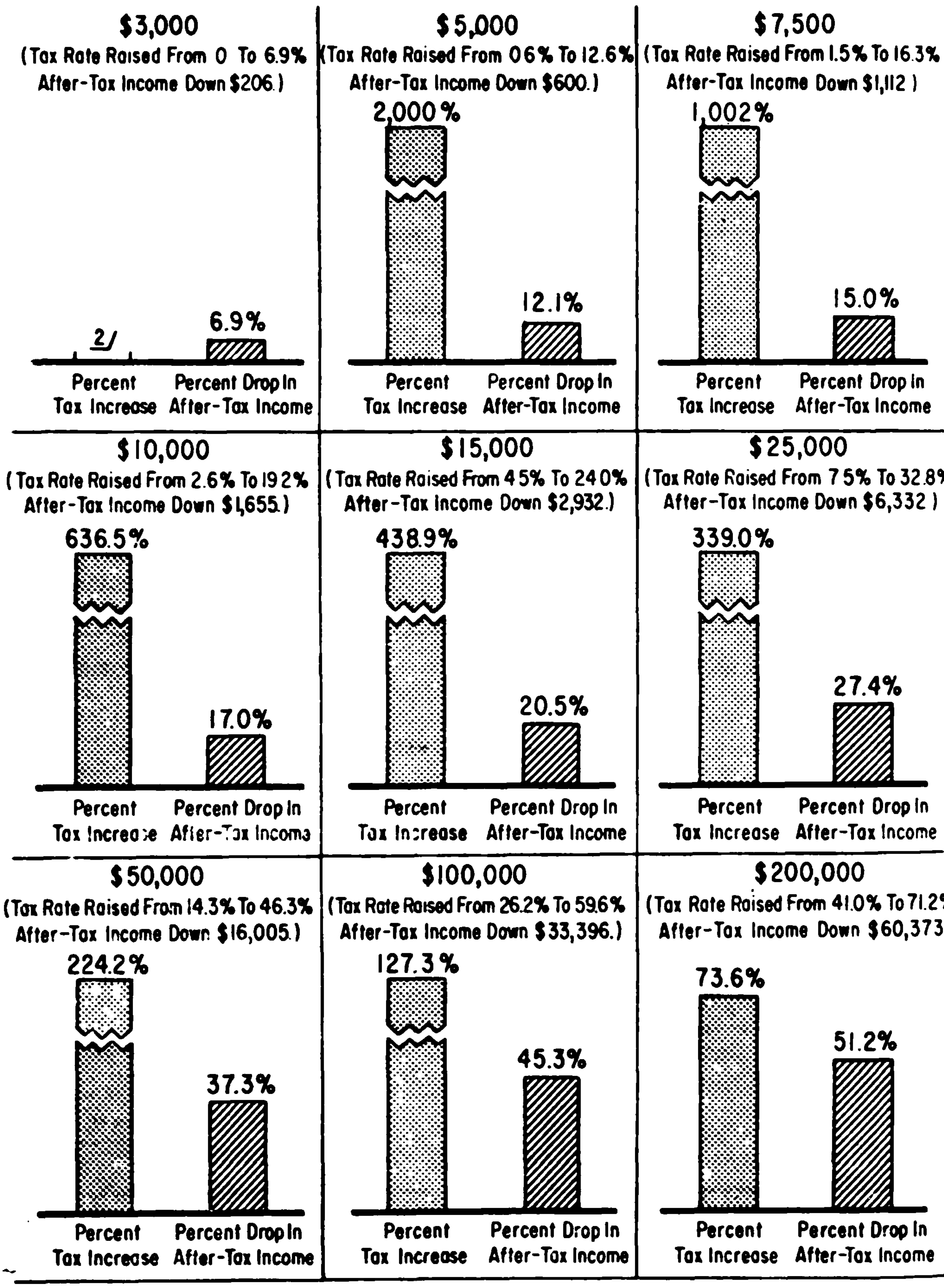
1/ Percent distribution of 1945 tax returns (taxable and nontaxable) by income group estimated by CEP on basis of Treasury Dept. data.

2/ The share of the total tax increase applicable to the adjusted gross income of each income group based on CEP estimate of amount of taxes which would have been paid in 1945 had 1939 rates and regulations obtained in 1945.

CHART B

PERSONAL TAX INCREASES, 1939-1945

Percent Federal Tax Increase And Percent Decrease In After-Tax Income Married Couple With Two Children At Various Income Levels[1]



1/ Federal tax for 1939 and 1945, as applied to adjusted gross income, estimated by CEP, assuming 10 percent deduction for taxes, interest, contributions, etc. Allowance was also made for earned income credit in 1939.

2/ No tax at this level in 1939.

Note: Tax rates shown are effective tax rates.

filing reurns with incomes of $10,000 and over would receive 57 percent of the total tax cut attributable to the decreases in tax rates; the 1.87 percent with incomes of $20,000 and over would receive 24.8 percent; and the 0.31 percent with incomes of $50,000 and over would receive 8.7 percent. This indicates that the lower income people, relative to their number, enjoyed a much smaller share of the decrease in the tax burden, while the higher income people enjoyed a much larger share. In other words, the distribution of the decrease in the tax burden was regressive.

Turning to the effect upon a taxpayer at a given income level, using the same assumptions as to family size and deductions as in previous chapter, chart D shows that, comparing 1963 with 1945, the $3,000 income taxpayer is estimated to receive a 70.9-percent cut in his effective tax rate, while the $200,000 income taxpayer would receive only a 19.1-percent cut. This makes it appear that the changes were very progressive. But looking at the changes in disposable (after-tax) incomes, which are the only changes of practical economic or social significance, the $3,000 income taxpayer is estimated to enjoy an increase of only 5.2 percent in his disposable income, and the $5,000 income taxpayer only a 4.8-percent increase; the $10,000 income taxpayer would enjoy a 6.7-percent increase; the $50,000 income taxpayer, 26.7 percent: the $100,000 income taxpayer, 36.9 percent; and the $200,000 income taxpayer, 47.2 percent. It is thus made even clearer that the 1945–63 reductions in tax rates were highly regressive in their effects upon income distribution.

Some may argue that the same considerations which made the distribution of the increase in the tax burden progressive when taxes were being sharply increased during the period 1939–45 appropriately made the distribution of the decrease in the tax burden regressive when taxes were sharply reduced during the period 1945–63. This argument would be correct only if the distribution of the total Federal personal tax had become too progressive as of 1945, from the viewpoint of its impact upon economic growth and incentives. (It was certainly not too progressive from the viewpoint of economic and social justice, considering the vast disparities in disposable (after-tax) incomes even in 1945, and the many millions of families and individuals still living in poverty and deprivation.) But, as shown in the previous chapter, the distribution of the tax burden as of 1945 was entirely consistent with our fantastic growth achievements and high economic incentives during World War II. And as is shown subsequently, the much less progressive distribution of the tax burden more recently has worked against adequate economic growth. It has done this mainly by creating periodic maladjustments between (a) investment in expanding the means of production and (b) private consumer demand. It follows that the necessary reduction of taxes after 1945 should not have moved so far in the direction of less progressive taxation.

Changes in corporate tax treatment, 1945–63

The Revenue Act of 1945 repealed the excess profits tax as of January 1, 1946, and also reduced the corporate surtax rates. The 1954 Revenue Act permitted, as of the end of 1953, the expiration of the excess profits tax imposed during the Korean war. The same act introduced a liberalized treatment of depreciation allowances, and also liberalized some other business allowances. This trend was carried considerably further by congressional and Treasury action in 1962. The excessively favorable tax treatment of business investment and its consequences are discussed fully subsequently.

But it should be noted at this point that, even in early 1957, when overcapacity relative to demand for ultimate products was abundantly apparent, the administration and the Federal Reserve System both urged restraint upon consumption and more emphasis upon investment, although the portents of the oncoming recession were in full view. The further tax concessions to investors by legislative and administrative action in 1962, while not yet succeeded by another recession, evidenced a similar misplacement of emphasis.

Misinterpretation of consequences of 1954 tax reductions

Some analysts say that the tax changes of various sorts contained in the Revenue Act of 1954, when combined with the very large automatic reductions of tax rates in 1954 under earlier legislation, contributed mightily to the economic recovery after the 1953–54 recession. But these analysts overlook that the deficiencies in the tax structure after 1945 and on into 1953 were among the factors inducing the recession by distorting the relationship between investment and consumption. The recession of 1949 was also due in part to errors in national economic policy, including the regressive trends in tax policy from 1945 forward. Further, the deficiencies in the tax structure from 1954 forward (including the tax changes in that year) were among the factors which prevented the recovery following this recession from bringing us back at any time to conditions anywhere near maximum employment and production. Thus, these 1954 tax changes, even while they gave the economy a temporary shot in the arm in the longer run were not of the type suited to maintain adequate economic growth. This lesson has great relevance to the current tax proposal. To illustrate, although we had a big upturn in 1954–55, our economic growth rate in real terms was only 2.1 percent from 1955 to 1956, and only 1.9 percent from 1956 to 1957. Thus, the assertion by the Council of Economic Advisers and others that our chronic problem of an inadequate growth rate commenced in 1957 rather than in 1953 is questionable. And of course, deficiencies in the tax structure continued to be one of the important factors which induced (a) the recessions of 1957–58 and 1960–61, and (b) our very unsatisfactory growth rates even during the nonrecessionary periods between 1958 and 1963.

Summary of overall effects of tax trends, 1945–63

There can be no doubt that the huge tax reductions immediately following World War II, coupled with the tremendous accumulation of savings which resulted from the method of financing the war and other reconversion policies, helped very much in smoothing out the transition from war to peace. Even so, the tax changes which commenced as World War II ended resulted by the time of the 1954 tax changes in a tax structure ill-suited to our economic and social needs during the past decade.

The difference between the tax structure from 1954 forward through 1963, and the tax structure as it was in 1945, had a regressive effect upon income distribution. Especially during the past decade, our progress toward reducing poverty and deprivation among scores of millions of Americans has slowed down to a snail's pace. Our rate of economic growth during the most recent decade has been abysmally low, involving enormous harm to our private and public priorities at home, and also serious effects upon our international purposes and prestige. Of course, errors in many other national economic policies besides tax policy contibuted to these results. Nonetheless, the trends in tax policy should be borne in mind, when we turn to consider what kind of changes in national tax policy we need now.

(6) My sixth basic proposition is that the current tax proposal in its present form, especially because of the defects in its internal composition, would provide a very inadequate stimulus to the U.S. economy.

Earlier in my testimony, I set forth my estimates that the current tax proposal in its present form, when fully effective, would allocate $6.1 billion to the consumption function, and $7 billion (including the $2 billion value of the 1962 corporate tax concessions) to the investment function. It is assumed that practically all of the estimated allocation to the consumption function would actually be spent, for this estimate excludes that portion of the total personal income tax cut which I estimate would be saved for investment purposes. Using the "multiplier" of about 3, which is widely accepted, the $6.1 billion of increased consumer spending when the proposal became entirely effective (let us say circa 1965 or 1966) would add about $18.3 billion to total national production in that year.

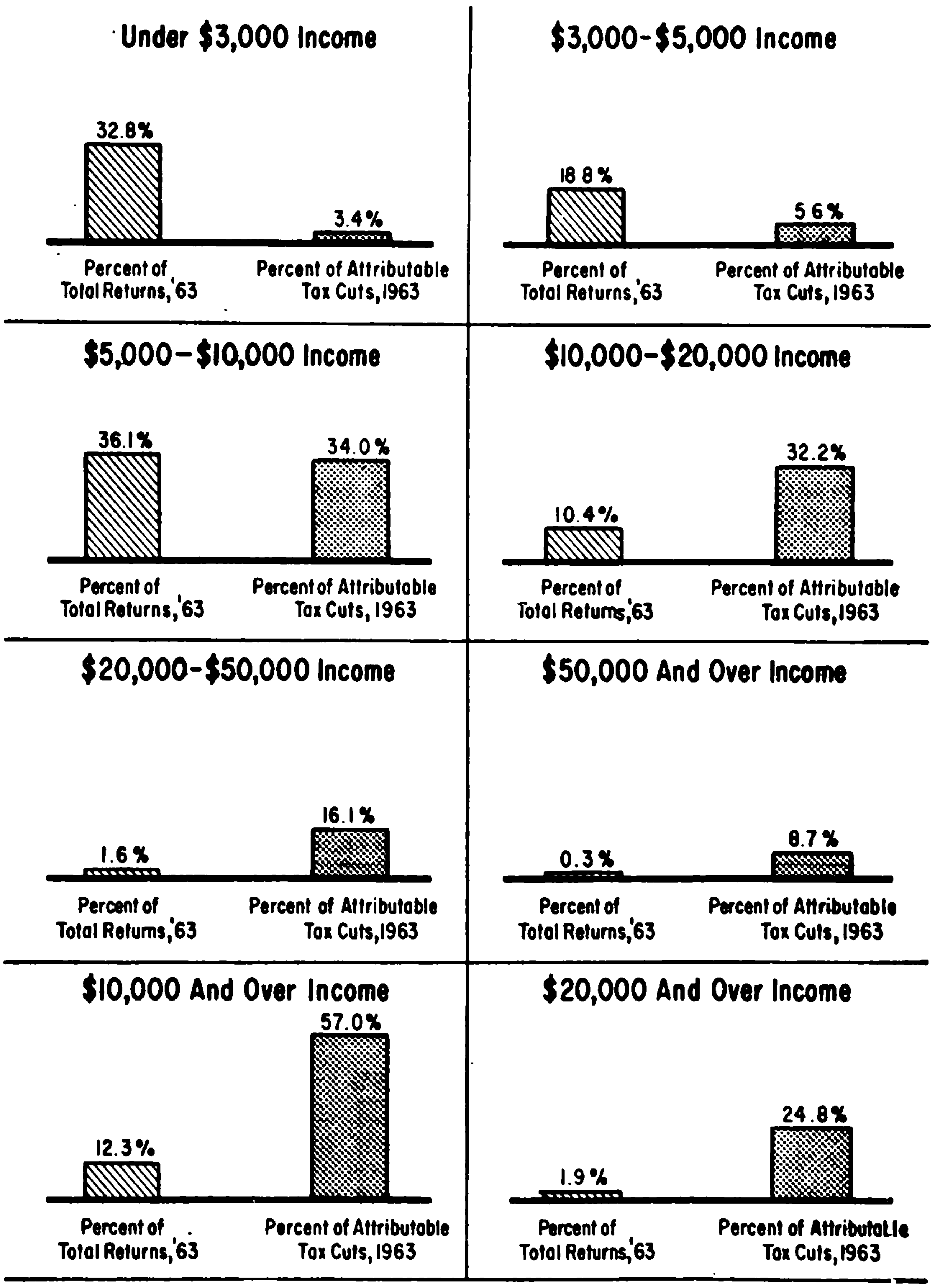
But the estimated allocation of $7 billion to the investment function (circa 1965 or 1966) would not all flow promptly into investment, especially in view of the outlook for continuation of a good deal of "overcapacity" and insufficiency of private and public demand for ultimate products. Some of this $7 billion amount would be "saved" instead of invested, both by individuals in the higher income brackets and by business. Thus, I would estimate that only about $4 billion at most would flow reasonably promptly into investment (if the allowance for "saving" seems high, it should be noted that my estimated investment stimulus contains the $2 billion 1962 corporate tax concessions, even though these are not part of the current proposal). Again using the "multiplier" of 3, the $4 billion investment flow would add about $12 billion to total national production (circa 1965 or 1966). Adding this $12 billion to the $18.3 billion estimated in the preceding paragraph, the whole estimated stimulus to total national production would come to $30.3 billion as of 1965 or 1966.

This $30.3 billion figure needs to be contrasted with the $107 billion figure, which I have set forth earlier in my testimony, representing the difference be-

CHART C

PERSONAL TAX CUTS, 1945-1963:

Distribution In 1963 Of Total Tax Returns[1/] And Of Total Federal Tax Cuts Attributable To Tax Rate Decreases [2/]



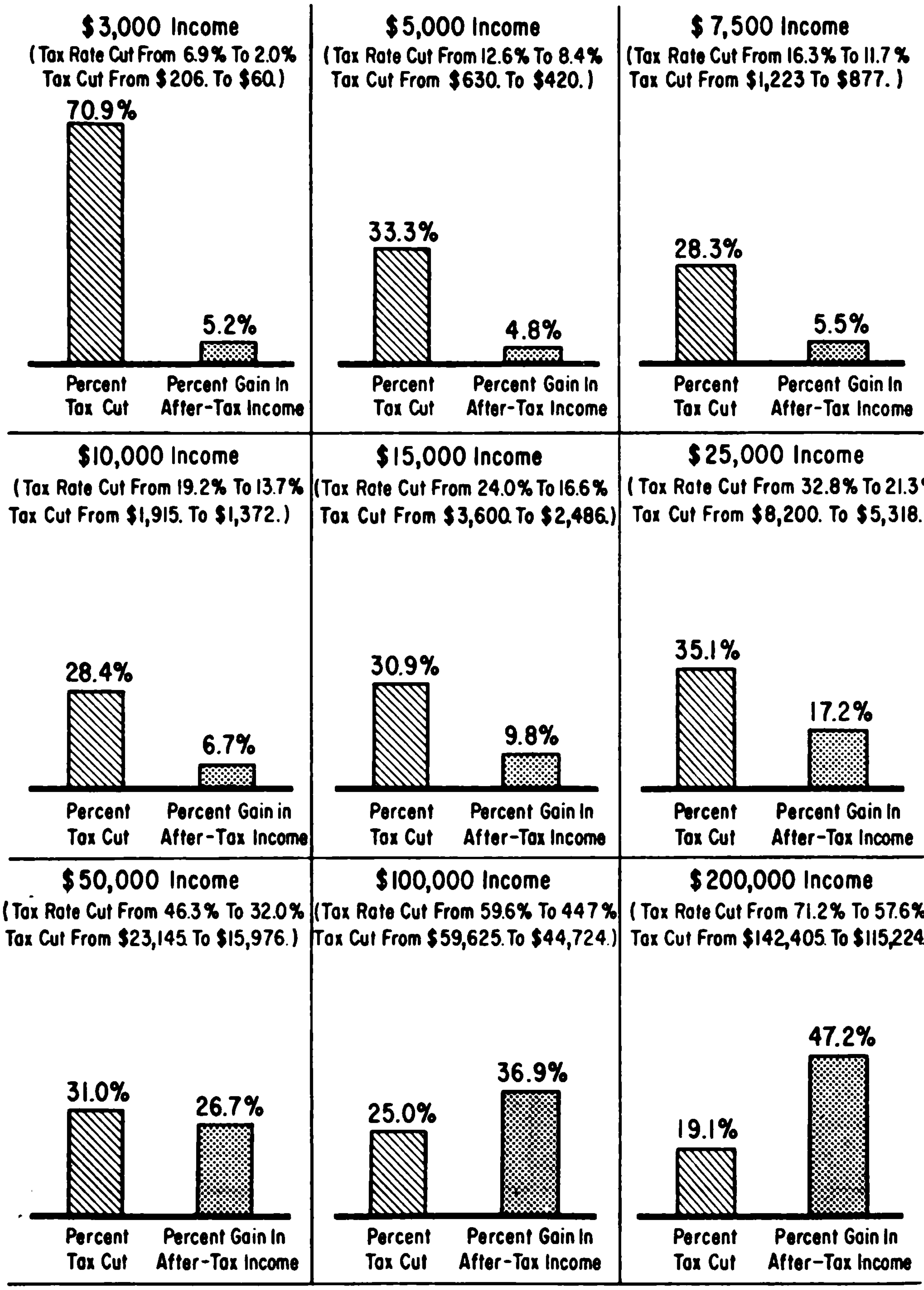
1/ Percent distribution of 1963 tax returns (taxable and nontaxable) by income group estimated by CEP on basis of Treasury Dept. data.

2/ The share of the total tax decrease applicable to the adjusted gross income of each income group based on CEP estimate of amount of taxes which would have been paid in 1963 had 1945 rates and regulations obtained in 1963.

CHART D

PERSONAL TAX CUTS, 1945-1963:

Percent Federal Tax Cut And Percent Gain In After-Tax Income Married Couple With Two Children At Various Income Levels[1/]



[1/] The amount of Federal tax, as applied to adjusted gross income, was estimated for 1945 by CEP and for 1963 by Treasury Dept. Both estimates assume 10 percent deduction for taxes, interest, contributions, medical care, etc.

Note: Tax rates shown are effective tax rates.

tween my estimate of needed total national production in 1966 and my estimate of where total national production would then be if our national economic policies were to remain about in status quo—that is, if the tax program were not put into effect.

For the first calendar year to which the current tax proposal in its present form would be applied, presumably 1964, my estimate is that the stimulative value of the proposal would be in the neighborhood of $14½ billion. This figure would be a very small portion of the $55–60 billion by which we need to lift total national production in 1964 above the 1964 level likely to result if our national economic policies remained about in status quo.

Moreover, the slight impact of the tax proposal during the first year to which it would be applied has a vital bearing upon its value when in full operation. Obviously, if a patient needs an injection of 100 units now, the same result is not obtained by giving him 33 units now and similar amounts a year and 2 years from now. Thus, an editorial in Business Week as early as February 9, 1963, said this:

"The fact is that the tax program, as it stands, will not do what President Kennedy himself has been talking about—remove the drag that an outdated tax structure has put upon the economy. The tax reductions it proposes are too small and too slow to give a substantial lift to production and employment for several years, if at all."

(7) My seventh basic proposition is that the current tax proposal in its current form would have a low ratio of results, when measured against the costs involved. Further, even properly designed tax reduction, while highly useful, is no substitute for other programs required to deal with the unemployment problem, in view of the new technology and automation.

My whole analysis up to this point converges upon the proposition that the current tax proposal in its present form would yield small results when measured against its costs, because it is not properly adjusted to the problem of economic equilibrium, and because a large portion of it would be "saved" instead of flowing into investment and consumer outlays. There is no need to elaborate further upon this point; the remedy is to change the composition of the proposed tax reduction.

But even well-designed tax reduction cannot cope with a large portion of the unemployment problem, or cannot cope with this problem nearly as efficiently as other measures. Some of the reasons for this have been frequently stated. For example, specific spending programs can be directed much more pointedly to where the unemployment problem exists, and do not have the disadvantage of vast increases in the disposable incomes of corporations and individuals who do not need these increases at all.

But there is a far more important reason, largely overlooked by most economists and analysts, why programs other than tax reduction (even if well-designed) must play so large a part in dealing with the unemployment problem. This reason is as follows: The rate of advance in productivity, technology, and automation in many of our conventional mass production industries is becoming so fast that no feasible increase in the demand for their products is likely to add very significantly to their levels of employment in the years ahead, when measured against the required expansion of employment opportunity. To indicate the size of this task, it has been estimated in responsible quarters that we need about 22½ million new jobs during the next decade, to absorb the growth in the labor force, to reduce unemployment to levels consistent with maximum employment, and to provide new types of job opportunity for those who will continue to be displaced by technology and automation.

To be sure, an increase in aggregate demand through appropriately designed tax reduction will help employment in these conventional mass-production industries to find higher levels than would be the case in the absence of this increase in aggregate demand. But the amount of increase in aggregate demand which would be needed, to yield in these conventional mass-production industries a major portion of the needed expansion of employment during the next decade, would be entirely unattainable for many practical reasons. And even if it were attainable, the result would be so many of these conventional products that we would have nowhere to put them except in the ocean, while we would still be suffering from gross neglect of some of the highest priorities of our national needs.

The inability of our conventional mass-production industries to make the major contribution to the expansion of employment opportunity during the next decade is very well illustrated by my 31st chart, which depicts the impact of technological progress upon employment trends in manufacturing during the period 1947–62. Using the years 1947–49 to represent 100 with respect to the ratios of the various indexes which I shall now cite production workers in manufacturing measured against total manufacturing employment declined from 101.1 in 1947 to 90.2 in 1962. Total employment in manufacturing measured against GNP declined during the same period of time from 105 to 66.6. Total employment in manufacturing measured against industrial production declined from 103 to 62.5. And most significantly, production workers in manufacturing measured against GNP declined from 106.2 to 60.1. These trends reveal how unrealistic would be any expectancy that a large portion of the employment expansion needed in the years ahead can take place in our manufacturing industries.

My 32d chart, which I regard as of almost unique significance, contains my estimates of alternative employment trends, comparing 1965 with 1960, based upon alternative assumptions of high and low overall economic growth rates. First of all, taking the high overall economic growth rate assumption, by which I mean nothing more than the growth rate consistent with restoration and maintenance of maximum production and employment, total civilian employment would need to be 12.7 percent higher in 1965 than in 1960, according to my estimates. But even assuming this overall economic growth rate, my estimate is that employment of production workers in manufacturing would at best be about 8 percent higher in 1965 than in 1960; employment in mining only about 3 percent higher; and employment in transportation and public utilities only about 2.6 percent higher. Among the largest feasible increases in employment, taking into account both the relative trends in technology and automation and the likely pattern of our basic nationwide needs and preferences, are in contract construction, where I estimate an employment expansion potential of about 30 percent, comparing 1965 with 1960; in public employment at all levels of government, where I estimate an employment expansion potential of 20.6 percent; and in the various service occupations, where I estimate an employment expansion potential of 22 percent.

But this volume of employment expansion will not be accomplished simply by training and educating people for jobs which are not available to absorb them. And it is manifest that a avery large proportion of the expansion in the areas of activity with the highest employment expansion potential depend upon public outlays, upon new combinations of private and public endeavor, and upon the availability of more credit at lower costs which in turn depends upon our national public policies. To illustrate, contract construction cannot advance by anywhere near the required amounts, without tremendous increases in the volume of housing for low- and middle-income families and also in urban renewal, and very large increases in a wide variety of useful public works, which depend vitally upoin the combinations of public and private efforts just described. Private employment in needed service occupations, and public employment at all levels for useful purposes, cannot expand in the needed amounts without these same combinations of private and public efforts, designed among other things to overcome our serious shortages of educational and health facilities and personnel. And the needed improvements in our mass transportation systems cannot occur, without similar combinations of private and public efforts.

None of these purposes will be served in very large measure by tax reductions which would add merely to more plant and machinery in our conventional mass production industries, and to increases in random spending by 190 million-odd consumers mainly for the customary varieties of conventional products. This is the core reason why the promise to hold our domestic Federal public outlays to their current levels, which actually means a reduction on a per capita basis as our population grows, as a quid pro quo for the proposed tax reduction or for any other tax reduction, simply does not face up to the towering problem of unemployment and low economic growth.

It is not the purpose of my testimony before this committee at this time to discuss in detail these other needed programs. In brief, the very large expansion of social security benefits, the reduction in interest rates, improvements in minimum wage protection, a new public attitude toward the wage problem, and a variety of other approaches are essential to add directly to the needed expansion of private incomes and private consumption. And merely to indicate the size of the needed outlays for the public programs referred to in the preceding two paragraphs, I am including in my testimony my charts 33 and 34, which attempt to project ahead a Federal budget, in the overall and in its main components, consistent with maximum employment and the priorities of our national public needs.

CHART 31

IMPACT OF TECHNOLOGICAL PROGRESS ON EMPLOYMENT TRENDS, 1947-1962

Ratios of Indexes, 1947-1949 = 100

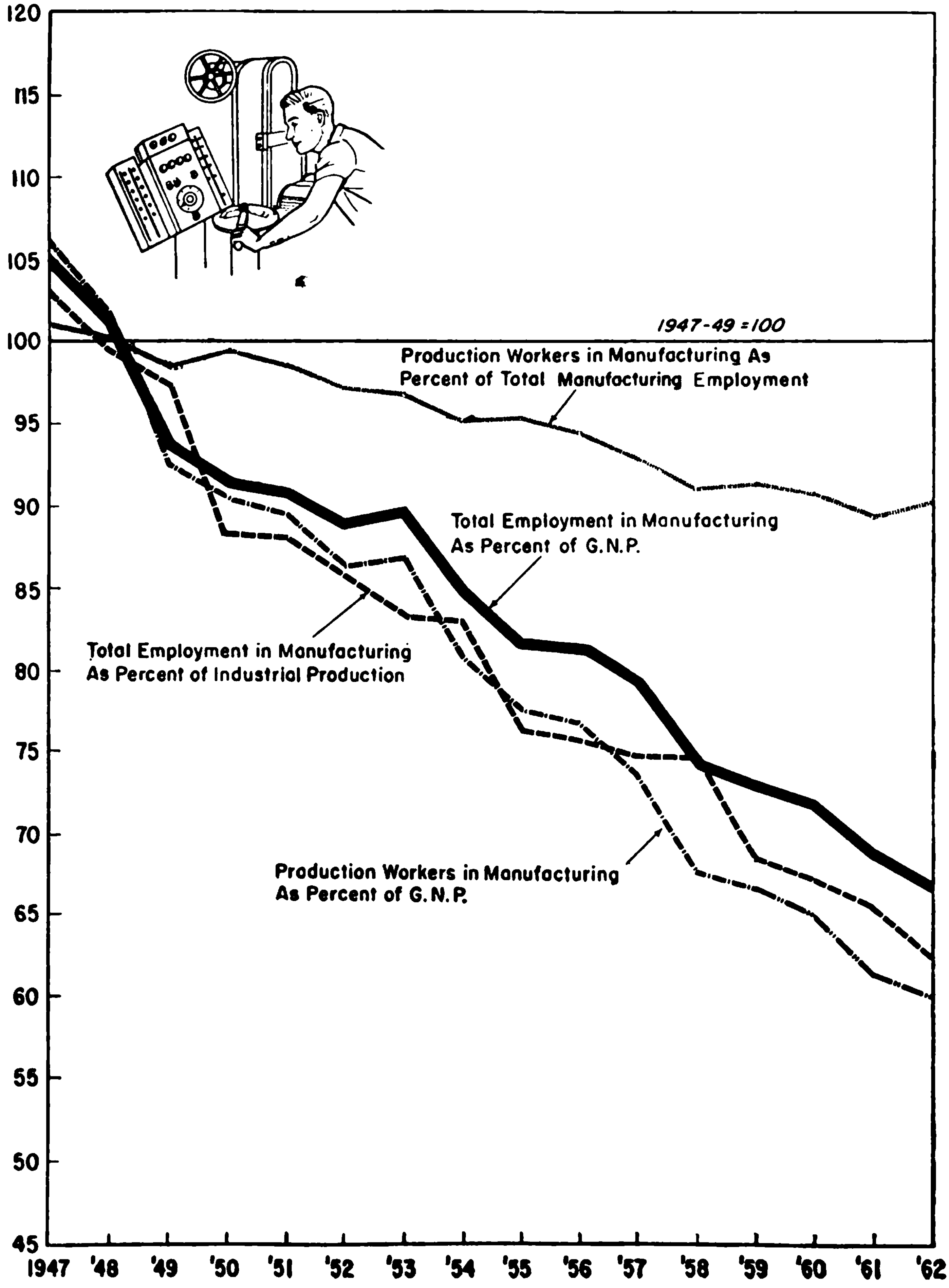


CHART 32

ALTERNATE EMPLOYMENT TRENDS, 1960-'65, AT HIGH & LOW OVERALL GROWTH RATES

Index: 1960 = 100

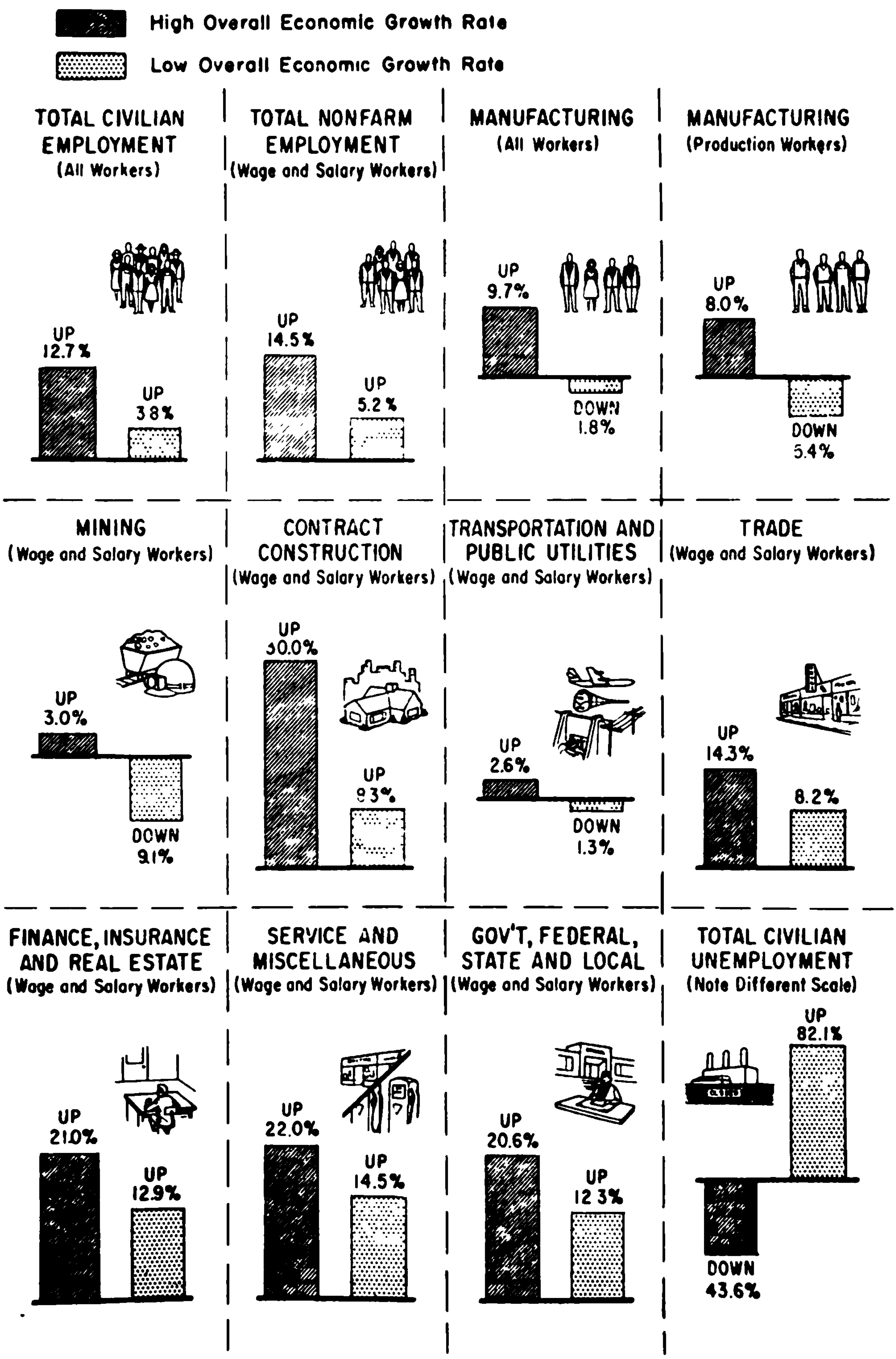
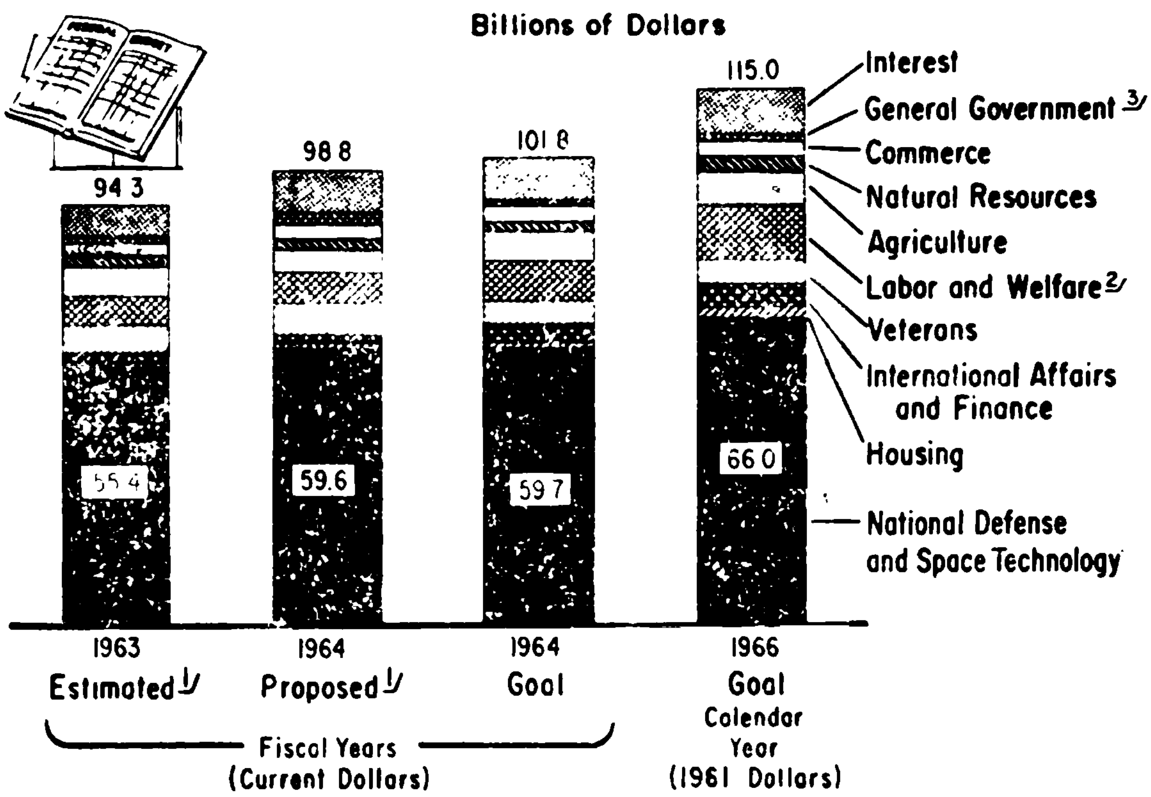
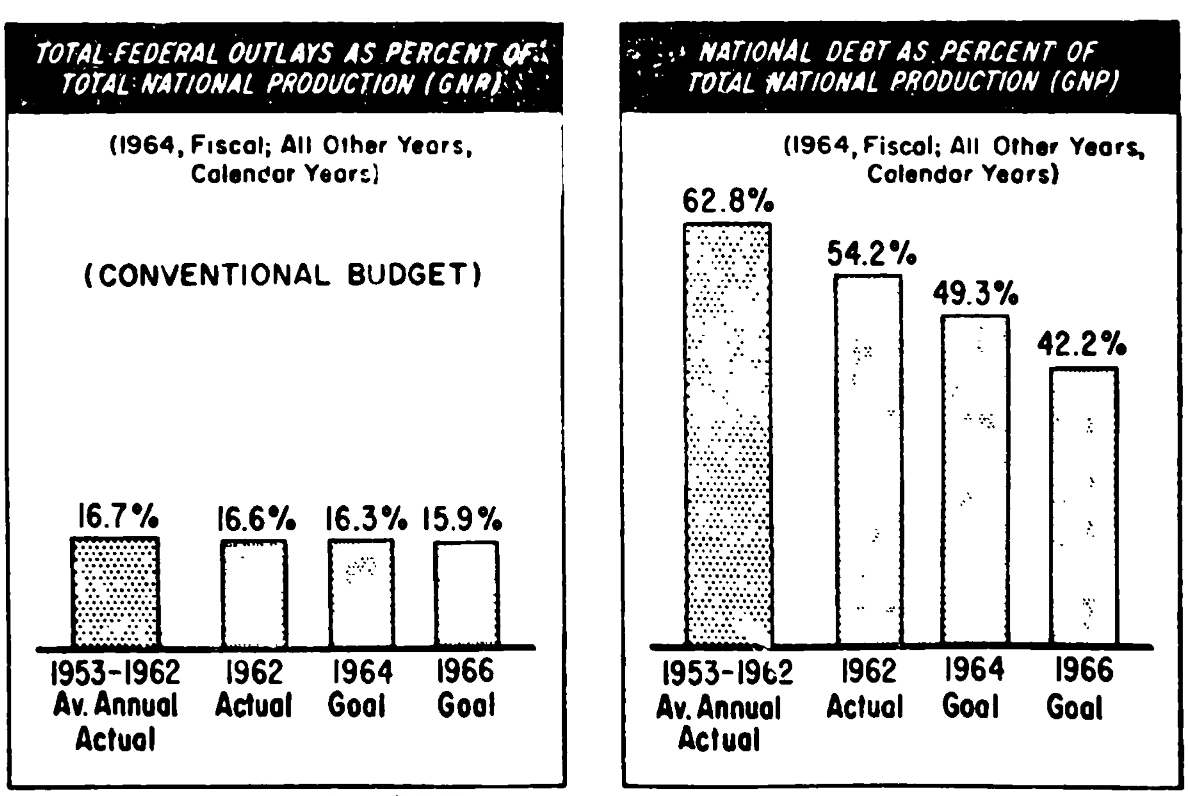


CHART 33

TOWARD A FEDERAL BUDGET CONSISTENT WITH MAXIMUM EMPLOYMENT AND THE PRIORITIES OF NATIONAL PUBLIC NEEDS



BURDEN OF FEDERAL OUTLAYS IN A FULLY GROWING ECONOMY WOULD BE LOWER THAN IN RECENT YEARS



1/ Based upon Budget Message of Jan 17, 1963

2/ Including education and health services

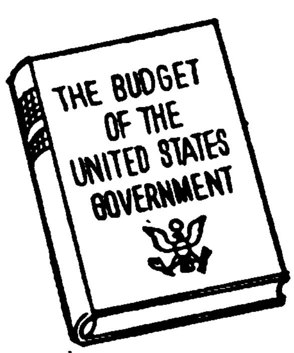
3/ Including contingencies and less interfund transactions

CHART 34

GOALS FOR A FEDERAL BUDGET GEARED TO ECONOMIC GROWTH AND PUBLIC NEEDS

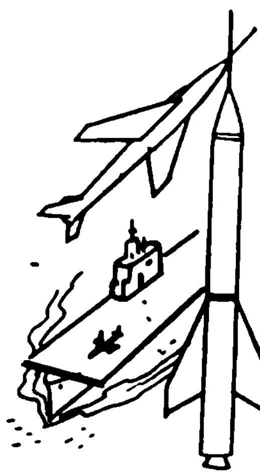
1964, Fiscal Year; 1966, Calendar Year
Per Capita Outlay in 1962 Dollars

TOTAL FEDERAL OUTLAYS



Year	% of Total Output	Per Capita
1964 Adm.[1]	16.80	505.86
1964 Goal	16.29	521.20
1966 Goal	15.91	577.89

NATIONAL DEFENSE, SPACE TECHNOLOGY AND ALL INTERNATIONAL

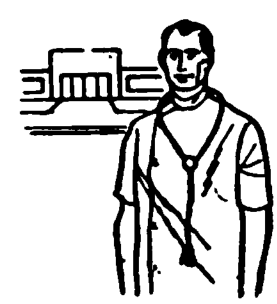


Year	% of Total Output	Per Capita
1964 Adm.[1]	10.59	319.03
1964 Goal	10.16	325.11
1966 Goal	9.82	356.78

EDUCATION

Year	% of Total Output	Per Capita
1964 Adm.[1]	.26	7.87
1964 Goal	.32	10.24
1966 Goal	.62	22.61

HEALTH SERVICES AND RESEARCH



Year	% of Total Output	Per Capita
1964 Adm.[1]	.28	8.41
1964 Goal	.32	10.24
1966 Goal	.44	16.08

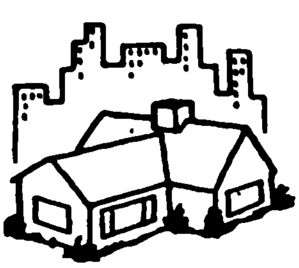
PUBLIC ASSISTANCE

Year	% of Total Output	Per Capita
1964 Adm.[1]	.51	15.48
1964 Goal	.51	16.38
1966 Goal	.51	18.59

LABOR AND MANPOWER, AND OTHER WELFARE SERVICES

Year	% of Total Output	Per Capita
1964 Adm.[1]	.16	4.85
1964 Goal	.16	5.12
1966 Goal	.15	5.53

HOUSING AND COMMUNITY DEVELOPMENT



Year	% of Total Output	Per Capita
1964 Adm.[1]	.05	1.42
1964 Goal	.16	5.12
1966 Goal	.31	11.06

ALL DOMESTIC PROGRAMS AND SERVICES

(Includes also Agriculture; Natural Resources; Veterans; Commerce; Interest; General Government, etc.)

Year	% of Total Output	Per Capita
1964 Adm.[1]	6.21	186.83
1964 Goal	6.13	196.09
1966 Goal	6.09	221.11

[1] Administration's proposed budget as of Jan. 17, 1963.

MY SUGGESTIONS FOR IMPROVEMENTS IN THE CURRENT TAX PROPOSAL

The general nature of what I regard to be the needed improvements in the current tax proposal are clearly indicated by my foregoing analysis of its weaknesses. Beyond this, it would be presumptious for me—and in any event I am not prepared at the moment—to specify the detailed changes in the current proposal which would increase its effectiveness as a major vehicle of economic and social progress.

But I do feel called upon to make a few broad suggestions, keeping within the ambit of the about $11 billion which represent the size of the tax proposal in its current form.

First, for reasons which I have already stated, I submit respectfully that general corporate tax reduction at this time is unnecessary and wasteful. More than enough was done on this score in 1962. All or most of the $2.2 billion contained in the current measure for this purpose could most usefully be diverted to other tax reduction purposes.

Second, I respectfully submit that the allocation of $4 billion or about 45 percent of the proposed personal tax cuts of $8.9 billion to taxpayers with incomes of $10,000 and above, who constitute only about 12½ percent of all taxpayers, is wasteful on economic grounds and indefensible on social grounds. I submit that about half of this amount, or about $2 billion, could most usefully be diverted to tax reduction of a more useful and efficient sort. The two foregoing suggestions come to a total of about $4.2 billion.

Third, I respectfully suggest that the exemptions be lifted enough to absorb this $4.2-billion amount. The current customary exemption of $2,400 for a family of four has 67 percent less purchasing power than the 1939 exemption. The families benefiting most by the exemptions are even now hard pressed to make ends meet. Helping them more will help the economy most, and be a most worthy human and social gain. This proposal, in addition, would return to the higher income groups some portion of the $2 billion diversion suggested above.

These three basic suggestions do not attempt to spell out the technical changes in the proposed bill which would accomplish these results. But the technical task of adjusting the proposed bill to these results, or to roughly comparable results, would be neither difficult nor time consuming, if undertaken by those equipped for this task.

Changes in the proposed tax measure along these or similar lines would be beneficial on all scores. They would provide much more stimulus to the economy, by bringing much closer together the relationship between the size of the tax concessions and the portion of these concessions which would actually be spent rather than saved. They would in themselves constitute the most worthy tax reform, because they would bring about a more equitable and socially useful distribution of the tax burden. They would be more beneficial in terms of the Federal budget, because by their increased economic effectiveness they would result in a smaller Federal deficit than the current proposal in the short run, and offer more promise of getting back to a balanced budget in the long run. They would, properly explained, have more appeal to the American people. The most that I can ask, however, is that this committee, as I am sure it will, give serious consideration to these suggestions.

While I feel that speed is of the essence, in order that an effective tax measure may be enacted this year, I respectfully submit that this vital consideration should not discourage any member of this committee from seeking to improve the pending bill in the light of his own judgment. This is the largest tax reduction bill in history. It is therefore one of the most important measures ever to come before the Congress with respect to our domestic economy and our fiscal affairs. Whenever this measure takes effect, and whether the consummation of its provisions is spread out over several years or not, its impacts on our economy and our national fiscal affairs, and therefore upon every citizen of this great Nation, will stretch for years into the future. The course that this measure will set upon enactment will be, to a large extent, irreversible. Under these circumstances, the axiom that "haste makes waste" is pertinent. Although most of those now in favor of a large tax reduction have been in favor of it for almost 3 years, and so have I, we have survived without catastrophe although such tax reduction has not yet been enacted. We can certainly survive long enough to obtain the best kind of measure which this committee and the Congress can write. Who is there really prepared to say, in good conscience, that a seriously defective measure enacted a few days or weeks earlier would be preferable to a satisfactory measure enacted a few days or a few weeks later?

In conclusion, I want to return to what I said in the outset. Nothing I have said throughout this testimony should be construed as opposition to the objectives of the adminisration and the other proponents of the current measure in its present form. Further, I am so convinced of the imperative need for large and immediate tax reduction that, if I were forced to choose between the current measure in its present form and consideration of alternatives which would delay enactment until next year, I might prefer the former course. But I cannot believe that these are the only two alternatives. This committee, the Senate, and the Congress of the United States fortunately do not need to choose beween two alternatives, each of which I submit is far less desirable and no more feasible in practical terms than the substantial improvement of the current tax proposal and its enactment at this session of the Congress. It is my fervent hope that this will be the outcome.

Mr. KEYSERLING. In connection with my prepared statement, I make a request of the committee to insert, in addition, five short pages from a study of the tax subject which I have made, with charts, which I did not bother to have copied again into my statement.

The CHAIRMAN. I do not believe the committee has a copy of the statement.

Mr. KEYSERLING. I ask as an addition to my statement to have inserted in the record five brief pages with charts from a study which I have made of the tax subject, which I did not bother to have copied in detail in my statement itself because of the pressures of time, but it would follow naturally at that point.

The CHAIRMAN. Without objection.

Mr. KEYSERLING. Mr. Chairman and members of the committee, in the opening parts of my statement I emphasize the reason why, speaking generally, I am in favor of the objective of a large and immediate tax cut to stimulate the economy. However, my views on that subject are well known, and I would like to pass that and come to the reasons why I have serious concern about some specific provisions of the current bill.

First of all, I would like to call your attention especially, and I will read briefly from my statement.

The question naturally arises as to whether my views just stated are based upon the assumption that we will have an economic recession next year if we do not undertake large tax reduction now. My record before this committee and elsewhere makes it clear that I do not believe that changes in fiscal policies as profound and enduring as those embodied in the pending measure should be based upon hazardous attempts at precise short-range forecasting.

I do not think that the sound case for tax reduction has been furthered by those who on one day have warned us that we are likely to have a recession next year if the pending measure is not enacted promptly, and who on the next day have said that the economic outlook is good for the near future and that the main reason for the pending measure is to accelerate our long-range rate of economic growth. Nor have the forecasts of some of these people been sufficiently accurate in recent years to add much to their persuasiveness when they use these forecasts in support of the pending measure.

While some will admit that my own forecasts have tended to be more accurate than theirs, I do not place much store in the ability of anyone—including myself—to make these short-range forecasts with any degree of accuracy.

Instead, my position in favor of a large and immediate tax cut is founded upon the chronically rising tide of idle manpower and plant which has afflicted the American economy for a decade or so.

Now, going over from there to the top of page 3, my prepared statement reads that my general support of large and prompt tax reduction has led some of my friends, in the Government and elsewhere, to question why, at this late date, I raise these criticisms of the current tax proposal, when in their view the choice is between this measure in substantially its present form and no measure at this session of the Congress.

My first answer to these questions is that I would not so denigrate this committee and the Senate of the United States as to accept the viewpoint that they have no important role to perform in considering this measure, except to rubberstamp a proposal which has come over from the House Ways and Means Committee and the House of Representatives, whose views and responsibilities I also respect.

And while the hour is late, it is not too late to look before we leap, especially with respect to a tax proposal which will profoundly affect the American economy for many years to come, and which to a substantial degree will even set an irreversible course, because the history thus far of this very proposal shows how hard it is to alter or reverse our fiscal policies once written into law.

And even if it were too late for my single voice or others added to mine to change in any respect the momentum of support which this measure has already acquired in exactly its current form, it is never too late to honor the principle that there is always need for some critical evaluation of our national economic policies.

Now I will say, no longer reading from my prepared statement, that many who are now supporting this tax bill have been for large tax reductions for 3 years, and we have not suffered an economic calamity because this has not happened, and we are not going to suffer an economic calamity if this committee, as I know it will, takes long enough to go through this thing with a fine-tooth comb and try to get a better measure than the one now before it.

I want to compliment this committee for the evidence already amply given that it is not going to be stampeded into reckless action on this measure, because of the cries of those who think that they have arrived at perfection in the formula embodied in the current bill.

First of all, regarding the current economic situation, and from here on I am going to summarize without referring to my prepared testimony, I would like to direct the attention of the committee to the second chart of which you have copies. I am referring to the charts as numbered in my prepared testimony, and included therein.

The significant part of the chart is the third sector, which shows that, despite all the excitement and propaganda about this marvelous economic upturn, I have shown by 12-month periods our rate of economic growth.

Senator RIBICOFF. Mr. Keyserling, would you be good enough to indicate the number because I think what we have here may be different than what you are showing? What number is that?

Mr. KEYSERLING. That would be chart No. 2, Senator Ribicoff, at the back of your statement.

If we look at the last sector of that chart, it shows that, by 12-month periods from the first quarter of 1961 through the second quarter of 1963, every single 12-month period has shown a declining rate of economic growth. In other words, the economy for at least a year or so has been in another period of what I call stagnation.

Furthermore, as you know, in the third quarter of 1963, there has been no adequate improvement in the situation, as evidenced by the views of the administration that without this tax cut we may be moving toward a recession next year.

Senator GORE. Will you repeat that statement? I did not quite get it.

Mr. KEYSERLING. That in each of the 12-month periods——

Senator GORE. I got that.

Mr. KEYSERLING. We have moved to a lower rate of economic growth.

Senator GORE. I heard that.

Mr. KEYSERLING. And that in the last 12-month period from the second quarter of 1962 to the second quarter of 1963, as shown on the chart, the economic growth rate has only been 3.3 percent, and the third quarter, which is not shown on the chart, is not at all satisfactory, as evidenced by the increasing concern about the economic outlook after the first quarter of next year.

Now, I would also point out to you that the 3.3-percent growth rate shown in the last 12-month period is not to be compared with the 5-percent growth rate that would represent a healthy growth rate if our economy were now reasonably fully employed. The actual growth rate required to restore us to reasonably full employment would be about 8 or 9 percent for 2 years, so the fact is that we are now moving at a rate of economic growth only one-third of the amount required to bring us back anywhere near to full use of our plant and resources.

Probably this is why the Council of Economic Advisers, which in early 1961 was saying that we would have 4 percent unemployment, by early 1963, is now hopefully forecasting that we may have 5 percent unemployment by 1965 or 1966, if this tax bill which they are advocating so vigorously is passed.

Senator CARLSON. I do not know if Mr. Keyserling wants to yield; I would be interested if he does not do it now but at some time would mention how our growth has compared with some European countries.

Mr. KEYSERLING. I will be glad to mention that, Senator.

Senator GORE. Mr. Chairman, while there is an interruption could I just ask for a quick definition?

What do you mean by "growth rate"?

Is this expressed in terms of the gross national product?

Mr. KEYSERLING. I am talking about the growth rate in gross national product in uniform dollars, which is the most customarily accepted measure.

Senator RIBICOFF. What do you mean, uniform dollars?

Mr. KEYSERLING. Adjusted for price range, the real rate of change in output.

It is very interesting that the administration has so enormously changed its own targets for the restoration of full prosperity. It is quite a commentary upon the policies thus far adopted.

Senator GORE. What do you mean?

Mr. KEYSERLING. I mean, as I have said, that in early 1961 they were aiming toward 4 percent unemployment by early 1963. Now they are saying that we may get 5 percent unemployment by 1965 or 1966, if this tax bill is enacted. In other words, they have shifted their target 2 years ahead. They have changed the percentage target from 4 to 5, and they are hopeful now rather than sure, and they are predicating it on this tax bill.

Senator SMATHERS. What is the present percentage of unemployment?

Mr. KEYSERLING. I am coming to that in just a second, Senator.

Senator GORE. When they say 5 percent, that means they are still shooting for a reduction from present levels of unemployment?

Mr. KEYSERLING. Oh, yes, they are shooting for it just as we are shooting for the moon.

Coming to the third chart—they are shooting for it but they have not made much progress.

Coming to this third chart, which indicates the points I have just made, this shows three types of unemployment—full-time unemployment, the full-time equivalent of part-time unemployment, and concealed unemployment, which represents the people who have stopped looking for jobs and who therefore are not being counted because of the inadequacy of job opportunity.

Now let me say to this committee that while, for a number of years before this committee and elsewhere, I have been using this kind of figure which differs from the official figure, it seems to take others about 5 years to catch up; there have just been some very important studies issued which show an estimate of true unemployment now of 8.8 percent, compared with my estimate of 9.3 percent, or very close.

In other words, others are finally realizing that people unemployed part time have a full-time unemployment equivalent, and that people are ceasing to look for jobs every day when they have found for 100 consecutive days that there are no jobs to be had.

So the true level of unemployment now, as shown by the last part of this chart—this is chart 3 in the charts that you have—is now as I figure it 9.3 percent, which is compared with 4.9 percent in 1953, and even if you take the official figures on full-time unemployment, the rate was less than 3 percent in 1953, and as we all know has been hovering between 5½ and 6 percent now.

So we have had a doubling of the rate of unemployment in the short time of 10 years, and no improvement in the most recent year, and I think, as I have said before this committee, that under the current framework of policies we will have another 50 percent unemployment increase in the next 4 or 5 years.

Now, of course, the important thing is what to do about it, and what this tax bill has to do with it.

My essential method of analysis is to focus upon the two main sectors of the tax bill, one of which has to do with the stimulation of investment through a corporate tax cut, and through the granting of tax reduction to what I would call higher income people. The only conceivable reason for the tax cut for higher income people at this time is that they will save it and invest it, because if they are going to spend it immediately for consumption, I do not think even Mr. Dillon would argue, for example, that a $300,000 income taxpayer should have a 16-

percent increase in his disposable income for the purpose of buying more consumer goods when the Government is already running a big deficit, when we have so many competing national needs, and when there are so many low-income people who are much more worthy of help by their Government.

Now, one other general point which I have made before, before this committee, but which is so important that I want to make it again.

A lot of people tend to the general idea that when a tax cut is made the Government is not giving anybody anything because it is merely giving them back their own money. I say that when the Government is running a deficit a tax cut deliberately contrived to increase that deficit is a subsidy. It is a subsidy exactly the same as if the Government left tax rates just where they are and mailed back to every corporation, and every personal income taxpayer, checks in the exact amounts of the tax cuts which they would get under this bill.

When the Government furnishes services to the people for less than the collection from them in the way of taxes, it subsidizes them. It is furnishing them with services at less than cost, and this has nothing to do with the separate question of whether public expenditures are too high or too low. This is true all the time.

While I favor this under certain circumstances for certain purposes, I do not favor the wasteful giveaways or throwaways which are involved in substantial parts of this tax bill for reasons which I will disclose. I do not favor that kind of subsidy.

Senator SMATHERS. Mr. Chairman, I wonder if I might ask this question.

I have a very high respect for Mr. Keyserling as an economist. Would you care to say who you are representing here today or are you just speaking for yourself as an individual citizen?

Mr. KEYSERLING. I represent nobody except my own conscience and my own studies, and I very much appreciate the opportunity which this committee has given me so early in this hearing to speak, although I represent no powerful interest. Maybe it reflects the fact that, in previous appearances before this committee, I have been objective and events have tended to bear out what I have said before this committee as time has ensued. So I want to express my appreciation to the committee for that.

Senator SMATHERS. I was just wondering, because I do know that your testimony has been very valuable in the past, and I know it will be very helpful to us now.

Were you at one time the economist for the Truman administration?

Mr. KEYSERLING. Yes; I was the Chairman of the Economic Council under President Truman.

Senator SMATHERS. And under President Roosevelt?

Mr. KEYSERLING. Under President Roosevelt there was no Council. I did many things for President Roosevelt.

Senator SMATHERS. Do you in any way represent the AFL-CIO?

Mr. KEYSERLING. I do not represent them in any way; in my capacity as a private economist I have done work for them as well as for business groups, but here I represent nobody but my own conscience.

Senator SMATHERS. You are here as a private economist speaking your own individual thoughts?

Mr. KEYSERLING. Exactly, exactly.

Now, my analysis of the tax bill divides into a consideration of its two main approaches.

One is to attempt to stimulate investment by corporate tax cuts and by tax cuts for high-income families.

As I have said, I do not think even the Secretary of the Treasury would advocate enlarging the disposable income of $100,000 or $200,000 families, when the Government is running such a big deficit, except for the avowed purpose of stimulating savings and investment. I can hardly imagine that he thinks they need more money in these times paid to them as a subsidy by the Government to increase their personal consumption.

I call attention to a statement the Secretary made a few days ago before a business group, where he said rather gleefully that if one combined the 1962 tax concessions, which I opposed before this committee, with the corporate tax cuts in this bill, the Secretary of the Treasury said that those two things together would increase the after-tax—I underline "after-tax"—incomes of new investors by 35 percent; contrasted, I may say, and as I will point out later, with a 2-percent increase in the after-tax expendable income of the $3,000 family.

Now, when corporate profits are higher than ever before, when retained earnings are higher than ever before, when the Secretary of the Treasury and many others have admitted that we have a prolixity of savings jammed up in all of our savings institutions, when we have large unused plant capacity, why do we need to pay out about $4 billion in subsidies involved in this corporate tax cut plus the cut of 1962 to increase the after-tax disposal income of investors by 35 percent? What are they going to do with the money?

They are going to save much of it. Much of this tax cut is going to be wasted.

Now, then, I also analyze what portion of the tax cut going to the higher income families would be saved and invested, because they are not going to spend it all for immediate consumption and the administration does not so argue. Then I analyze what portion of this tax cut would go into immediate consumption and discuss the problem of consumption.

Let's come to my next chart, No. 14.

I have made an examination of the economy in operation over the last 10 years, which has helped me with my forecasts, and what I have found is this: I have found that, broadly speaking, we have had a succession of upturns, periods of stagnation, and recessions. Every time we have had an upturn—and I am not saying this critically of business—every time we have had an upturn, the rate of investment in plant and equipment which add to our productive capacity has moved so much faster than the increase in demand for ultimate products that we have soon had a lot of overcapacity and then industry has cut back sharply on its investments and we have had another recession.

These investment upturns have been fed by a very ample level of profits after taxes, by a very ample level of credit for these purposes, by a greatly increasing level of retained earnings, and by all the other funds which feed investment.

This committee will recall that in early 1957—and it is always good to turn to history when it is lively and pertinent—the chairman of this committee was conducting a great investigation of the financial condition of the United States. The then Secretary of the Treasury and the then Chairman of the Federal Reserve Board came before this committee in defense of the tax amortizations that were being handed out in great volume, and said that we needed more savings and more investment, and that we had too much consumption.

This committee asked where were we in short supply, and everything was in oversupply except one type of lead pipe, and I pointed out to this committee that we were heading straight toward a recession in the latter part of 1957 because American industry was not able to sell enough products, and that they did not need these tax bonanzas.

Unhappily, my forecast was correct. My views did not prevail. The same kind of situation is true today, and even more so, because profit levels and unused capacities and funds available to business, which I do not want them not to have, are even more prolix than they were in early 1957.

Senator GORE. Will you be more specific there?

You say the same situation prevails?

Mr. KEYSERLING. I am coming to that.

Let's move on to the next charts.

What I have done in the next charts—I will come back to the consumption matter. We are now talking about the investment matter.

Now, on this chart No. 14, in the second section of this chart, I have traced the course of investment in plant and equipment which expands our ability to produce in each of the basic periods of economic upturn during the past decade.

Here, Senator, I come directly to the quantitative evidence of what I have said in general.

During the 2 years before the 1957 recession, as shown on my chart. investment in plant and equipment grew about 9 percent, and ultimate demand represented by the buying of private consumers at that time and by the outlays of governments grew by less than 3 percent. In other words, this investment in plant and equipment which was fed by ample profits and funds of all kinds grew three times as fast as the demand for their products.

Consequently, as shown by the second sector of the lower half of my chart, we had a big economic downturn. Of course, when you have a big economic downturn, the investment drops faster than anything else because they are disgorging themselves of their own excesses. This is natural.

Now, coming to the first half of 1959 through the first half of 1960, another economic upturn period, in this period investment in plant and equipment grew by 11.6 percent, and consumption again grew by only 2.6 percent. So the investment in plant and equipment again grew more than four times as fast as consumption, and we had another economic downturn.

Now, coming to the current period which I have shown how the first half of 1961 through the second half of 1963, investment has been growing at a rate of 8.5 percent and demand for products at a rate of only 5.1 percent, so the Council of Economic Advisers itself concedes that we have 15- to 18-percent excess capacity in our basic American industries. In other words, this most recent upturn, with minor variations, is an exact repetition of what happened before each of the previous downturns, and is again being met with an urging on the part of some that the Government provide these tax subsidies in order to enable people to invest much faster.

Now, this does not mean that I am against investment. If we had a healthy balance in the economy, if we had an adequate growth rate, we would have a higher rate of investment in the long run, but we would not have these serious ups and downs caused by the unbalances.

One of the main factors in the unbalance, I respectfully submit, has been the tax policy of the United States.

Senator RIBICOFF. How would you get the balance then?

Mr. KEYSERLING. I will come to that in just a second, Senator Ribicoff.

Now let's go on to the next series of charts.

My charts 15, and 16, and 17 examine the three periods of economic upturn since 1953, including the most recent and current one, and show the relative rates of growth in prices, profits, and investment. The bars which show the investment in plant and equipment illustrate rather dramatically, but nonetheless truly, the nonsustainable excessive nature of these investment booms as they relate to the growth of excess plant capacity.

Let's move over those three because the committee can study them, and I am appreciative of their time.

Senator GORE. Mr. Chairman, I would like to identify those periods.

Mr. KEYSERLING. The first period is the 2-year period before the 1957–58 recession.

Senator GORE. Will your associate indicate which one that is?

Mr. KEYSERLING. This is the whole chart 15. The whole chart deals with that one period.

In other words, I have taken a whole chart for each of the three periods.

The next chart, which is 16, deals with the period before the 1960–61 recession.

The end bars again represent the nonsustainable investment boom.

The next chart——

Senator GORE. What do you mean by nonsustainable investment?

Mr. KEYSERLING. By nonsustainable investment boom, I mean a boom which is proceeding at a rate which expands our productive capacity much more rapidly than the expansion of the demand for products which these plants turn out. In other words, if investment is growing at a rate which expands plant and machinery by 8.5 percent a year and the demand for products is only expanded 5.1 percent a year, which is the actual figure from the first half of 1961 to the second half of 1963, then you get more excess plant capacity.

Then, it would seem to a reasonable man that this is not the time when you need to hand out billions of dollars in tax concessions to stimulate investment.

This is the nature of my argument. In other words, they are not lacking funds.

Senator RIBICOFF. As far as you are concerned, if this tax bill goes through, what is your contention or predictions as to when you would have a substantial recession next?

Mr. KEYSERLING. I said at the beginning of my statement that I never attempt to call the tune on that. The Government would be in a much better position if it did not. I am merely saying that, if this tax bill should pass in its present form, these unbalances would be exaggerated rather than corrected, just as they were exaggerated by the tax bonanzas of 1957, and just as I show in my prepared testimony that they were exaggerated by the composition of the tax cut in 1954.

Senator RIBICOFF. Is there an unbalance now?

Mr. KEYSERLING. There is an unbalance now.

Senator RIBICOFF. It is not the contention of Mr. Dillon that this tax cut will stimulate this additional consumption?

Mr. KEYSERLING. It is his contention.

I will come to that in detail in a minute, by showing how the tax cut is distributed between consumption and investment.

Senator GORE. That is something that I tried all day yesterday to get, and Senator Bennett was the only man who really supplied us with any estimates.

Mr. KEYSERLING. I am going to give you some estimates on it right now in response to your question, and in response to Senator Ribicoff's question.

Let's move on to the next chart.

Well, let's skip those.

Senator GORE. What table are you going to now?

Mr. KEYSERLING. Let me come to it and then I will tell you what it is.

If I may, before answering that question, I just want to round out for a few minutes what I am saying about the investment profit picture.

You have two problems. You have investment as it relates to funds available for investment, and you have investment as it relates to the demand for products.

Now I am taking the funds side, because a tax reduction for corporations does not relate to the demand side for their products.

When the General Motors Corp. gets a tax reduction, it gives them more funds to build more plants. It does not give them funds with which to buy cars.

Now I am saying that there is no——

Senator RIBICOFF. Will General Motors build more plants if there is no demand for more cars?

Mr. KEYSERLING. To a considerable extent they will not, and that is why I say that this tax concession is substantially wasted. But I take the alternative position, Senator Ribicoff, that if they did build more plants and installed more machinery, merely because, as before, they have so much money that they do not know what to do with it, that they want to put it to use even when the demand is not there, we will have an exaggeration of this——

Senator RIBICOFF. But do you think General Motors, if they had the funds they would just build more plants because they did not know what to do with the money?

Mr. KEYSERLING. I would rather assume that they will not, therefore I say they do not need more money.

Senator SMATHERS. How many shareholders does General Motors have?

Mr. KEYSERLING. Hundreds of thousands of shareholders.

Senator SMATHERS. Do you think it is conceivable that they might pass on in higher dividends to their shareholders some of this money?

Mr. KEYSERLING. Yes, I think they might pass some of it on, but I am not aware—I just read in the newspapers that dividends are higher than ever before—I am not aware that there is any compelling need by this indirect route which the Senator suggests to give several billion dollars of tax reduction to corporations when the Government is running a big deficit, and when, as I will indicate, the money could be put to much better use, in order to enable them to pay still higher dividends.

The CHAIRMAN. The increased dividends will not equal the repeal of the 4-percent dividend credit?

Mr. KEYSERLING. Would not equal what?

The CHAIRMAN. Assuming they did increase the dividends, it would not equal the repeal which this bill provides, of the 4-percent dividend credit?

Mr. KEYSERLING. I believe that is right, Mr. Chairman.

Let me say this: that if the administration should take the position, which I am not ascribing to it, that the corporations would pay this tax cut out in increased dividends, then the whole basic posture of the administration deteriorates completely, because they are arguing for this tax cut on the ground that the corporations need more money for investment purposes. This is certainly a true statement of their position.

Senator WILLIAMS. Secretary Dillon took both positions in his statement.

Mr. KEYSERLING. Secretary Dillon takes several positions which seem to me inconsistent, as I will shortly show.

Let me give one illustration of that.

Senator GORE. You mean every and all?

Mr. KEYSERLING. Let me give one illustration of that.

Again getting back to the wonderful hearings that the chairman of this committee held in 1957 and 1958—and I do not go back to this merely to show my knowledge of history, but why do we not ever learn from experience? Why do we not ever learn from experience?

In 1957, it was argued that there was a shortage of savings, and that therefore we needed tax cuts to stimulate savings and investment.

Recently the Treasury was before another committee, and a member of the committee challenged the Treasury as to why they were driving up the short-term interest rates.

Will this not run up the long-term interest rates?

They said no.

Of course I disagree; it will run up the long-term interest rates, but they said no.

The reason they gave was that there was such a prolixity of savings in the hands of banks and financial institutions and corporations that the long-term interest rates would not go up because there was an oversupply of savings.

So here we have the Treasury at one time advocating tax concessions to corporations because they say there are too few savings; at another time, they advocate tax concessions to corporations when they say that there is so much savings that the investor does not know what to do with them. Therefore, I have reached the——

Senator GORE. Secretary Dillon was the spokesman in both instances, was he not?

Mr. KEYSERLING. Well, in the earlier instances I suppose it was Secretary Humphrey. But I must say that the proclivity of Secretaries of the Treasury, in recent years, of both political parties, to use subsidies to hand out bonanzas to those who have no need for them, seems to be very nonpartisan.

Senator SMATHERS. Let me ask you a question on that point, Mr. Keyserling.

In other words, it is your general feeling that a tax cut given to a corporation amounts to a subsidy?

A tax cut given to an individual, is that also a subsidy?

Mr. KEYSERLING. A tax cut when the Government is running a deficit is a subsidy. But I am not against all subsidies. I am against wasteful subsidies that will accomplish no comparable economic benefit.

I am not necessarily, in fact I would not be—I will come to that later on—I would not be against a lifting of the exemptions, even though it would be a subsidy, because I think it would really stimulate the economy.

Senator SMATHERS. What I am interested in is your calling it a subsidy.

In other words, from your viewpoint it is a subsidy because it is money that rightfully belongs to the Government and the Government then gives it to some of these individuals, therefore it is a subsidy?

Mr. KEYSERLING. I said a little earlier that everybody thinks, most people think, unfortunately, that when the Government reduces taxes it is not giving anything to anybody because it is giving them back what it collected from them. But if I am rendering to you a service which is worth $100 and you pay me $100 for it, and then I give you back $25, the fact that I am giving you back something does not mean it is not a subsidy because I am giving you $100 in the cost of services and you are only paying $75 for it.

Senator SMATHERS. So then it is your theory that this tax cut is a subsidy—because, actually, every individual and every corporation owes more to the Government and is getting more important services and benefits from the Government than they are actually paying?

Mr. KEYSERLING. Yes. This has nothing to do with whether there is waste in Government or whether some expenditures are too high. The fact is that under normal circumstances the cost of Government should be paid for by the taxpayer.

Now, as I say, I do favor a tax reduction at this time, even though it involves a subsidy, provided that every dollar of this tax cut is used in the most efficient and economical way in terms of stimulating the economy and improving the equitable distribution of the tax burden. But I am irrevocably against subsidies paid in a manner which I think I demonstrate fairly conclusively would be wasteful by all experience and all logic, in that they would not be spent actually for investment, and if they were spent fully for investment immediately they would merely increase the excess plant capacities that now exist.

Senator SMATHERS. But you like to call this return of taxes by the Government a subsidy on the part of the Government to the individual and corporations.

Mr. KEYSERLING. I use the term "subsidy," Senator, to illustrate my point. I do not care too much about labels. It does not matter whether you call it a subsidy or whether you call it X or whether you call it Y.

The point I am making is that it is a misdirected wasteful extravagant yielding of funds to the wrong places in our economy at the wrong time. Now, whether one calls it a subsidy or not, some other economist might say it is not a subsidy, I do not care about the label. I call it a subsidy to dramatize what I think is a valid point.

The CHAIRMAN. But you had in mind mainly a reduction of taxes on borrowed money when you call it a subsidy?

Mr. KEYSERLING. That is right.

The CHAIRMAN. If we reduce this wasteful spending, which I have been advocating for years, then we can have a tax reduction without creating a further deficit. So the subsidy, as I understand you, is linked with the fact that this particular tax reduction will add an amount whatever it may be to the public debt, for future generations to pay.

Mr. KEYSERLING. Well, as the Senator knows, I say very respectfully and I have not always been in complete agreement as to whether the Government should incur a deficit when it is already running one. But nonetheless, what the Senator says I do agree with to the point that he seems to feel as I do that it is a subsidy when you cut taxes when you are already running a deficit.

The CHAIRMAN. I want to say this to Dr. Keyserling.

He and I have disagreed, but I have always respected not only his knowledge but also his judgment on many occasions. I regard him as one of the best informed economists.

Mr. KEYSERLING. Thank you very much.

The CHAIRMAN. That is one reason why when we received this letter, requesting that he be heard, that he was given this position which follows those who advocated the legislation.

Senator SMATHERS. May I ask a question on that point?

The CHAIRMAN. Yes.

Senator SMATHERS. I am delighted to see Mr. Keysterling here and, as I said earlier, I have great respect for him.

Did the committee send out letters requesting witnesses to appear, as the Senator indicated, or——

The CHAIRMAN. Wait 1 minute. I did not indicate that at all.

Senator SMATHERS. Excuse me.

The CHAIRMAN. I said when Dr. Keyserling wrote to the committee asking to be heard that I have such a high regard for his knowledge of this subject that he was made the first witness in opposition to the bill.

Senator SMATHERS. I am delighted. I thought I understood the chairman to say, and I could have been entirely wrong—the reporter has got it right there, that is why I wanted to get it straight—I thought that actually these people had asked to appear. But the chairman said "when he wrote him." I guess you mean in response to his request.

The CHAIRMAN. Yes. You wrote the letter first asking to appear?

Mr. KEYSERLING. Surely.

Senator SMATHERS. Right.

The CHAIRMAN. The chairman did not.

Mr. KEYSERLING. Surely.

Senator GORE. Mr. Chairman, before we get completely away from the question of availability of investment capital——

Mr. KEYSERLING. I have some more that I want to say about that.

Senator GORE. I indicated that I thought you were reading a direct quotation from Secretary Dillon and it is very much like one I have read. I now have it.

In an article in the magazine "Banking" in May of this year, Secretary Dillon said this:

> At present when our economy is not operating at full speed, it is characterized by what one might call an excess of savings.

Mr. KEYSERLING. Exactly.

Senator GORE. Now, if we have an excess of savings, is that not available investment capital?

Mr. KEYSERLING. Why, certainly.

Senator GORE. Are not our corporations in the most liquid position they have been in in many years?

Mr. KEYSERLING. They most certainly are.

Senator GORE. Where is there a shortage of investment capital?

Mr. KEYSERLING. Only on the part of some random small businesses that would not be helped much by this bill anyway, not on the part of the massive corporations that would get most of the reductions.

Senator GORE. If struggling small business is in need of capital, this could be better supplied by a proper loan program and credit policy than by a tax policy which may not reach them at all.

Mr. KEYSERLING. You are absolutely right, and this brings up the collateral point that the Government at one and the same time is handing out these—I will say "subsidies" again—to provide capital where it is not needed.

Senator GORE. Let's just call them tax cuts.

Mr. KEYSERLING. Tax cuts, while at the same time it is tightening up on the money policy and driving up interest rates which it admits will have a repressive effect on the economy, so that with the one hand it is attempting a wasteful kind of stimulation: on the other hand, it is attempting what I would regard as a wrongful kind of repression.

Incidentally, with respect to the small businessman who is the only one who has to borrow money—General Motors does not have to borrow money, and I am not saying this critically of General Motors—the credit policy is adding insult to injury with respect to the struggling small fellow, while this policy is piling bonanza on bonanza with respect to the big fellow. I do not think the Senator could be more right.

Now, let's come over to this picture.

Senator RIBICOFF. Mr. Chairman, I was just wondering, and I commend you for having Mr. Keyserling, since we have both a practical and theoretical economist here, to put this in perspective, I wonder if it would be proper to have Mr. Keyserling in simple, slow language give us the difference, from the philosophical economic point of view, and the difference between the point of view of our chairman on why a tax cut is needed, Secretary Dillon's point of view why a tax cut is needed, and your point of view which differs both from the chairman's and Secretary Dillon's.

I think what we have to get out here—there has been no perspective on these different points of view. I think it would be most helpful because we have a man here who I think could summarize and explain the differences in philosophy.

If it is not proper, Mr. Chairman, I would certainly withdraw that question.

Mr. KEYSERLING. I am not here to discuss the differences between my views and those of the chairman, whom I very much respect.

Senator RIBICOFF. We all respect him.

Mr. KEYSERLING. Because that is really not an issue with respect to my testimony. But nonetheless, I will attempt briefly to do what you suggest.

The position of Mr. Dillon is—and we are now talking about the proposal of the administration—that a large tax cut is needed to stimulate the economy, when the economy has very slack resources, and when, even though tax rates now are not balancing the budget, they are at levels which would balance the budget and provide a surplus before we get back to full employment, and that a tax cut which would pour more into the economy than is taken out would serve the useful purpose of stimulating the economy.

This is the general central position of Mr. Dillon and of the administration, and to that extent I agree fully.

Now, the second problem has to do with the nature of the tax cut that they are proposing. The nature of the tax cut which they are proposing would provide certain tax cuts for investment purposes and certain tax cuts for consumption purposes.

The CHAIRMAN. I would like, in response to the Senator from Connecticut, make clear the chairman's position.

Taxes, high taxes, are due to high spending. That is the only reason for high taxes. I think this Government is infiltrated from top to bottom with unnecessary expenditures. I believe that many billions of dollars can be saved and, if it is saved, then it would be possible to have a tax reduction—without a deficit—that would go to the people who have been paying the high taxes, because to my way of thinking—and I am just saying it as a plain, blunt man—taxes are linked with expenditures.

As you know, Dr. Keyserling, never before has any President of the United States advocated a planned deficit in order to reduce taxes.

Mr. Truman, as I recall it, went so far as to say he would increase taxes instead of lowering taxes.

You recall that?

Mr. KEYSERLING. Yes, sir.

The CHAIRMAN. And Mr. Truman, incidentally, is opposed to this plan of passing the burden on to future generations and adding to the debt.

Mr. Eisenhower is opposed to it and, so far as my inquiry goes, there is not a single President in the history of the United States who has ever deliberately urged a tax reduction on the basis of planned deficits.

I think it is even more dangerous to do it at this time because, as you know, Doctor, we have had deficits for 3 previous years.

Now, even the administration admits that, if this bill is passed, there will certainly be deficits for 6 consecutive years.

To my way of thinking, a deficit is bad enough, but when it becomes a habit, when it becomes a custom, it is even worse and may lead to serious consequences.

Senator Ribicoff wanted to compare the chairman's position with that of the administration and Mr. Dillon. I am anxious to see a tax reduction, but expenditures should be reduced first.

I point out repeatedly where these reductions could be made; each year I prepare what I call a Byrd Budget. Among other things we must not overlook the fact that there was $87 billion of unexpended balances carried over as of July 1, and that is available to the President for expenditures at his pleasure.

That is plainly my position.

I think there is no more inappropriate time, no more dangerous time to have 6 or 7 or 8 years of continuous deficits that I know of in the history of our country. I do not know when you think that the budget is going to be balanced.

Arthur Byrnes said it might be as late as 1972. The administration does not claim it is going to be balanced for 2 or 3 more years. So we are getting on a permanent deficit basis.

Mr. KEYSERLING. Mr. Chairman and Senator Ribicoff, the chairman of the committee has expressed his views much more competently than I could. But let me say this: Whether or not my views coincide with those of the chairman has nothing to do with the point I am making here, because the point I am making here is that the tax reductions embodied in this bill, looking at their size and who they are going to, would be indefensible whether the Government was in deficit or whether the Government was in surplus or no matter where the Government was, because, even if the Government was in surplus, we would still want to make tax reductions that were equitable, which I believe these are not, and we would want to make tax reduction in a way that would be helpful to the economy, which I believe these are not.

So that, really, whether I could dot and cross every "i" and "t" of what the chairman has said, to go off on that tangent in my testimony would merely distract us from what I am talking about.

What I am trying to show and prove, if I can, is that this $11 billion of tax reduction at this time, in its nature, in its composition, is such that a large part of it would be wasted and will do no good, and that part of it is distributed in a way that is socially inequitable and unjust.

Senator GORE. What do you mean by wasted?

Mr. KEYSERLING. I mean that it will not be spent, it will be saved.

Senator GORE. You mean, then, insofar as being stimulative of the economy—is that what you mean by waste?

Mr. KEYSERLING. That is right. When our large corporations sit around a table to determine their rate of investment, the first thing that they consider is whether investment in plant and equipment will improve their technology and productivity, and thus give them a competitive advantage over those who cannot afford to make that investment. That is the first thing they consider.

The second thing they consider is whether the current and prospective demand for their products justifies the increase in their productive capacity.

The argument I am making is that, if our corporations now answer these two questions in the affirmative, there is no problem of a barrier to investment in the form of a lack of funds. Their after-tax profits are very high. Their retained earnings are very high. There is such a prolixity of savings that even the Secretary of the Treasury admits it.

Therefore, if they answer these two questions in the affirmative, they will make the investment, and therefore it is an arrant waste of funds to provide them with billions of dollars of concessions to enable them to make the ratio of their available funds to any likely investment even higher than it is now.

Senator GORE. When it is already adequate.

Mr. KEYSERLING. When it is more than adequate, and this has nothing to do with any differences that there might be between me and the chairman.

This is an immutable principle that is true all the time. They just do not need this kind of addition to their funds now, and much of it will be saved. It will not be invested.

But to a certain degree it will be invested, because American business is capital hungry. It is in the hands of a managerial class who are mostly not owners, and they like to have more shiny machinery. So they will use a small part of it for investment. So we will have a still bigger unbalance in the economy, and still more people put out of work.

Now, if you turn it around the other way, it is true even under current tax rates that a high enough level of demand to keep these plants reasonably fully employed always generates enough after-tax profits to enable them to make enough investment and enable them to pay out high enough dividends, then they do not need a tax reduction now. That is why I say it is wasteful. It will either be wasteful or damaging.

It will be wasteful if they save it. It will be damaging if they use it.

Now, to amplify the proof of this, let's look at just a few of these other figures on where they now stand.

First let's look at the profit picture. I have shown on chart No. 24 the profit picture for key corporations from 1953 through the second quarter 1963.

If you look at the vertical bar which represents the second quarter of 1963, you see in most of these key areas about the highest profits on record.

Now, I am not against these profits. And these are after-tax profits, not before-tax profits. Why do they need to have a 35-percent increase in these after-tax profits, as the Secretary of the Treasury admitted, in order to stimulate investment?

Now, let's come to the next chart, No. 25. These are profitable sales ratios right through the second quarter of 1963, for the most part breaking all records. This is also after taxes. The trouble is not with the profit-sales ratios; the trouble is with the volume of sales. In other words, if plants are operating with 15 percent idle capacity, which is the typical experience now, the right way to increase their profits is to create a condition in the American economy where they will be operating at 90 percent or 92 percent of capacity, not to give them a tax bonanza so that the ratio of their per unit after-tax profits will be even higher than now, although they are breaking all records now.

That is what this bill would do.

I am not so surprised that such a momentum of support has been obtained for this proposition. A lot of people like Santa Claus. Why would not the businessmen whom Mr. Dillon talked to, who usually have been more against deficits than I am, why would they not, when he proved to them the facts and figures on what this was going to do to fill their coffers, even if they do not do more business, why would they not be for it?

I am unhappy that they are, but I do not think counting noses that way gives us a very good guide to fiscal policy.

Now let's go on to the next one.

Senator RIBICOFF. In the sense of what you are saying, if they have this excess capacity, while they may have a year or two or more profits, there will be another dip.

Does the business economist realize this, too?

Mr. KEYSERLING. I do not want to speak for them, but I think so. I think the business economist is aware that we have a lot of unbalance in the economy.

Let me say that I called to the attention of this committee—no, I called to the attention of the Joint Economic Committee—in January, when I was testifying on the tax proposition as of that time, that there was an article in Business Week as of that time which I inserted in the record, which showed these high retained earnings, which showed these high profits, which showed this excess plant capacity, and which categorically said, Business Week said, the investment today is based upon the expectancies of tomorrow. In other words, it said specifically that what business needed was an ability to sell more of its products, not tax concessions, which would enable still more profits without more sales.

The CHAIRMAN. Is it not true the Du Pont Co. just a day or so ago announced the highest profits in history?

Mr. KEYSERLING. Senator, this is not only true of the giants like Du Pont.

The CHAIRMAN. Its stock went up 5 points in 1 day.

Mr. KEYSERLING. It is generally true, as I tried to show by these previous charts. It is not only true of Du Pont and General Motors. It is true generally across the board.

Since you mentioned the stock market, let me say something about that.

We look at the stock market as an indicator of business activity. Maybe yes and maybe no. When you have these large tax concessions to people who have not got room for much more investment, especially to high-income individuals whom the Secretary of the Treasury says needs this in order to invest more, where are they going to invest more?

They are going to invest more in the stock market. And when they invest more in the stock market, it drives up the stock prices, and when it drives up the stock prices you do not have any increase in the national wealth. This is not real investment. This is merely a recalculation of how much money is going into the stock market in ratio to the number of stocks. And this stock market boom that we have been having now is an indication that there is an excess of savings already flowing into the stock market. It is not flowing into investment.

Some people think buying stock is investing. If I own General Motors stock at 62 and somebody else buys it from me at 65, it does not mean anything except that unused savings are driving up stock prices.

Senator GORE. It does not mean any more money to General Motors?

Mr. KEYSERLING. It does not mean any more money to General Motors and, if it did, they have got plenty already. I have nothing against their having it, but this thing just is not needed.

Now, this chart numbered 26 is a picture from 1947 to 1962 of funds available to corporations. Their available funds have increased. The portion of these funds used for plant and equipment has grown, and, most important, down at the bottom, the portion of corporate funds drawn from internal sources has risen, partly in consequence of the tax changes of the last 10 years, both by the Congress and by Executive action, so that from 1953 to 1962 they were financing 69 percent of their total corporation funds from internal sources as against 65.7 percent in 1947–53.

I maintain that this is getting far away from the typical American system. I think I am talking pretty conservative economics when I say that 70 percent of such funds should not come from internal sources. Investment is for the purpose of selling goods in the future, and earning a profit by selling these goods to the public. In other words, you should be paid for your investment after you make it; that is what I have to do if I make an investment. I make it and then I get paid for it by using what the investment creates.

The CHAIRMAN. What do you think about the dangers of inflation?

Mr. KEYSERLING. I think that there is not a danger of generalized inflation in view of the economic slack. I think there is danger of the kind of selective inflation to which I called so much attention in earlier years; namely, a selective inflation of these sectors of the economy resulting from them having far too much relative to their needs as against other sectors of the economy.

The CHAIRMAN. What bearing does deficits have on the question?

Mr. KEYSERLING. Would what have?

The CHAIRMAN. What bearing, what influence does deficit spending by the Government's adding to the public debt have on inflation?

Mr. KEYSERLING. I think deficits add to general inflation only when the economy is operating near full employment, Senator. I know our views on that are not exactly the same. In other words, I do not think that a deficit in itself adds to inflation when the economy is operating far below full employment.

But, as I say again, that does not go to the problems in connection with this tax bill.

The CHAIRMAN. The only reason I asked that is that the hearings that you referred to that our committee have had in 1955 and 1956, I believe, Bernard Baruch, whom I regard as one of the greatest economists and one of the greatest men this country ever produced, testified that Government deficits had a great influence on inflation.

I do not know whether you agree with that or not.

Mr. KEYSERLING. As I say, I think a Government deficit is inflationary when you are operating near full employment, but not otherwise. But, again, my differences with Mr. Baruch or you on this have nothing to do with what I am saying about this tax bill.

Now, what I am doing here—and this is partly responsive to an earlier question asked by Senator Ribicoff—having analyzed this problem of investment, and the problem of consumption which I am going to analyze in a little bit, I have computed how this tax bill divides between funds made available for investment and funds made available for buying the products.

Senator GORE. What table is that, Mr. Keyserling?

Mr. KEYSERLING. Chart 27.

Now, in making this analysis, I have added in the $2 billion tax concession in 1962. I think it is appropriate, because it is really a part of the same program of the same administration.

I think it is also appropriate because Mr. Dillon himself, in his recent talk, coupled the two in saying that the two together would provide a 35-percent increase in after-tax income.

If the committee does not think it is appropriate, they can take the $11 billion figure in this bill rather than the $13 billion figure.

I think it is appropriate to look at the two together.

Now, looking at the two together, as shown by my left bar there—this is a very important chart—the value of the 1962 tax concession to investors is $2 billion. The approximate value of the corporate tax cut in this bill is $2.2 billion. The approximate value of the personal tax cut is $8.9 billion.

You get a total of about $13 billion, or about $11 billion, if you left out the $2 billion.

Second, I have apportioned this between stimulus to investment and stimulus to consumption. The $2 billion tax concession to corporations in 1962 was clearly an investment stimulus, and this is clearly true of the $2.2 billion tax cut to corporations under this bill.

Then I have had to apportion the personal tax cuts and make an estimate of what part of it would be used for investment and what part of it would be used for consumption.

I think my estimate is reasonable for the reasons that I have given. In other words, I apportioned the tax cut in the lower income ranges mostly to consumption, because obviously, if a $3,000 family gets a little tax cut, they are not going to invest; they are going to spend it.

If the very high income family gets a big tax cut, they are going to try to invest it, and in any event I do not have to prove this because this is the rationale given by the administration, that the tax cuts in the higher income brackets are needed for investment.

Anyway, the way it comes out is that this bill, together with the $2 billion in 1962, would allocate $7 billion to the investment function and $6.1 billion to the consumption function.

I say that the $7 billion for the investment function is wasteful—nobody can be exact about this thing——

Senator GORE. You are not saying this will actually be invested. This is $7 billion of available——

Mr. KEYSERLING. Exactly, and I am coming to the next point.

I am saying that this is the allocation by virtue of the national tax policy. If I thought the whole $7 billion was going to be invested, it would create employment, it would create production—then I would not say it was wasteful. I might question it on other grounds. But what I am saying is that, in view of the history of the past 10 years which I have outlined in such great detail, in view of what I have said before this committee previously on every similar point, which I must say without pride turned out to be right, and in view of the analysis of where these investors now stand with respect to funds and capital and retained earnings, for them to get $7 billion in tax cuts will not result, and cannot result, in $7 billion more of investment than there would be if they did not get the tax cuts.

Now, no economist can figure out with the precision of an adding machine how much of the $7 billion will be used and how much will be wasted.

I make my own computation that a very large part of it will be wasted, and that, in any event, if the Government were going to use this $7 billion in some other way, either by the collection of taxes or by giving a better tax break to some other lower income people, or by spending money for some things that people really need, that any of these, including Senator Byrd's alternative, any of them would be better than handing out this $7 billion in this particular way, because if there were no actual bill before this committee and if there were no public issue, and somebody asked me as an academic matter to figure out a wasteful way of using $7 billion, gentlemen, this would be it. This would be a wasteful way of using $7 billion.

Now, we come over to the personal tax cut side. I have already shown the reasons for my economic objections to the distribution of the tax cut between $7 billion for investment and $6 billion for consumption.

In the desire to be quick, I passed over earlier in my detailed demonstration that, while we do not have a deficit in investment, we do have a big deficit in consumption.

Why should I need to prove that?

If so many economists had not become so foolish, nobody would have to prove it, because if your plants are operating with 15 percent idle capacity, and if your true level of unemployment is 9 percent, there must be a shortage of buying on the part of the American people for what the plants can produce.

Be that as it may, this brings me to the second phase of my argument against the detailed composition of this bill; namely, that after you pass over the investment side of it, and talk about the personal tax cuts of $8.9 billion, how are they distributed?

The way I figure it, for reasons already shown, about $4 billion of those personal tax cuts would go to families with incomes over $10,000. That does not sound very high, but they are only 12.5 percent of all taxpayers. Only 55 percent would go to taxpayers with incomes under $10,000, who are about 87.5 percent of all taxpayers. A substantial part of the tax cuts going to the top 12.5 percent would, for the reasons I have given, be saved for the purposes of investment, and therefore would be substantially wasted.

But let's look at the distribution in terms of a second consideration which I respectfully submit no great and just nation can afford to neglect: the equities of the situation.

Now, the Secretary of the Treasury and his technical people have been putting out a lot of mathematical tables to show that, under this bill, the low-income people would get the biggest tax break and the high-income people would get less. This is a mathematical trick. The reason that it is a mathematical trick is what they are computing is the ratio of the two different tax rates rather than computing the effect upon incomes.

Now, after all, all that any tax bill really does in the final economic analysis is to increase the disposable income of the people getting the tax cut, or reduce the disposable income of the people if taxes are raised. This is all there is to it economically.

The other thing is merely a formula.

Senator GORE. You mean disposable income; is that not what you have left after you pay taxes?

Mr. KEYSERLING. That is right.

Senator GORE. After-tax income?

Mr. KEYSERLING. After-tax income.

In other words, this tax cut will increase the disposable income of the people.

Senator GORE. Some people have raised objections to examining this bill from the standpoint of its effect on after-tax income. But I notice in Secretary Dillon's speech at White Sulphur Springs he used this term with respect to corporations.

Mr. KEYSERLING. Please do not ask me to rationalize the various statements of the very pleasant and estimable Secretary of the Treasury. I just could not do it.

Now, the fact is——

Senator GORE. My only point, Mr. Keyserling, is that I see nothing wrong with examining this bill from the standpoint of its effect upon people's real income after they pay their taxes, whether it is a corporation or a person.

Mr. KEYSERLING. That is what I am now proposing to do, Senator, for this very commonsense reason: that, whether one be a conservative or a liberal, whether one believes that you should balance the budget or not, the only effect of a tax change in real terms is what it does to people's incomes. The administration admits this, because the argument the administration gives for this bill is that it will increase the disposable incomes of people and therefore they will spend more and therefore we will have more prosperity.

If I am in a certain income bracket, I do not care anything about what mathematical result you get by comparing the tax rate that I pay now with the tax rate I will pay later, except insofar as it changes what I have left after I pay the taxes.

Now, when you look at it that way, which is the only proper way, what do we see under this bill? This is shown on my chart 28.

The $3,000 family would have a 2-percent increase in its disposable income under this bill. The $200,000 family would have a 16-percent increase in its disposable income.

To state it simply, the more income you have now before taxes, the bigger increase in disposable income you will get under the bill.

Now, let me address myself here to one of the arguments made by the Secretary and by my friends in the Government. They say that, because the higher income people are paying higher tax rates, any large-scale tax reduction would necessarily, by the mathematics of the situation, increase their disposable income by a bigger percentage than the lower income people.

In the first place, this is not true. I am going to show you that you can have a different composition of the tax cuts that will not do this. But, if it were true, it would simply be an argument against tax reduction at this time, because there is nothing sacrosanct about tax reduction.

You do not just want tax reduction per se. You want tax reduction to do something. If the consequence of tax reduction is that it must at this time increase the disposable income of the $200,000 family by 16 percent so that they can go to Europe again and increase our balance-of-payments problem, and only increase the disposable income of the $3,000 family by 2 percent, it is fundamentally wrong at this time. It is a waste of the tax reduction and we ought to find a better way to use the money.

So it is no answer to say that the mechanics of the situation make this unavoidable. It is avoidable.

This is regressive, at least in the sense that it would make the Federal income tax structure less progressive than it is now.

Senator BENNETT. Mr. Keyserling, is not the opposite of regressive, progressive; and are you suggesting that the tax pattern be made more progressive if you object that this one is too regressive?

Mr. KEYSERLING. I am suggesting that, if there is room for tax reduction now, in view of all the competing objectives, whatever limited amount is available for tax reduction should be used where it will be most efficient in terms of two considerations:

First, where will it be most efficient in terms of stimulating the economy? That is what it is for.

Second, where will it be most efficient in terms of reducing the hardships imposed upon a large part of our people from the inherited tax rates carrying over from World War II.

Now, if we take the first of those tests, I am simply saying that this distribution of the tax cut will not be efficient from the viewpoint of stimulating the economy. I have spent the last half hour explaining why I feel that way, because much of it will be saved rather than invested.

Senator BENNETT. What you are saying is that you are in favor of a program which would increase the progressivity from the top end to the bottom end because you want to center your reduction at the bottom end?

Mr. KEYSERLING. First of all, I do not want to center it at the bottom end.

I would have some of the tax reduction spreading over the whole structure.

Secondly, on this whole question of how progressive the tax structure is, I have a word to say about that because the Senator's question is very relevant.

We have the impression that the tax structure has become too progressive, because of the high rates at the top. But let us remember always that one of the main arguments made by the administration for its original tax proposal was that the tax rates at the top were so high that the Congress had had to enact a lot of loopholes in order to ameliorate this, and one of the main reasons given by the administration for reducing the rates was that by closing some of the loopholes you would in a fairer and more equitable way improve the tax structure.

Now what happens? With many of the reforms abandoned, and the rates not being changed comparably, you have a much less progressive proposition than the administration offered originally.

I am not necessarily arguing now that it should be made more progressive. I am arguing that it should not be made more regressive, and I am arguing it this way: I am arguing that the justification for a tax cut now is that the stimulus to the economy and the doing of justice outweighs the arguments for not having a tax cut now. To get this stimulus, and to do this justice, the current bill needs to be altered substantially.

Senator GORE. May I interject? I have before me a table presented by the Treasury Department. I have looked for an opportunity, Mr. Chairman, to call attention to it, at least to one part of it, and I think this might be an appropriate time.

It shows, Mr. Keyserling, that under present law a typical family, consisting of a man, wife, and two children, with typical dividends, capital gains, et cetera, with an adjusted gross income of $1 million now pays $261,929 in taxes, and, according to this table prepared by the Treasury, this typical million-dollar-income family of four has after-tax income of $1,239,659.

I bring this up because we hear so much about how people of very high income are so severely taxed. And here is the table of the Treasury.

Let me read another example. This typical family—I wouldn't say this is a typical family. Let me read what the table says:

Married couple with two dependents with typical dividends, capital gains and other income, and typical itemized deductions.

A family with a $500,000 income—adjusted gross income, that is—pays taxes of $154,249, and has an after-tax income under present law of $567,116.

Now, how would these two families be affected by the pending bill? This is not my calculation. Let me repeat and emphasize, this is the table presented by the Treasury.

Let me come back to the $1 million family, the family with an adjusted gross income of $1 million. Under the proposed bill, according to this table, this family would pay $238,037, and have an after-tax income of $1,263,551.

I wanted to bring this out, Mr. Keyserling, to show that even under present law the portion of total income, and of adjusted gross income, that is paid in taxes is much less than is generally believed.

Mr. KEYSERLING. I think all of this is true, Mr. Chairman, and it is an additional point. My demonstration stands without that, but I appreciate the Senator bringing in this additional point.

What I am saying is that there is no economist in the Government, no financial analyst, who will question the factual accuracy of this particular demonstration. So it converges on a matter of policy; and the matter of policy is very simple. Is this the time for a personal tax cut which will increase the disposable income of the $200,000 family by 16 percent and increase the disposable income of the $3,000 family by 2 percent?

I say no, for two basic reasons. First, it is not an efficient way to stimulate the economy, because a lot of the tax cuts up at the top will be saved, or will be spent going on trips to Europe, which will increase our unfavorable balance-of-payments problem, and second, that it is not equitable.

This bill would give me a substantial tax reduction. I don't think that this is a high priority for the Government now. I don't think, I know—it would not increase my standard of living to any appreciable degree. I would buy a few more stocks. And what good would that do anybody? Or, if I spent it, I would take another trip to Europe, and we would have to raise interest rates still higher to take care of the gold problem, and that would cancel out the effect of the tax cut. The whole thing hasn't been thought through.

Now let's come to the next chart.

Senator BENNETT. Before you leave that chart, is there any climate or atmosphere in which you think tax relief should be given to the top brackets?

Mr. KEYSERLING. Yes; when the Government is running a substantial surplus.

Senator BENNETT. Then you would give it to the top brackets and deny it to the lower brackets?

Mr. KEYSERLING. No, I haven't said that. You have got a problem of equitable tax reduction at any time. But I am saying that, when the Government is running a big deficit, and when the quid pro quo that you are paying for the tax cut is a relinquishment of a lot of other purposes that would seem to me highly desirable, that this is not the particular time to use this amount of money in this way.

I am not against tax cuts generally for anybody. Everybody is for tax cuts.

Senator BENNETT. Let me ask you a related question. Is there any atmosphere or climate in which you think the range between the top rate and the lower rate should be reduced, the extent of range should be reduced and the top moved closer to the bottom?

Mr. KEYSERLING. The real question you are asking me, Senator, is whether our tax system has become too progressive.

Senator BENNETT. That is right.

Mr. KEYSERLING. The materials that I have asked to have included in my prepared testimony, which are based upon a comprehensive study that I made of this matter, is that, putting aside the question of whether tax rates in general are too high, and limiting one's self to the question of whether the changes in our tax system have made it too progressive, my study leads me to the following conclusions:

My first conclusion is that the changes in the tax structure from 1939 to 1945, which made it much more progressive and which also made it much higher because of the tremendous level of expenditures, was good for the American economy. I am talking now not about the higher rates but about the increasing progressivity.

It was good for the American economy from the viewpoint of economic balance, from the viewpoint of the relationship between investment and consumption, and from the viewpoint of equity. I develop that at considerable length in my study.

My second conclusion is that, broadly speaking, the changes in the tax structure which have taken place from 1945 to 1963, again putting aside the lower levels due to the fact that we are not now in World War II, these changes have made the tax structure less progressive, and I think this has not been good for the economy.

I think this is tied in very closely with our poor rate of economic performance. I think it has been one of the factors in the recurrent investment booms, and so forth and so on.

Therefore, my answer to your question really is that, quite apart from the question of the tax rates being high because of expenditures being high, which is a separate question, our tax system has not become too progressive, and that we would be ill advised to make it less progressive.

Further, so far as this particular proposition is concerned, some parts of it are so untimely and so out of line with considerations of economic need and equitable justification that this proposition is deficient even if the Senator in his good judgment, which may be as good or better than mine, did not agree with my general statement as to the progressive or regressive nature of the tax changes during the past 24 years.

May I say that, in my prepared testimony, and I am not going to take the time to repeat it now, compared the effect upon after-tax income of the proposal as it now stands with the proposal as originally made by the administration, including a number of reforms. The proposal originally made by the administration, in broad outline, was subject to some of the criticisms that I am making now. However, the reforms had a partly compensating effect upon the distribution of the personal tax cuts. With many of the reforms out, even with the other changes that the House Ways and Means Committee made in the rates, the current bill is more defective than the original proposal. Now coming over to the next chart——

Senator GORE. Before you leave that, Mr. Keyserling, I think in all candor I should say that in my view a case can be made for some change in rates if these privileged devices were stricken out.

But all of the reforms, as you say, have been jettisoned, and according to this table which the Treasury itself presents—they select a typical family, I did not select it, they did, the Treasury did—this $1 million adjusted gross income family, after this bill becomes law, will only be paying taxes at the rate of 23 percent of its adjusted gross income.

Now I say in all candor, Mr. Chairman, that it is unconscionable to start reducing rates in the higher brackets without accompanying such a reduction with a vigorous closing off of the special tax treatment and favors now in the law.

Mr. KEYSERLING. Senator Gore, let me say this to clarify any misimpressions that may have arisen from what I said before.

I certainly agree wholeheartedly with the proposition that if a very high income person—and I will just take nominal examples—is now paying an effective tax of 60 percent despite the fact that in looking at the rates he ought to be paying 75, but is paying 60 rather than 75 because of a lot of loopholes, I certainly agree that it would be better fiscal policy and better everything else to take out the loopholes so that he is still paying the same 60 percent effective, but paying what he really ought to be paying in accord with business and equitable principles, instead of having loopholes accounting for the difference between what he ought to be paying and what he actually is paying.

I think this is an incontestable principle, and I agree with the Senator completely on that. Therefore, this is one of the reasons why I say I am not opposed to some reductions in the higher rates, if there is compensating closing of the loopholes.

But I am practical enough to think, not only on the basis of time, but for other reasons, also, that it would be rather unlikely that the loophole-closing originally proposed by the administration could become an effective part of any legislation enacted within a reasonable time. And since I am making this assumption, I am merely saying that whatever reasons may have existed—and on this I agree completely with you—for cutting these top rates with the loopholes closed does not exist with the loopholes not closed.

I should think anybody could see that. And I should think the administration could see that very clearly. Now the only real argument the administration has on this is that we are in a hurry, and there is not time really to go into this matter.

Senator GORE. Mr. Chairman, in view of the fact that this table has been discussed, I feel I should request that this table, furnished by the U.S. Treasury Department, be printed in the record at this point, and clearly identified as not being a table of Dr. Keyserling, but of the Treasury Department.

The CHAIRMAN. Without objection.

(The table referred to follows:)

TAX SAVINGS AND INCREASE IN AFTER-TAX INCOME UNDER HOUSE BILL

Married couple with 2 dependents, with typical dividends, capital gains and other income[1] and typical itemized deductions

Adjusted gross income [1]	Present law		House bill		Tax cut or increase in after-tax income		
	Tax	After-tax income [2]	Tax	After-tax income [2]	Amount	Percentage tax cut	Percentage increase in after-tax income
$3,000	0	$3.131	0	$3,131	-----	-----	-----
$4,000	$143	3,987	$103	4,027	$40	28	1
$5,000	299	4,827	219	4,907	80	27	2
$6,000	455	5,671	339	5,787	116	26	2
$7,500	719	6,917	569	7,067	150	21	2
$10,000	1,193	8,993	972	9,214	221	19	2
$12,500	1,657	11,079	1,373	11,363	284	17	3
$15,000	2,196	13,189	1,830	13,555	366	17	3
$17,500	2,745	15,288	2,296	15,737	449	16	3
$20,000	3,369	17,344	2,820	17,893	549	16	3
$25,000	4,755	21.271	3,983	22.043	772	16	4
$30,000	6,822	25,139	5,297	26,164	1,025	16	4
$40,000	10,026	32,305	8,392	33,939	1,634	16	5
$50,000	14,254	38.947	12,217	40,984	2,037	14	5
$75,000	23,799	57,421	20,672	60,548	3,127	13	5
$100,000	33,965	79,247	29,670	83,542	4,295	13	5
$200,000	63,318	184,262	56,675	190,905	6,643	11	4
$500,000	154,249	567,116	138,216	583.149	16,033	10	3
$1,000,000	261,929	1,239,659	238,037	1,263,551	23,892	9	2

[1] Includes such income as wages and salaries, interest, rents, business and partnership income, royalties and typical dividends and capital gains. Estimates of typical dividends and realized capital gains and itemized deductions are based on 1960 tax return data.

[2] After-tax income exceeds AGI for very high income taxpayers because 50 percent of the long-term capital gains, which constitute a high proportion of income for such taxpayers, is included in AGI under present law and 40 percent is included under the House bill.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 11, 1963.

Mr. KEYSERLING. Now on this matter of the progressive nature of the tax structure, the question which was raised by Senator Bennett and which is a very good question, I think I answered that, but I want to add one thing to my answer: that in considering whether or not the Federal income tax structure as of now is too progressive, we certainly must take account of other types of taxes, such as indirect Federal taxes, and State and local taxes.

The fact is that the State and local taxes, whatever the reasons may be, have none of the progressive features of the Federal income tax, and indeed are absolutely very regressive.

Unfortunately economists have not made much study of this recently, but I have here a study that was made in 1954, which is even more relevant today. Actually our tax structure has not changed much since 1954.

My chart No. 29 shows that, if you look only at the Federal income tax, the family of $2,000 income paid only 2.7 percent of its income in Federal income taxes in 1954, while the family of $10,000 income and over paid 14 percent. That looks very progressive.

But when you look at the State and local taxes, the $2,000 family paid 9.8 percent of its income in taxes, the $3,000 to $4,000 family paid 8.9 percent, the $5,000 to $7,500 family, 8.4 percent, and the $10,000-and-over family only 7.4 percent, so that these State and local taxes are extremely regressive.

And this situation is very much more severe now than in 1954 because, as we all know, State and local expenditures have risen very much faster, and even the tax-supported part of them has risen very much faster than the Federal tax outlays supported by taxes. So that in consequence of the State and local taxes and the indirect taxes as shown on my chart, it is certainly true that our nationwide tax system as it applies to the American people is very, very much less progressive than it appears to be if you look at the Federal income tax alone.

This is certainly a factor to be taken into consideration, in determining whether or not this is a particular juncture at which to enact the particular kind of changes in the tax structure which are in this bill.

I don't want to linger on my chart 30. This is merely a picture of income distribution in the United States as it bears upon the desirability at this moment of increasing the after-tax income of the $200,000 family by 16 percent, and the after-tax income of the $2,000 family by only 2 percent.

This shows that more than a fifth of the multiple-person families in the United States have incomes of less than $4,000 a year, and so forth and so on. That can be studied more in detail. I don't need to concentrate upon it now.

Now, finally, I want to talk a bit about the ineffectiveness of this kind of a tax reduction from the viewpoint of stimulating the economy.

I think the chairman, as reported in the papers, asked the question of how $2 more of spending money distributed among a large number of people, I guess per week, was going to do very much to help the economy. The answer of the administration is that when you add it all up it comes to a lot.

But there is another very important matter which shows that these tax cuts will have very much less stimulative effect upon the economy than the administration calculates, for this reason.

What are the people who get the tax cuts going to spend the money for? They are largely going to spend the money for buying a little more of what they have already been buying.

They may buy another automobile a little sooner. They may buy another refrigerator a little sooner, and so forth and so on. Most of this increased buying will concentrate upon those parts of the economy, what I call the conventional mass production industries, where the rate of technology and automation is advancing very much faster than any conceivable increase in the demand for products.

This is indicated by my chart 31, which shows, for manufacturing as a whole from 1947 to 1962, that the index of production workers in manufacturing as a proportion of our gross national product declined from an index of about 102 to an index of about 60. This is the whole meaning of the technology and automation that the administration is talking about.

The administration itself, when it talks about 22½ million jobs needed over the next 10 years, ascribes about 10 million of that need to the displacement of workers from the mass production industries and the need for them to find a job somewhere else.

So this tax reduction, aside from the part of it that is wasted through the saving process, will as it bears upon the spending process have some effect, but a much lesser effect than some other kinds of programs would have. If we really want to wrestle with the unemployment problem, and if we are going to use the same amount of money—and here again I am not getting into a difference of opinion with the chairman as to whether we should use the money, but assuming that we were going to use $5 billion, $6 billion, $11 billion, $20 billion—that amount of money directly spent by the Government where the unemployment is high, and directly spent for the things the Nation needs, would have an infinitely greater multiplier effect upon stimulating employment than this randomly disbursed and variegated distribution of spending power among millions of families by tax reduction.

Now to illustrate how acute a problem this is, if we move over to this next chart 32, I have projected ahead, assuming high and low growth rates, and taking account of technology and productivity, I have projected ahead the likely increases in employment opportunities in the United States.

Now, I can illustrate very simply what I am getting at. If you look at the first box, total civilian employment would need to go up about 12.7 percent, total civilian employment by 1965 over the 1960 level. But even if you assume the overall growth rate needed to bring us to that level of employment, then I look at manufacturing, and I take the trends in technology and the trends in automation, and the likely disposition of consumer outlays among various types of expenditures and the fact as I show it on the previous chart that since 1947 employment in manufacturing has moved from an index of 102 to an index of 60 as a percentage of GNP, and what this all means is that, even if you had a high rate of economic growth, your employment in manufacturing would at best go up a great deal slower than the rate of the needed increase in employment.

This is also true of mining; this is also true of transportation and public utilities.

So it inescapably follows that, if we are going to ever get back to full employment, we have to encourage the diversion of a larger proportion of our productive resources to the things which the American people need enough more of so that, when compared with the technological trends, you could get really big employment increases.

Tax reduction, particularly tax reduction of the kind proposed, is a very inefficient approach to this problem for obvious reasons. The tax reduction will be spent, insofar as it is spent, for a little more here and a little more there of those kinds of products which are in the industries where the rate of technology and the rate of automation is advancing so rapidly that you may stop a continuation of the decline of employment at the rate that it has been declining, but not help it much.

In order to get the desired employment, we would have to divert more of our resources to education, to health, to housing, to urban renewal, to mass transportation. I am not here talking only of public spending. I am talking of private spending too, encouraged by national policies, and, if you will, by tax policies.

Senator GORE. You are speaking of loans, too.

Mr. KEYSERLING. What?

Senator GORE. You are talking about loans as well as——

Mr. KEYSERLING. Yes; and I am talking of public works and of private outlays encouraged by cheaper credit and encouraged by variable tax concessions for this purpose.

All I am saying is that you are not going to get any appreciable rediversion of production into the areas where it must be diverted from the viewpoint of the technological problem and the automation problem and the national need, by these random tax cuts.

We will simply get a little more automobiles, a little more refrigerators, a little more of this, a little more of that, and the economists in the Government who are now rubbing their eyes that as against the 4-percent unemployment they were going to get in 1963 they now hope to get 5 percent by 1965, if they are lucky, they will rub their eyes 2 or 3 years from now, if they get this tax cut, and they will see that it did not accomplish what they thought it was going to accomplish.

Now coming finally to a suggestion, I think it is presumptuous for me to suggest to this committee just what kind of changes are worthy of consideration in this bill, certainly as to the technical aspects.

But in résumé of my argument, I said first that of the $7 billion allocation which this tax bill along with the $2 billion cut in 1962 would make to the investment purpose, both through corporate tax cuts and through tax cuts for high-income individuals which would have to go into investment if there was any justification for them at all, a large part of this $7 billion will be absolutely wasted, saved rather than invested, in view of the current position of corporations with respect to profits, earnings, retained earnings, idle capacity, and everything else.

Secondly, I say that, from the social and equitable point of view, which nobody in any good conscience can afford to neglect, when you are making a $11 billion tax reduction in times like these, the distribution of the proposed personal tax cuts as they would bear upon disposable income are entirely unjustifiable.

Third, I am saying that, whether we are going to engage in a contrived deficit now of $11 billion or $6 billion or $3 billion or $20 billion, whatever it may be, applying all of it to these kinds of tax cuts will have a very low leverage effect upon the increase of employment, because of the technological and automation reasons, because people getting tax cuts are not going to start to rebuild cities, to improve mass transportation, to improve our national resources, to provide educational and health facilities. They are going to start buying a little more of the things where the technology is advancing so fast that the employment is going to continue to drop, or at best rise only slowly.

Now, I can't go into all policies here. I can only talk about the tax bill. Positing an $11 billion tax cut, what changes in its composition would improve the pending measure?

I would suggest that no economic or social argument can be made for any appreciable part of the corporate tax cut at this time. If you want to play a little bit with those rates, particularly to try to make them a little more favorable to small business, fine. But on economic grounds, not to speak of social grounds, with corporations already having got a $2 billion concession in 1962, this additional corporate tax concession now proposed is not needed.

On the personal tax cuts, as I have shown, the current distribution of the personal tax cuts of $8.9 billion would be $4 billion to the 12½ percent of the taxpayers who have incomes of $10,000 and above, and $5 billion give or take to the 87½ percent of the taxpayers who have incomes below $10,000.

This is extremely wasteful on economic grounds, because much of the cuts in the higher levels will be saved, and if they were not going to be saved but were going to be spent for consumption, then there would be no possible social justification for increasing the consumption of the $200,000 family by 16 percent, and of the $3,000 family by 2 percent.

So taking that composition, I would suggest that about $2 billion of the $4 billion tax reduction for the 12½ percent at the top be sliced off and used lower down.

That would mean about $4 billion, give or take, $2 billion in corporation and $2 billion in personal. If that $4 billion were used to raise the exemptions by the amount that would be involved in utilization of this $4 billion, which is my suggestion, some part of that would actually revert to higher income people, because the exemption would apply all the way up the line.

Now what would you have, if you did that? You would have a tax cut much more stimulative to the economy, because much more of it would go where it would be spent.

Second, you would have a tax cut that on equitable grounds would be defensible rather than indefensible, when you examine the whole picture of incomes, the imposition of the tax burden, including especially the State and local tax burden and everything that goes with it.

Third, from the technical point of view, I don't want to exaggerate, something like this could be done in a day by somebody who really had the technical competence to work it out—and I am not saying what the committee should do, I am merely making a recommendation.

Finally, let me read what I have at the end of my statement. Then I am through, and I appreciate your attention.

Changes in the proposed tax measure along these or similar lines would accomplish these results.

They would be beneficial on all scores. They would provide much more stimulus to the economy, by bringing much closer together the relationship between the size of the tax concessions and the portion of these concessions which would actually be spent rather than saved.

They would of themselves constitute the most worthy tax reform, because they would bring about a more equitable and socially desirable distribution of the tax burden. I think this is the most important kind of reform of all, if you want reforms.

They would be more beneficial in terms of the Federal budget, because by their increased economic effectiveness they would result in a smaller Federal deficit than the current proposal in the short run, and offer more promise of getting back to a balanced budget in the long run.

And I may say parenthetically, Mr. Chairman, that these comments would be equally applicable if you wanted a $20 billion tax cut, or only a $6 billion tax cut, or a $2 billion tax cut, or any size tax cut. That is a separate question.

The most that I can ask, however, is that this committee, as I am sure it will, give serious consideration to these suggestions. While I feel that speed is of the essence, in order that an effective tax measure may be enacted this year, I respectfully submit—and I wish that my friends from the administration would heed this, because they have been pressuring a lot of people almost as much as some others——

Senator GORE. Don't look at me, Leon.

Mr. KEYSERLING. I respectfully submit that this vital consideration should not discourage any member of this committee from seeking to improve the pending bill in the light of his own judgment.

This is the largest tax reduction bill in history. It is therefore one of the most important measures ever to come before the Congress with respect to our domestic economy and our fiscal affairs.

Whether this measure takes effect, and whether the consummation of its provisions is spread out over several years or not, its impact on our economy and our national fiscal affairs and therefore upon every citizen of this great Nation will stretch for years into the future. The course that this measure will set upon enactment will be to a large extent irreversible. The very fact that it has taken so long to get anywhere on this change shows how hard it is to change tax policies.

Under these circumstances, the axiom that haste makes waste is pertinent. Although most of those now in favor of a large tax reduction have been in favor of it for almost 3 years, and so have I, we have survived without catastrophe although some tax reduction has not yet been enacted. We can certainly survive long enough to obtain the best kind of a measure which this committee and the Congress can write.

Who is there really prepared to say in good conscience that a seriously defective measure, enacted a few days or a few weeks earlier, would be preferable to a satisfactory measure, enacted a few days or a few weeks later?

The CHAIRMAN. Thank you, Mr. Keyserling. We are glad to have you appear before our committee.

It is 12:10. The committee will recess until 2:30.

(Whereupon, at 12:10 p.m., the committee recessed to reconvene at 2:30 p.m., the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order. Until Senator Douglas arrives, I will ask Mr. Richard H. Headlee of the U.S. Junior Chamber of Commerce to testify.

Senator BENNETT. Mr. Chairman, as Mr. Headlee is coming up, I am happy to welcome here as a citizen of my State of Utah, a young man of whom we are very proud. He is just starting on his service as president of the U.S. junior chamber, and I am delighted to introduce him to you and the members of this committee.

The CHAIRMAN. We are very happy to have you, Mr. Headlee.

STATEMENT OF RICHARD H. HEADLEE, FOR THE U.S. JUNIOR CHAMBER OF COMMERCE

Mr. HEADLEE. Thank you very much.

Chairman Byrd, members of the committee, and guests, it is a pleasure for me to appear before this distinguished group as spokesman for the U.S. Junior Chamber of Commerce. I am Richard H. Headlee, a concerned president representing 225,000 young men and their families residing in 4,900 communities of our Nation.

I appear because the young men of this Nation have much at stake in the legislation to be developed by this committee. Each of us faces numerous taxpaying, incentive-seeking years in our climb up the economic ladder.

Since 1957, the Jaycees have worked for tax rate reform so that America might fully realize its potential in economic growth. This concern with income taxation, both individual and corporate, and its effect on the Nation's economy stems from our organization's role in providing young leaders who actively participate in local, State, and National affairs. Our work stresses individual responsibility, opportunity, freedom, and competition. Our organization is furnishing leaders who bear great burdens of responsibility for the future strength of our Nation and the well-being of our society.

We view the existing tax structure as a limitation on the success of current leadership—a structure which, if not reversed, will steadily compound the problems of future leadership.

I should like to direct my testimony to three areas which we consider important to writing sound and meaningful tax legislation.

First, the need for reform of our present overall tax rate schedule.

Second, special attention to the middle income brackets to reduce the steep climb of rates.

Third, tax reduction should be accompanied by a display of fiscal responsibility by the Federal Government, insuring a balanced budget until the lower rates produce increased revenue yields from economic growth.

OVERALL TAX RATE REFORM

Our present tax system has a negative influence on our economic goals and is a treemndous impediment to the investment incentive required for economic development and growth.

Jobs, income, goods and services, and national and personal security all depend primarily upon the activities of private business. Corporations and unincorporated businesses are the source of the vast bulk of our national income. To advance economic welfare, we must all endeavor to eliminate all taxation barriers to business expansion and efficiency.

Excessive progression in the rates of individual and corporate income taxes are serious deterrents to initiative, savings, and risk taking. They retard employment, consumption, and investment.

Our Jaycee creed states that "economic justice can best be won by free men through free enterprise." If we do not provide the maximum opportunity for free enterprise to flourish to its fullest, we are creating not only economic injustice but social injustice as well. We are confident no one would deny a job to another if the means for securing employment could be found, yet, hesitation in releasing the tax shackles on capital which bind our free enterprise system is the same as denying jobs to the unemployed. We must agree that taxation reappraisal is of prime necessity in the interests of all.

STEEP CLIMB FOR MIDDLE INCOME BRACKETS

The major source of our country's investment capital is the taxpayer in middle income brackets. In these brackets are to be found the able and energetic men and women of any generation who, if not restrained by unfair tax rates, provide the financial resources for a more rapidly expanding economy.

Our society recognizes the principle that people who work hard and contribute more are entitled to higher rates of compensation as a reward for their labor. The steep graduation of our present tax rate structure is contrary to this belief. Under the House-passed tax legislation, H.R. 8363, taxpayers in the middle income brackets would continue being penalized for their efforts.

There should be nothing in our political or social framework which requires continuation of steep graduation through the middle brackets; yet, to date no one has asserted the leadership desire or "guts," if you will excuse that term, to remedy this injustice of the illogical past.

Unfortunately, H.R. 8363 increases the steepness of graduation in the middle brackets (see tax table attached). The measure of rate graduation is the buildup of percentage points of tax in relation to the size and income level of tax brackets. Under present law, over one-half, 36 out of 71, of the percentage points of graduation are reached at the taxable income bracket of $20,000–$22,000. Under H.R. 8363, two-thirds, 35 out of 56, of the percentage points of graduation are reached at the same bracket. Therefore, H.R. 8363 increases from one-half to nearly two-thirds the concentration of percentage points of graduation up through the $20,000–$22,000 brackets. This is not our direction.

Tax legislation must be enacted which would accomplish the reverse. The key to reform of rate graduation is fairly applying the percentage points between brackets as an individual progresses up the income scale. If the graduated rate structure were systematically reformed, there would be a more logical buildup of the percentage points of graduation in the middle brackets.

Jaycees believe the only type of graduation which would be logical, equitable, and economically sound would be one where rate jumps are in a fair proportion to the graduated scale.

Again, I call your attention to the tax table we have prepared. Note the column entitled, "Jaycee Recommended Rate Reform."

The Jaycees feel the schedule should begin with a 15-percent rate in the first bracket. Under the schedule we recommend, the reduction in savings of $1.3 billion in the first bracket, coupled with added savings of $1.2 billion, would be spread throughout the middle income brackets up to the $20,000–$22,000 bracket, or a total of 13 percentage points of graduation at that level. The 13 percentage points in the middle brackets amount to about one-fourth of the 55 total percentage points, leaving more points for equitable distribution to all brackets. It would be fair to state that a vast majority of Jaycees fall within $0–$4,000 taxable income brackets; yet, our concern is with the future and a society concerned with incentives and just compensation for labor.

We believe the American people support the idea wherein those citizens who work hardest at any undertaking are entitled to a higher rate of pay and income commensurate with performance. The Jaycees strongly urge this committee reflect this view while considering tax legislation.

FISCAL RESPONSIBILITY AND TAX REFORM

Tax reduction and sound fiscal budgeting go hand in hand. A commitment to live within the Government's means should be made by Congress to the American people. I should like to add must be made by Congress to the American people. This would instill much needed confidence in any tax bill Congress may adopt. At the same time, we are certain assurance of this nature would ease and justify passage of the bill.

The release of the tax shackles is of prime importance to the clear thinking future leaders of this great country; yet, we caution emotional or political haste must play no part in the enactment of sound, logical tax legislation. This legislation must contain the vision of impartial, concerned leadership such as presently embodied in this committee. We urge you to study this matter at great length. We have struggled for tax rate reform since 1957 and will not sacrifice nor compromise logic for expediency. Should legislation enacted not be the solution to our basic economic problems, we face serious repercussions. The economic strength of our country rests with your decision, and the perpetuation of the free enterprise system lies in the balance.

Speaking for the U.S. Junior Chamber of Commerce, allow me to congratulate you for the dedicated efforts you display on behalf of our free enterprise society. We have confidence and wish you Godspeed in a decision for our economic future.

The CHAIRMAN. Thank you very much, Mr. Headlee, for your excellent presentation. Are there any questions?

Senator BENNETT. Mr. Chairman, just to keep the record clear I ask that the tax table to which Mr. Headlee referred but which he did not read be included in the record at the conclusion of his remarks.

(The tax table referred to follows:)

Tax table for personal tax rates

Taxable income bracket (thousands)	Present ($47,900,000,000 revenue) (1)	H.R. 8363 ($9,500,000,000 tax savings) (2)	Jaycee recommended rate reform ($10,700,000,000 tax savings) (3)	Percentage points between brackets (1)	(2)	(3)
	Percent	*Percent*	*Percent*			
0 to $2	20					
0 to $0.5		14	15			
$0.5 to $1.0		15	16		1	1
$1.0 to $1.5 [1]		16	17		1	1
$1.5 to $2.0		17	18		1	1
$2 to $4	22	19	19	2	2	1
$4 to $6	26	22	20	4	3	1
$6 to $8	30	25	21	4	3	1
$8 to $10	34	28	22	4	3	1
$10 to $12	38	32	23	4	4	1
$12 to $14	43	36	24	5	4	1
$14 to $16	47	39	25	4	3	1
$16 to $18	50	42	26	3	3	1
$18 to $20	53	45	27	3	3	1
$20 to $22	56	48	28	3	3	1
$22 to $26	59	50	30	3	2	2
$26 to $32	62	53	32	3	3	2
$32 to $38	65	55	34	3	2	2
$38 to $44	69	58	36	4	3	2
$44 to $50	72	60	38	3	2	2
$50 to $60	75	62	40	3	2	2
$60 to $70	78	64	42	3	2	2
$70 to $80	81	66	44	3	2	2
$80 to $90	84	68	46	3	2	2
$90 to $100	87	69	48	2	1	2
$100 to $150	89	70	52	2	1	4
$150 to $200	90		56	1		4
$200 and over	91			1		
$200 to $300			60			4
$300 to $400 [2]			65			5
$400 and over			70			5

[1] 4-way split of 1st bracket.
[2] 3-way split of final bracket.

The CHAIRMAN. Any questions? Thank you very much, Mr. Headlee.

Mr. HEADLEE. Thank you very kindly for this opportunity.

(The following was later received for the record:)

PROVO, UTAH, *October 24, 1963.*

CHAIRMAN, SENATE FINANCE COMMITTEE,
Senate Office Building,
Washington, D.C.:

The Provo Jaycees support testimony given by National Junior Chamber President Richard Headlee on tax reform before Senate Finance Committee. Encourage your support.

PROVO JUNIOR CHAMBER OF COMMERCE,
Provo, Utah.

The CHAIRMAN. Mr. Keyserling, I understand that Senator Douglas has some questions.

STATEMENT OF LEON H. KEYSERLING—Resumed

Mr. KEYSERLING. Thank you.

Senator DOUGLAS. Mr. Keyserling, as I explained this morning, I had a meeting of the Banking and Currency Committee, which was marking up one of the small business bills, and therefore could not be present for most of your testimony, but I have had the chance to read most of your statement, and I find myself in general accord with it, and I wondered if I might ask you some questions to develop more fully some of the points.

You made the very correct basic point that a larger proportional amount of the incomes of the lower income groups will be spent for consumer goods than in the case of the upper income groups.

Now I have not been able to get hold of the more recent collection of budgets, family budgets, that the Department of Labor has collected. As I remember it, the overall average of the group study was that 93 to 94 percent of income was spent on consumer goods, and, I believe, services.

Now do you have the figures of what percentage would be spent, let us say, by the $4,000 family which is on the poverty edge, the $6,000 family, the $8,000 family, the $10,000 family and the $50,000 family? I don't know whether they went as high as $50,000 or not, by income groups.

Mr. KEYSERLING. Senator Douglas, I don't have comprehensive data on that because, unfortunately, economic research, while it spends a great amount of money, neglects many important problems. But I will say this, which I have set forth in some of my previous studies. Approximately the lower half of our population, who fall below a certain family income level, whether it be $6,000——

Senator DOUGLAS. $5,000 or $6,000.

Mr. KEYSERLING (continuing). $5,000 or $6,000, actually dissave.

Senator DOUGLAS. Dissave?

Mr. KEYSERLING. Dissave.

Senator DOUGLAS. That is they go into debt.

Mr. KEYSERLING. They go into debt on net balance. They spend more than their incomes. Progressively as you get higher up in the income scale, there is more saving.

Now this I know definitely, although I don't have the precise divisions. I would add only one point: While I am sure that this is true, if it were not true, it would not affect my conclusions in any way, because if one assumes that the net spending to saving ratio were the same for families at all income groups, then there would be no argument for putting the cuts at the top in order to induce saving, and there would be every equitable and social argument for putting them lower down, so either way you get the same result.

Senator DOUGLAS. Yes.

Mr. KEYSERLING. But I am definitely confident that in the neighborhood of half of the people dissave, and that the $4,000 or $3,000 or $2,000 family spends for all practical purposes well above——

Senator DOUGLAS. Therefore if 7 percent of income is saved, this comes from the one-half of the population with incomes of $5,000 or $6,000 a year.

Mr. KEYSERLING. Broadly speaking this is true, unquestionably, on net balance.

Senator DOUGLAS. And therefore would probably run well over 14 or 15 percent on the average, and in the upper income groups much more than that.

Mr. KEYSERLING. In a broad way.

Senator DOUGLAS. Now in the old days, Mr. Keyserling, as you know, efforts were made to identify savings and investment. It used to be said, well, even if people save, that goes into capital goods, and hence constitutes a demand for labor just as much as the amount spent on consumer goods and services. This was the criticism advanced against John H. Hobson's little book, "The Economics of Unemployment."

Now you draw the very valuable distinction between savings and investment, isn't that true?

Mr. KEYSERLING. Yes, Senator. If John A. Hobson were wrong, and if Say's law were right, savings would always equal investment, and there would be no serious unemployment. But due to the disequilibriums which I have described, savings exceed investment, and unemployment and over capacity result.

Senator DOUGLAS. You introduced an interesting phrase there, overexpansion, but you yourself have shown that a very large proportion of the population, I believe you fix it at somewhere around 25 percent, is really on a poverty level, and Dwight Donald in his article, "The Invisible Poor," which appeared in the New Yorker last winter, seems to more or less corroborate your figure. He estimates somewhere between 40 and 45 million people in this country are poor.

Now there is a tremendous potential market. Why shouldn't the savings be invested to produce commodities for these people who need them so badly?

Mr. KEYSERLING. They certainly should be, but that involves the question of whether the 25 percent to whom you refer, plus the rest of the consuming group, have enough purchasing power after taxes to absorb the growth of plant and equipment.

This is the very kind of an equilibrium that we are all striving for. Now to make myself perfectly clear, I am not anti-investment.

Senator DOUGLAS. I understand.

Mr. KEYSERLING. My studies point out that, during the past 10 years, you would have had much more investment if we had had a 4- or 5-percent growth rate than with a 2½-percent growth rate.

Senator DOUGLAS. As a matter of fact, we have clashed in the past because I thought you emphasized investment unduly, I can say this.

Mr. KEYSERLING. Well, that may be.

Senator DOUGLAS. But now certainly your credentials in favoring investment are very good. What you are saying is that savings do not equal investment.

Mr. KEYSERLING. Savings do not equal investment because the flow of income tends to produce during each upturn a faster rate of growth in our productive capabilities than the growth in demand for ultimate products.

This consumption deficiency is not simply a matter of the propensity to spend as some economists say. It is a matter of income, as I think my studies very clearly show.

Senator DOUGLAS. But if business were to reduce its prices, would not this bring the total monetary demand for goods in line with the capacity of industry?

Mr. KEYSERLING. Surely it would, and this would be the ideal way, if we lived in a free competitive economy in that sense. The reduction in prices would reduce profit margins, and profits per unit of sale, but it would be helpful to ultimate profits by expanding volume.

But what I am saying is that, since business is not doing that, and since there is an excess on that side, why increase it by handing them out tax bounties? There is nothing wrong with their margins now, as all of my figures show.

Senator DOUGLAS. In other words, if we could have a completely competitive system, this would right itself, but because we don't have a completely competitive system, we have a situation in which the sum total of price tags on goods produced or which could be produced are in excess of the sum total of the monetary purchasing power of consumers.

Mr. KEYSERLING. I agree with that completely, Senator. If we had a completely competitive system, Hobson would be wrong. But Hobson observed as Keynes later did, that we don't have a completely competitive system.

Senator DOUGLAS. Do you see any tendency in recent years for savings not to be invested and therefore for the liquid funds of corporations to accumulate?

Mr. KEYSERLING. Oh, yes. I show it in one of my charts, and let me just refer to it again, as shown in my chart No. 26 as you have it, you will see there that the portion of corporate funds drawn from internal sources has risen.

Senator DOUGLAS. Which chart is this?

Mr. KEYSERLING. This is chart No. 26, which shows the very pronounced tendency over the past decade for a very much larger portion of the financing of corporate activity to be drawn from internal sources, which is a composite of savings, savings in the form of profit after taxes and not distributed in the form of dividends, in other words, it is corporate saving as distinguished from individual saving.

That is one partial indication. It is not a complete answer to your question, because you might say these retained profits and depletion allowances are used.

But I take a different kind of pragmatic test. I don't attempt to determine the proper level of savings in ratio to investment by any fixed percentage test. I look at the economy functionally, and I try to see what is happening. If you have vast overcapacity, then your rate of investment has been at a nonsustainable rate or more than could be used. That is the only kind of ultimate test.

Senator DOUGLAS. The corporation accountants have developed a term which they call, I believe, cash flow, and is it not true that the amount of savings plus depreciation has been greatly in excess of the amount of actual investment?

Mr. KEYSERLING. It has, and I would call your attention, Senator—I don't recall the exact page number, but in the January 1963 report of the Council of Economic Advisers, there is an extensive quantitative analysis of the ever-increasing ratio of cash flow to actual investment, which is one of the prime tests of the prolixity of savings. That is why I can't square that with the proposal emanating from the same source.

Senator DOUGLAS. You have gone to a great deal of effort in getting these figures together. Let me say I wonder if you would, for the record, be willing to assemble some of these so they can be put in the testimony.

Mr. KEYSERLING. I certainly would. And let me just say here that all of the figures which I have shown on these charts, as to the rising profits, which I am not against except that they are going to kill the goose which laid the golden egg, and the rising retained earnings, are an understatement, because they do not take account of this particular matter of cash flow, which I have had a great deal of occasion to go into recently, particularly in connection with the railroad industry. When that is taken into account, and I will provide some figures on that, the case is even clearer. (The material referred to will be supplied subsequently.)

Senator DOUGLAS. Where is this money invested, in short-term Governments and in real estate?

Mr. KEYSERLING. I have not studied in detail the portfolio of such investments. Some of it is in short-term governments, and some of it is truly frozen savings, just lying on deposit.

Senator DOUGLAS. You mean in savings accounts?

Mr. KEYSERLING. Yes.

Senator DOUGLAS. Drawing interest.

Mr. KEYSERLING. Yes.

Senator DOUGLAS. Well, presumably the savings banks reinvest.

Mr. KEYSERLING. Not fully because if they did fully, unless they invested in Government obligations, that investment would draw down the true level of savings so that you would have savings equaling investment. In other words, there is some net residual, much too large, of truly frozen savings.

Senator DOUGLAS. To the degree that the liquid funds of corporations are invested in short-time governments or in real estate, they do not add to the productive equipment of the country, though they constitute claims upon the national income.

Mr. KEYSERLING. As I said to the chairman this morning, when a corporation that has funds that it can't use for investment puts it in real estate, it is like putting it in stocks. I mean that the price of real esate may go up because there is another buyer, but it does not change the real wealth of the Nation, it does not affect the employment, it does not effect production, and it does not add to our productive capacity.

Senator DOUGLAS. Have you checked the effect of the investment credit and increased depreciation rates which were put into effect last year, which I think was $2.5 billion? Have you made any estimate as to how much of this was reinvested?

Mr. KEYSERLING. Yes, I have. It is absolutely impossible to do this on a definite basis, because it involves a subjective judgment as to how much would otherwise have been invested if they had not got these credits.

We know the figure on investment, but we don't know how much would otherwise have been invested. But the whole trend of my studies over the 10 years, and this I said to this committee and elsewhere earlier, is that the level of investment by the large corporations has not been much affected by this credit, but has been determined largely first by their desire to get the competitive advantage of better machinery and equipment than others have, and second, by their appraisal which was turned out to be not too good, as to future markets.

But in any even, looking at the ratio of their investment to available funds, it is hardly conceivable to me that they would not have invested about the same without these particular bonanzas.

Senator GORE. May I say the McGraw-Hill survey concluded that only 40 percent of the additional investment in 1963 could be in any way attributed to the investment credit and depreciation changes, and this amounted to not much more than 40 percent of the revenue lost by these changes.

Mr. KEYSERLING. Well, this is the waste or leakage that I am talking about, Senator Gore.

Senator DOUGLAS. In other words, the $2.5 billion stimulates something over $1 billion of investment. Those figures I think were published in Business Week, and they check substantially with my memory.

In other words, for every $2.5 billion which corporations received by the investment credit and through the faster depreciation rate only $1 billion went out in actual investment, and there is a big gap between the two, which took the form of cash flow, or liquid funds not invested in socially productive equipment.

Mr. KEYSERLING. I submit, and this, of course, must be judgmental, that even that estimate may be on the high side. There is no way of applying a slide rule to it.

Senator DOUGLAS. But for every dollar which is added to the income of those with incomes less than $5,000 there would be a $1 stimulation in consumption.

Mr. KEYSERLING. Just about. Now, there is another way of checking that the investment credit achieved much less than was expected for it, and that is the expectancies and forecasts of the very competent people in the Government who advocated this credit. For example, one of the reasons why we have had a stagnating rate of economic growth in the last year and a half, as I showed this morning, or 2 years, is that the various measures taken did not yield nearly as much as was expected by those who urged them.

Every economist, every analyst inside and outside the Government, says that the rate of investment has been what they call disappointing as measured against expectancy.

The real reason, I think, as shown by my examination of the three periods of economic upturn, is the deficiency of ultimate demand. If the investment credit in 1962 had been $4 billion instead of $2 or $2.5 billion, it would not have produced much more investment, because businessmen have some judgment, and you have got 15 percent idle capacity now, and the figures for the last 2 months, as we read them in all the responsible journals, show a shrinking level of sales.

In fact, the actual level of sales, quite aside from the fact that you need about a 9 percent growth rate for 2 years to get to full employment, the actual absolute level of sales during the past 2 or 3 months has been declining.

So here we are facing a situation, business is facing a situation, where they face a rising gap between their current productive capacity and the markets for their products.

Senator DOUGLAS. If we take the investment credit as an example, a further $2.5 billion cut would not produce more than roughly a $1 billion increase in investment, whereas a $2.5 billion addition to incomes in the lower level would produce a $2.5 billion total initial stimulation.

Mr. KEYSERLING. This is rather near to my own estimate, Senator. In part of my testimony, I point out that if you take the $11 billion tax reduction proposed, and the $2 billion in 1962, and add them together, you get $13 billion.

Applying the ordinary multiplier of 3, and I would not argue whether that is just right, you get about a $40 billion stimulus.

My own estimates are, and they have turned out to be pretty nearly right in the past, my own estimates are that, when this tax bill became fully effective, the GNP stimulus, instead of being the $40 billion that I mentioned, would be only about $30 billion. In other words, you would have a 25-percent leakage because of the distribution of the cuts, and you would have a much higher leakage as to that part of the cuts which is devoted to the corporate tax reduction, and to the reduction in the high brackets.

Senator DOUGLAS. Now may I turn to the question of the multiplier? In 1958 when we were in a recession, I advocated a tax cut rather than an accelerated program of public works. I did so largely because of the fact that if we could have passed a tax cut it would have gone into effect immediately, whereas public works programs would have been long drawn out. and in view of the composition of the Public Works Committee, might well have been spent in areas where there was not much unemployment.

But is it not true that if we want to expand total demand, the multiplier is higher for expenditures on public works than for a tax cut?

Mr. KEYSERLING. The multiplier is higher for two reasons:

One of the reasons is the reason that you have given, that you do not have the leakage. In other words, if we spend $1 billion, you have spent $1 billion. If you give $1 billion in tax cuts in the wrong place, you may only get $600 million of spending. This is one reason.

This is the reason, the usually accepted reason. I do not think it is the most important reason.

The second reason which I develop is this: that you have to look also at the composition of demand as it bears upon employment. In other words, suppose you have a billion-dollar tax reduction and it is all spent. It will be spent largely to increase slightly on a per family basis the demand for the products of conventional industries. A person will buy another car, we will assume, or another refrigerator. But this begs the whole technological problem because the technological rate of advance in these industries is so tremendous that, as I showed this morning, the ratio of manufacturing employment to GNP has gone down from 102 to about 60 since 1947.

What that means is as follows:

Suppose you said you wanted to create full employment solely by the expansion of the production of automobiles. This is an extreme example, but it exactly illustrates my point.

You can do it, and you can do it by tax reduction and other things. But the amount that you would have to expand the demand for automobiles to create full employment that way, in view of the technological trends in the automobile industry, would mean that you would have to lift the demand for automobiles to about 30 or 40 million cars a year.

In the first place, we do not need them, there would be no place to put them but in the ocean, and it would be entirely impossible on economic and practical grounds to move along this approach. So this is an illustration that, looking at the technological problem, the problem of automation, we must turn elsewhere for most of the employment expansion. I do not understand my friends in the Government, because they admit this. They say there are going to be 22.5 million new jobs needed in the next 10 years, and that 10 million of these are needed to absorb those whom they say will be displaced from the conventional industries by automation and technology, even under a full employment program. These types of jobs, by definition, will not be created by tax reduction.

This means that, in order to get these people employed, you have to create new types of demand. It is a change in the structure of demand, not a change in the structure of the labor force, which is the first step.

Those new types of demand will have to be largely in industries and areas which depend to a large measure on public outlays or private outlays of a kind that will not be stimulated by tax reduction—housing, urban renewal, education, health, public works, and so forth.

Senator DOUGLAS. If I may come back for a moment to the comparative size of the multiplier, it seems to me that the multiplier for public works is higher than for a tax cut for another reason; namely, that the initial expenditure creates that amount of demand for labor and for materials, the expenditure of $1 billion creates a $1 billion demand, whereas a billion-dollar tax cut only has its secondary demand. It has an influence only to the degree that it is spent and/or invested. Therefore, I have always thought that if you had a multiplier, say, of three for a tax cut the multiplier for public works should be four.

Mr. KEYSERLING. Or two or three or two and a half or three and a half.

Senator DOUGLAS. That is right.

Mr. KEYSERLING. I agree entirely and completely with that, and I make the additional point, which I still say is even more important, Senator, that even after you know what the multiplier yields by way of spending, you still have to ask how much reemployment this increase in spending will create.

There I am saying that $2 billion of spending for mass industry products will not create as much employment as $2 billion of spending for some other things which we are very short of now.

Senator DOUGLAS. Now, of course, there is another stimulant in addition to the multiplier which is what is known as the accelerator, which was launched in economic theory by John Morris Clark in 1917. This is much more difficult to estimate in this case because the increased consumer demand will for a time merely absorb idle capital, but after a time a slight increase in consumer demand will create a greater proportionate increase in the demand for capital goods.

We had our statisticians in the Joint Economic Committee working on this, and they came out with a combined multiplier plus accelerator, stimulant of approximately four.

Now, this last point is somewhat conjectural, but I think certainly it is real.

Mr. KEYSERLING. I think it is realistic, and I would like to introduce another consideration at this point, which is largely neglected. This is what I call the increasing productivity of capital, which is just beginning to be noticed.

To put it in a simple illustration: if a steel plant increases its capital outlays by 10 percent, it may increase its output potential maybe by 15, 20, or 25 percent, because of the nature of the change in technology and automation.

Therefore, while one of the big arguments advanced for this tax cut on the investment side has been that it would increase the ratio of investment in plant and equipment to GNP, any realistic analysis would probably indicate that we need a lower ratio of investment in plant and equipment to GNP, and a higher ratio of consumption to GNP, to keep the economy in equilibrium in view of the increasing productivity of capital, and especially so if the tax reduction is of a type which would induce the investment in these industries where the technological change is so rapid.

Senator DOUGLAS. Now, Mr. Keyserling, we have heard various suggestions that if we reduce tax revenues initially we should reduce expenditures by the same amount, so that there would be no net deficit or no net added deficit credited.

What do you think of that idea?

Mr. KEYSERLING. Well, you know what I think of that.

Of course, I do not agree with it al all, because the whole purpose of the entire operation is to provide a net additional stimulus to the economy.

Senator DOUGLAS. That is, the purpose is to create additional monetary purchasing power through a Government deficit?

Mr. KEYSERLING. Yes.

Senator DOUGLAS. And the borrowing of additional credit from the banks which the banks create: is that not true?

Mr. KEYSERLING. That is true.

Senator DOUGLAS. And if we cut down expenditures at the same rate that you reduce taxes, one cancels the other?

Mr. KEYSERLING. More than cancels it because of the reason you gave before, that the cut in expenditures will probably result in a hundred-percent reduction in spending, I mean by definition, while the cut in taxes will not produce a 100-percent increase in spending.

I would like to mention here, again I do not remember the page number, but in the January 1963 Report of the Council of Economic Advisers, in their attempt to adduce an argument against cutting spending pro tanto with a cut in taxes, they said this would do even more damage and here I am paraphasing them:

"We know every dollar of expenditure is a dollar of expenditure, while of every dollar of tax cut, a part of it will be saved."

So they themselves were making the argument that a dollar of expenditure is much more valuable than a dollar of tax cut.

Why they have, under these conditions, permitted themselves to get into a position where they are promising as a quid pro quo for every dollar of tax cut to hold expenditures where they are, I cannot see. I cannot see it fit.

Senator DOUGLAS. It seems to me that a lot of the difficulty which is created by two groups talking about different worlds comes from the fact that some people find it very hard to accept the multipliers. The multiplier would create additional monetary purchasing power. Let us say people buy $10 billion more of goods. Then we employ a given number of workers who, with more money in their pockets, buy more and employ still more others who, with more money in their pockets, reemploy a fourth group, and so on.

You get a more or less constant fraction of a diminishing magnitude, and the sum of these products creates the multiplier which we believe to be somewhere around three, and which, with the accelerator, would be four, and which possibly under public works would be five; is that not true?

Mr. KEYSERLING. Yes.

Senator DOUGLAS. It is this accumulative process which seems to be so hard for many very able and very fine people to understand.

You say this would be obviously canceled if you cut expenditures by the same amount as you cut taxes.

Now let me ask you this question, if I may.

Some people say, "Well, we will reduce the amount of bank credit by the amount by which we cut taxes."

It is rumored, for example, that after the tax bill goes through, that the Federal Reserve System is going to raise longtime interest rates.

Senator GORE. It is not rumored.

Secretary Dillon forecast this in his speech to the bankers.

Senator DOUGLAS. What would you think of that?

Mr. KEYSERLING. I think that two things which seem inconsistent from one point of view, may be consistent from another point of view.

I do not want to impute anybody's motivations, but merely to talk about their economic philosophy.

It is perfectly consistent, if I represent a certain sector of the American economy in terms of my holdings and my interests, that I could reconcile a big tax cut for me with a big increase in my interest payments as a moneylender. That would be much easier than reconciling it from the viewpoint of economic sobriety.

I think that, from this point of view, it has been pretty general throughout our history that people who have been for lower taxes and lower Government spending have been for higher interest rates and so forth and so on. It is easy to understand.

Now, from the viewpoint of the economics of the country, they are entirely perverse and contradictory policies.

If you are going to make this kind of tax cut, and then say that because of this being "inflationary," and in order to protect gold, you are going to have a still tighter money policy, which we are very clearly moving toward, there again you cancel out a large part of the tax cuts.

I would say that an insistence that the money supply should be allowed to increase gradually in accord with our growth rate needs, whatever these may be, should be the only foundation from which you should begin to build fiscal policies, regardless of which is more important.

Senator DOUGLAS. And if we curtail the amount of loanable bank funds to industry in the same degree as you increase lending to the Government, you cancel the net stimulative effect, do you not?

Mr. KEYSERLING. And it is also equally important from the viewpoint of the balance between investment and consumption, because I have always believed, just as I believe that this tax cut is too much on the investment side and not enough on the consumption side, that actually the so-called tight money policy bears down harder on consumption than on the type of investment that this tax program would help.

Senator DOUGLAS. So what you are saying is that if you have a policy of tax cut, higher interest rates, and restriction of lending to private industry, the incomes of the well to do will be increased because they will be owners of the banks, and their taxes will be reduced?

Mr. KEYSERLING. That is right.

I am saying that both the indicated tax policy and the indicated money policy are both anticonsumptionist and regressive when the economics of the situation call on both scores for a policy that is expansionary and progressive.

In other words, they will both redistribute income in the wrong direction.

Senator GORE. Will the Senator yield for a moment?

Senator DOUGLAS. Certainly.

Senator GORE. I am being educated by this erudite exchange between two distinguished economists. It is with great trepidation that I even ask a question in this atmosphere.

As a layman who has studied some economics, has been exposed to it in Congress for a few years, I had ventured the suggestion that if you take the total thrust of the economic policies of Secretary Dillon, the proposed tax bill, the tight money policy, and the projected and proposed further increase in interest rates, and the political climate that is created as a result of the promises of virtually a no-new-start policy, restrictions or the public sector of our economy that the total thrust is in fact restrictive rather than stimulative.

Maybe I have gotten into very deep water here, but I would like to hear your comments on this proposition.

Mr. KEYSERLING. I do not think you are in deep water. I think you are just in clear water. I think you are absolutely right.

Senator GORE. I am better off than I thought I was.

Senator DOUGLAS. I am not certain of that, but I will say that you agree if there is a reduction in public expenditures, and to the degree that there is a reduction in private lending, this helps to cancel and offset some of the net stimulative effects of a tax cut? Whether it is equal to that or not——

Mr. KEYSERLING. I would, Senator Gore, without retracting what I said, I would modify my position to this extent, which I think you will appreciate: Whether or not it is on net balance positively recessive, it is certainly not nearly as stimulative as we need at this time or nearly as stimulative as a better use of $11 billion could produce.

Senator GORE. Will the Senator yield further?

Senator DOUGLAS. Certainly.

Senator GORE. Whether or not it is actually stimulative or contractionary will depend on the extent to which this or the other is done. But if, in fact, as the distinguished senior Senator from Illinois has pointed out, you cancel out the stimulative effect of the tax cut in these various ways he has mentioned—one way which has not been brought out, it seems to me, is putting savings into the purchase of additional Government bonds made necessary as a result of the deficit—if you cancel out any possible stimulation in these various ways; but having lost $11 billion in annual revenues permanently, will we not be in worse shape than if we had not reduced taxes?

Mr. KEYSERLING. Let me try to reconcile these two points of view, because I really think I can. I think this involves a distinction between short range and long range.

Let's put it this way:

First I would say, let us say just using mathematical examples that the economy needs 5 points of stimulus. Let us say that the combination of this tax cut in its present form and the monetary policy which is evolving gives it 1 instead of 5, whereas a more effective money policy and a better composition of the tax cut would give it 4. This is a mighty serious criticism of the composition of the tax cut and the monetary policy that reduces the stimulus from 4 to 1, regardless of whether they reduce it to minus 1.

This to my mind calls imperatively for a reconstruction of the tax cut to bring it nearer to 4 rather than to 1.

My second point is that, whether the current approaches would bring it below zero, as you say, may be a matter of timing.

I would put it this way: I would say that if I looked only at the next year, if this tax cut were enacted in exactly its current form, I think that for next year it would provide some net stimulus to the economy. But sometimes you can provide a short-range stimulus to the economy by doing a lot of wrong things. In other words, you can stimulate another investment surge of a kind, stimulate the economy for a little while, and find yourself worse off a little later on than you were before.

I really do believe honestly that, from the longer range point of view, the permanent commitment to the kind of tax structure and the kind of economic policy that is involved in these composite set of changes is setting us back in the long run, and storing up a bitter harvest, despite any shortrun stimulus that you might get next year. This is the way I really feel about it.

I also feel this is particularly true, when you take account of the psychological and political factors, because we all must know, and we already see in Presidential commitments, congressional action, and in popular attitudes, the effect of this policy upon other policies that ought to be considered, but that it becomes much harder to consider when you take this action.

So I would say that in the short run, maybe, it will provide a little stimulus, but in the longer run—and this is my main reason for being worried about it—it is a backward step.

Senator DOUGLAS. Mr. Keyserling, we have been talking in terms of aggregates.

Mr. KEYSERLING. I did not get the last word.

Senator DOUGLAS. Aggregates.

Mr. KEYSERLING. Yes.

Senator DOUGLAS. Total monetary purchasing power to put people to work with capital now unused producing goods which otherwise would not be produced.

Now, I was recently taken to task in talking in terms of aggregates. I make no apology for doing that. But I have also been taken to task for being a moralist, and that is something that is supposed to be very unfashionab'e nowadays. I got hold of some Treasury statistics which Secretary Dillon stated were correct; namely, that in the year 1959 there were 5 men in the country with "adjusted gross incomes" of over $5 million who did not pay 1 single cent in taxes, and that there were 10 men with adjusted gross incomes between $1 and $5 million who did not pay a single cent.

Now mind you, this figure, adjusted gross income, and Mr. Stam and Mr. Woodruff can correct me if I am wrong—does not include interest on tax-free State and municipal bonds. It does not include I believe drilling and developmental costs in the oil industry, and it does not include I believe half of capital gains.

Mr. Woodruff nods his head when I say that and I take it what I have said is correct, but nevertheless, you have five men in the country with over $5 million adjusted gross incomes without counting the income from these other factors, who did not pay 1 single cent in taxes, whereas a workingman with an income of $100 a week, $5,200 a year, this is solely income, just a little bit over the board of poverty, he will pay about $460 a year in taxes.

Now, whether this makes me a moralist or not, I think this is basically unfair, improper, should not be tolerated.

Senator GORE. Politically immoral?

Senator DOUGLAS. Politically and ethically immoral.

It may be legal, but it is politically and ethically immoral.

Therefore, some of us, including the Senator from Tennessee and I, and the Senator from Wisconsin, Senator Proxmire, believe that these obvious injustices should be cured. We are demanding in South America that the defects in their income tax structure and tax system be remedied so that the wealthy can pay their share of taxes. We demanded that in Greece. Whether that is why Mr. Onassis became an Argentinian citizen or not I do not know.

This has been one of the provisions which we try to carry out in the countries to which we give aid. But here at home it prevails in the most virulent and lurid form and we do not seem to be able to do anything substantial about it.

People seem to have lost any sense of injustice about this matter, and simply say, "Well, how can I get in on it?"

Now, do you want to make any comment?

Mr. KEYSERLING. Yes. I want to suggest two things that can be done about it. The first is for those who believe in the necessity of closing some of these loopholes continuing to fight toward that end with all the fiber and courage that they have. That is one thing that can be done. They may not be successful right away.

Senator DOUGLAS. Some of us have been trying that for 13 years.

Mr. KEYSERLING. Yes.

Now I think you are absolutely right. You ought to try for another 13 years.

Now let me come to the second point, which is——

Senator DOUGLAS. I am 71 years old.

Senator GORE. He will be here.

Mr. KEYSERLING. The second thing is that there is another practical approach, embodied in a recommendation I made here this morning. I think that, even allowing for these terrible loopholes, the greatest injustice in the tax structure is, while the American people have been led to believe that we have a very, very progressive tax structure, we do not. Too much of the burden is borne by the lower half of the population.

As I showed this morning, this is particularly true when you take into account the State and local taxes.

Senator DOUGLAS. That is correct.

Mr. KEYSERLING. Now, the Federal income tax cannot cure this whole thing, but it can compensate in part for the extremely regressive nature of State and local taxation. We also know that the States and localities have increased their tax-supported expenditures much faster than the Federal Government in the last 10 years, so that the regressive feature is looming larger. Therefore, this is certainly not the time for the Federal Government to make this compensating factor of the Federal income tax more regressive; that is, reduce the degree of its progressivity.

Now, therefore, I think one of the most important reforms, using the word "reform" in its true sense, that could be applied in connection with the consideration of this bill, is to put in the bill the reform which would retain, if not improve, the progressive nature of the Federal income tax structure as it now stands.

Talking about morals, this administration—excuse my language—would have been ashamed to send to the Congress a bill exactly like the bill they sent up, but without the reforms, because they would all have been forced to admit that without the reforms the changes in the rates were just indescribably regressive in their effect upon the tax structure. Now, that being the case, how can they stand by the current measure, with the reforms stripped from the bill, albeit that there were some changes in the rates by the House Ways and Means Committee, for it is nonetheless true that when these reforms are stripped from the bill, the net effect in terms of the redistribution of the tax burden is much worse than in the bill as first proposed.

Therefore, my practical recommendation is that, while it may take another 13 years to get the reforms, it might not be quite that hard to take a little bit from some of the corporate tax reductions in this bill and take a little bit from some of the tax reductions in this bill for the upper 12½ percent of the taxpayers, and put it into a lifting of the exemptions or some other formula which would redesign the imposition of the tax burden in a fairer way.

I suggest for particular study, in that connection, my charts which show how this bill in its current form actually affects the disposable income of people.

Senator DOUGLAS. Thank you very much.

I am afraid I have taken up more time than I should.

Senator GORE. Will the Senator yield?

Senator DOUGLAS. Yes.

Senator GORE. In line with your thinking, Senator Douglas, are these facts given me by the Treasury?

In response to my request the Treasury Department prepared a table which I inserted in the record this morning before your arrival, which showed that a family of four with an adjusted gross income of $1 million, of typical composition for this bracket, would under present law pay at a 26-percent rate, and if this bill is enacted, at a 23-percent rate.

As I say, I have had the table inserted into the record.

Now I noticed when I read these figures this morning—let me again read the heading, "Married Couple With Two Dependents, With Typical Dividends, Capital Gains and Other Income, and Typical Itemized Deductions."

When I read these figures on after tax income, I seemed to notice some incredulous looks.

One million dollars adjusted gross income, tax under present law $261,992. After tax income, $1,239,659.

Senator DOUGLAS. That is because there is real income which did not enter into adjusted gross income.

Senator GORE. That is right. That is one reason why I bring this up, because only half of capital gains, for instance, show up in adjusted gross income.

Now if this bill is enacted, the same taxpayer would pay $23,892 less, and he would have an after tax income of $1,263,551.

Mr. KEYSERLING. I would like to call the attention of the two Senators just once again to my chart No. 28.

Now that does not go up to $1 million, because, while I am just as morally shocked as you two Senators are about the treatment that the million dollar family receives while others receive such poor treatment——

Senator GORE. You understand what I am reading here reflects what the Treasury calls typical income for this group.

This is not an isolated or specific case.

Mr. KEYSERLING. Yes.

Senator GORE. This is represented by the U.S. Treasury Department as sort of a composite case with typical incomes.

Mr. KEYSERLING. Exactly, but here my chart 28, while it does not go up to the million dollar family, does go up to the $200,000 family, and that is plenty high enough for the purposes that I have here.

Now what does it show?

And there is nobody who has challenged these figures, and nobody can, except in ways insignificant to their import. It shows that if this bill went into effect, the $200,000 family would get a 16-percent increase in its disposable income. The $3,000 family would get a 2-percent increase. The $5,000 family, incidentally, would get even a smaller increase than the $2,000 family, because this bill is worse to the lower middle income people, but all the way along the line after that, the percentage of increase in disposable income under this tax cut would increase as the income got higher.

Now, there is nothing that could be more undesirable than that at this time, not only from the obvious social point of view, but from the economic point of view, because of the whole picture.

Senator Douglas, what do the Treasury and my friends in the Government say in answer to this?

They say mathematically, because the people at the top are paying the highest tax rates, you cannot have a big tax reduction without this happening.

Well, the answer is very simple:

The first answer is that you can, and I propose an alternative that would, and the second answer is that, if the very nature of the tax structure made this result inescapable in the process of reducing taxes, then it would be the wrong thing to reduce taxes.

There is nothing sacrosanct about tax reduction, just for the sake of tax reduction. It just is not right at this time to do what this bill would do.

Senator DOUGLAS. If Senator Carlson would permit me, I would like to ask one question more.

As I remember it, you advocate eliminating the reduction in the corporate income tax and diminishing by $2 billion the amounts given to those over $10,000 a year, or a total of $4.2 billion, which you would then distribute primarily in the form of increased personal exemptions.

Mr. KEYSERLING. Yes.

Now some of that increase in the personal exemption would return to the higher income people, some small part.

Senator DOUGLAS. Yes, surely.

Mr. KEYSERLING. But broadly speaking, it would mean a redistribution of the composition.

Now I am not—first of all, it is not for me to decide; this is just a suggestion.

Senator DOUGLAS. We have a rough rule of thumb that each $100 increase in personal exemption costs about $3 billion in revenue. That would mean an increase of about $150 per person or per dependent.

Mr. KEYSERLING. Something like that. I am not sure of the figures as you cite them, but my proposal is that the exemption be lifted enough to absorb the $4 billion or so to which I refer above.

Senator DOUGLAS. This is in addition to the minimum standard deduction which is already in the bill.

Mr. KEYSERLING. Oh, yes.

Senator DOUGLAS. So if we take $750, a family of four would get four times $750, or $3,000 plus $300, plus $300, or $3600.

Mr. KEYSERLING. Again, I am not sure as to all of these figures, but my proposal is plain: to change the exemptions, as contained in the current bill, by enough to absorb the $4 billion.

Senator DOUGLAS. A family of five would get $4,450.

Now, does this square roughly with the minimum subsistence figures which the Department of Labor publishes?

Mr. KEYSERLING. It certainly does, and furthermore, the obvious equity of it resides in this fact.

The $2,400 exemption now for the family of four has 67 percent less purchasing power than the exemption in 1939 had. So they have taken a 67-percent loss in real terms.

Now, if I were writing on a white sheet of paper, I might come up with something still further. I might say that the exemption should be raised more, and that this should be all that is done. But what

I here recommend is just sort of a practical middle-of-the-road ground to bring some improvement in the composition.

Senator DOUGLAS. I apologize to my very amiable colleague whom I have more or less intruded upon in these last minutes.

I want to apologize to you, Senator.

Senator CARLSON. If the Senator from Kansas may state so, he need not apologize because I have thoroughly enjoyed this discussion today. I appreciated very much Dr. Keyserling's appearance before this committee today in which he has given not only a thought-provoking discussion of this bill, but an illuminating one and one that I think we need more of.

I shall not ask any questions because he has been most generous of his time. But I do appreciate it very much.

Senator GORE. Mr. Keyserling, I think some might wonder why your percentages of increase in after-taxes income differs from the table which Mr. Stam prepared for me. I think that stems from the fact that you used as your base adjusted gross income, and I asked that the table be prepared for me on taxable income.

Mr. KEYSERLING. There is nothing magical about the figures. I am sure the figures of both are correct.

You can do it either way, and then you have to make certain assumptions as to whether you are using the standard deduction or the itemized deduction. But any kind of table prepared on any kind of basis will in substance show in essence the same thing.

Senator GORE. Of course, our whole tax system seems to hit hardest people whose income is in the form of wages and salaries.

Mr. KEYSERLING. Well, of course, this is the reason why all of my materials are understatements, because they are based upon the nominal tax rates that are written on a sheet of paper rather than what people actually pay.

Senator GORE. As unjust and as unfair as this situation is, would not the enactment of this bill make it worse?

Mr. KEYSERLING. Yes, because this bill would have a regressive effect upon the imposition of the tax burden.

Senator GORE. Now, if you calculate the percentage of income, after-tax income, strictly on the basis of rates applied to taxable income, then you would show a major attack upon the progressive graduated character of our Federal income tax structure by this bill.

Mr. KEYSERLING. Well, it just gets to a definition of the word "major." I do not think that the provisions of this bill are enough in themselves to change radically the imposition of the tax burden. I think they are a sizable step in a nondesirable direction.

Senator GORE. As an economist, how would you calculate or estimate the difference in its effect upon the economy, short range and long range, if, instead of an $11 billion tax cut, the Government undertook to complete the superhighway system with an equal amount of money?

Mr. KEYSERLING. In answering your question, I will just make one suggested modification, and I think it will answer your question anyway.

May I answer your question by saying how I would compute the difference between this $11 billion tax cut and an $11 billion expenditure by the Government for whatever range of public improvements seem most in the national interest. I am not implying any disagreement about the highway program, but I do not want to pin myself to a computation of the technical effects of that particular program.

Senator GORE. I understand.

Mr. KEYSERLING. I would say this—I think I have said it—first of all, the $11 billion tax cut, if it had a multiplier of three, would give you $33 billion of increased stimulation.

As I developed rather fully in my testimony, the wastage that would come from this tax bill, I figure a wastage in the range of 25 percent, would reduce that $33 billion by a quarter, roughly speaking, which is about $8 to $9 billion, so let's say reduce the $33 billion to $24 billion in terms of stimulus.

Let's say it would have a $24 billion stimulus when ultimately effective in full. This, of course, is aside from the distorting disequilibrating effect which might hurt the economy in many ways.

Now, suppose you took the same $11 billion in the form of increased expenditures, whether for highways or something else, and took the somewhat higher multiplier which I think Senator Douglas is justified in suggesting, whether 3½ or 4; suppose you took 4—4 times 11 would be 44—so you would have 44 as against 24, or almost twice as much stimulus from the same $11 billion.

If you took about 3½ on the 11, you would have about 38 instead of 24, or about 60 percent higher.

Senator GORE. So as a means of stimulating the economy, the kind of tax reduction proposed here is only one-half as effective as a public improvements program, or, to put it another way, one-half the amount expended for worthwhile public improvements would have an equal effect.

Mr. KEYSERLING. Yes, because I just said that I thought that the stimulative effect of this $11 billion in its current form would be about $24 billion. If you undertook a $6 billion increase in outlays, and multiplied it by Senator Douglas' 4, you would get the same 24.

Now we can give or take, but any way you look at it, there is no question about it. And this does not take into account other factors. We are talking only about quantitative stimulus to the economy. In addition, the $6 billion of additional outlays would build things of enduring utilization and utility to the Nation, whereas the random scatteration of somebody buying a freezer 3 months sooner here, and somebody buying a refrigerator 2 months sooner there, may be of lesser value.

Now, I do not want to get into that too much, because I believe in consumer tastes and choices, but nonetheless, I do believe that, with the great gaps we have in our public needs, they have a high order of priority quite aside from the quantitative stimulus.

But I agree with you entirely on your 2-to-1 proposition.

Senator GORE. Then assuming that the country needs this amount of stimulus——

Mr. KEYSERLING. Yes.

Senator GORE. We might have some questions about what segment of the economy needed stimulation, perhaps what areas of the country had greater need for stimulation, but, generally speaking, assuming that the country needs the amount of economic stimulation which is envisioned by this bill, the proposed bill is the most costly and the most inefficient and the most ineffective way to approach it, more costly than the wise use of credit and monetary policy, more costly than a community and public facility improvement program.

Would you agree with that?

Mr. KEYSERLING. I said this morning that, if there had been no tax bill, and I had just been asked as an economist or as a dreamer to sit down and write on a sheet of paper a relatively inefficient, costly, and inequitable way of attempting to stimulating the economy, I might have hit upon something close to this tax bill in its current form.

Senator GORE. I don't know that I can make it much worse than that.

One other point, though. One other point. Suppose that there is an area in America, for example the Appalachian, where, because of automation in the coal mines, because of various economic factors, there is a very high rate of unemployment. Suppose that you have a problem in West Virginia such as was discovered in the last campaign. Now, how does a general tax reduction reach an Appalachian Mountains villiage?

Mr. KEYSERLING. It would take as long as it is taking me to try to convince some people in the administration that they ought to reexamine their ideas in the light of actualities.

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

The CHAIRMAN. Any further questions?

Senator GORE. No.

The CHAIRMAN. Senator Carlson, do you have any questions?

Senator CARLSON. No.

The CHAIRMAN. Thank you very much, Mr. Keyserling.

The next witness is Mark M. Jones, president, National Economic Council.

Glad to see you Mr. Jones.

You may proceed, sir.

STATEMENT OF MARK M. JONES, PRESIDENT, NATIONAL ECONOMIC COUNCIL, INC.

Mr. JONES. Thank, your, Mr. Chairman. I am Mark M. Jones, president of the National Economic Council, 156 Fifth Avenue, New York.

I appear by direction of the board of directors of the council to submit a background point of view that deals more with what we think are fundamentals and not so much with the details of the pending tax bill.

We think that these proceedings might be likened to a bedside conference over a patient with a serious moral sickness. It is a social and economic sickness called inflation.

The precipitating cause of this sickness is Government spending—overspending so long continued as to have become chronic, and pyramided to proportions which suggest a mass madness on a scale without precedent in all history.

It is against such a background that I suggest the consideration of the question which seems to point up the problem most significantly. It is—must the U.S. economy go through the wringer?

Among the more noteworthy features of the present position and the 30-year record from which this question arises are the following:

1. A 36.9-cent dollar. This is on the basis of comparing January 1952 and May 1963, using the index of wholesale prices of the U.S. Bureau of Labor Statistics. It means that the people now must spend about $3 to buy what was a dollar's worth not too long ago.
2. A decaying and declining economy instead of a growing economy. I think it is just going ahead backward. For each step forward so-called, the prospect of two or more steps backward later is being set up. It is mainly a gimmick economy.
3. An alleged prosperity that is not really prosperity. At best it is a false state of seeming well-being resulting from a chronic economic fever caused by piling one synthetic, artificial, and unnatural device on top of another. Now we have a house of cards without precedent and one of the most colossal in all history.
4. Government expenditures for fiscal 1964 are running at an unprecedented annual rate of over $197 billion, Federal, State, and local. Because all Government expenditures are overhead expenses of the national economy, this represents an overhead of more than 50 percent of the real product.
5. A command economy resulting from Government intervention all over the place, with more than 2,000 commissions, boards, bureaus, committees, councils, etc., constantly extending and expanding. All this despite 30 years of experience right in front of people now living which clearly shows that most of such mechanisms really can't work in the public interest in any continuing sense. Our thinking, our policies, and our mechanisms have become saturated, diluted, and weakened by restrictions, restraints, coercion, compulsion, dicouragements, bureaucracy, and redtape.
6. Government subsidies of special privilege to labor monopolies which have upset the division of the product of industry, added to the constraints which the economy must drag along while at the same time impairing the fundamental processes of economic stability and growth.
7. A basic impairment of the dynamic qualities of incentives by overtaxation.
8. A standstill with respect to understanding the role of profits and capitalizing intelligently on the process of capital formation, notwithstanding that the purpose of business is not and never was profit alone, but always has been and still is to render a service at a profit.
9. Ostrich attitudes and policies which flout or disregard the elementary fact that enterprise is the basis of all well-being. This means enterprise in every field. Only rare genius in the exploitation of science and technology and in absorbing the impact of punitive economic illiteracy accounts for the fact that the opportunity is still open to talk about whether the economy is to go through the wringer.

In short, gentlemen, the condition we confront is politicalization of the economy at the expense of productivity.

THE PERTINENT RECORD

Taking a look at the record, it appears that it represents a cause-and-effect cycle which extends back about 30 years. One full generation ought to provide plenty of experience which may serve as raw material for "making a judgment" with respect to the course we have taken.

Particularly is this the case when we consider that in this 30 years, the Federal Government alone has expended one trillion four hundred sixty-one billion dollars, or an average of $50 billion a year for 30 years.

It is important also to remind ourselves that this course marked a departure. It is now clear in retrospect that it involved departure from principles upon which the country was established and upon which it became great. Also in retrospect, it seems evident that the principal causative factors in this departure were in Europe, and date back as far as the late 1890's. Coming to the surface beginning with the early 1930's, these forces became dominant factors in our moral sickness.

Therefore the present position largely summarizes the effects of 30 years of experience. These include departure from our distinctive principles, from our own experience, and from the laws of mathematics. Instead of continuing on with the development of what was only partially developed private capitalism, with which we had made such progress for 145 years, we took off on a tangent which many hoped would be a shortcut to utopia. I understand that when defined, the word "utopia" means not a place, in other words, nowhere. In any event, the result is that we are committed to politicalization of everything from thought to a debt burden that is to be passed on to our great great grandchildren.

NOTEWORTHY FALLACIES

This departure, beginning in the early 1930's, was especially significant because it was predicated on a profound mistake. This was the assumption that it is possible to capitalize upon science and technology and to integrate their values and benefits into a great society without utilizing scientific means.

In other words, the question of means was regarded as just a political matter to be treated with the absolute magic implicit in government and law. Just a matter of power and who had it.

Under such conditions, one fallacy after another became popular. From the standpoint of our moral sickness some which seems noteworthy in relation to the matters before the committee are as follows:

1. The fallacy that people and mass psychology can be factored, put into an equation, ground through a computer, and, like robots, will start, stop, eat, drink, sleep, and otherwise conform to a microwave impulse when a button is pushed in Washington or New York.

2. The fallacy that government enterprise can be something separate and distinct from private enterprise, that it can be superior to private enterprise, and that it can be regarded as an alternative to private enterprise. In 1963 semantics, we hear that there is a public sector in contrast with a private sector, that the two can be significantly differentiated, and that there is an opportunity for a choice between them as the basis for protecting and advancing the scale of living of the people.

3. The fallacy that socialism and communism are or can be alternatives to private capitalism when actually they merely represent

lower orders of economic patterns into which a society sinks if a full going-concern economy is not maintained.

4. The fallacy that the U.S. economy can be managed from one place, notwithstanding that the affairs of 188 million people spread over 3 million square miles of land surface involve a task too big and too complicated for any superman to comprehend or any system to control.

5. The fallacy that the Washington Frankenstein makes sense, when we have 30 years of experience to show that it is just a house of cards that can't really work in the public interest in any continuing sense, and probably will collapse and bury all of us unless we start soon to take it down.

6. The fallacy that we never had it so good and that this seeming prosperity is real prosperity which can be maintained indefinitely even though it is just red-ink prosperity which depends on fabulous overspending for present consumption and an immoral evasion of payment of its cost by those supposedly enjoying its benefits.

7. The fallacy, or should one say the wishful thinking, that there will not be a day of reckoning and it will not be necessary to resume a rational course at any foreseeable time and that skillful improvisation and thought control will enable those responsible to escape before the house of cards they are juggling comes "bumbling" down.

THE REVENUE ACT OF 1963

There is much more to be said in order adequately to round out the background of our moral sickness. However, I believe the foregoing should be sufficient to indicate that more is involved in consideration of the Revenue Act of 1963 than meets the eye.

Normally and under conditions recently prevailing, almost any reasonable person would favor a cut in taxes. There usually is one good thing about high taxes. It is that they can be cut. However, to cut taxes under normal conditions is one thing. Cutting them under the present synthetic, artificial, and inflationary conditions is another. To cut taxes for the benefit of the people and the economy and to cut them for the purposes of continued politicalization of the country are radically different objectives.

The fact is that if the Federal system ever did have what might be called financial responsibility, it largely has been lost during this departure of the past generation. Apparently, there is no early prospect of setting up a budget system that is sound and will work. If this is true, the one most important thing to do is not to give the spenders the money to spend. This, of course, would include a stop on borrowing.

Included in the more-than-meets-the-eye category also is the trumped up issue of whether to stimulate investment and employment by measures which might build up what is called the public sector, or to do it in a way that will build up the private sector. That this issue should exist, after a whole generation of experience which indicates that the differentiation is a fallacy, is one more example of how the force of government can be perverted by a few.

From the standpoint of the public interest, and notwithstanding the fantasies of the intellectual elite, the record clearly shows that what is called the private sector is more efficient, regardless of its weaknesses, and that it has a fabulous potential which must be allowed to develop if we are to sustain and increase the scale of living of the people.

On the other hand, the record clearly shows that what is called the public sector is the real problem child. It is far behind with respect to efficiency, and the larger it becomes, the less efficiency it delivers. If there were some formula for the calculation of waste in one sector versus the other, the contrast would be shocking. Moreover, in the public sector wastes accumulate and feed the continuing economic fever and the illusion of false prosperity resulting from inflation.

Worthy of special emphasis is the fact that if big spending is truly due to a desire for pump priming, it must be used only sparingly. A look at the record would cause one to wonder if those in control of the United States ever saw or heard of a pump. There also is the question of how we will be able to finance a depression in the future if we do not pay back our debt.

WITH RESPECT TO THE FUTURE

From the standpoint of protecting and extending the scale of living of the people it would seem logical to begin with consideration of the accumulated consequences of what has happened and not happened financially during the past generation. It is my understanding that estimates to this end indicate that addition of the public and private debt to public and private accrued liabilities, established pursuant to law, shows that we have piled up for the future about $1,750 billion in obligations that must be paid some time. Most of the additions (or so-called gains) that we thing we have made probably will end up as subtractions from the future, plus penalties. There is no reason to believe that the chickens won't come home to roost. The question is: When, and whether intelligence can influence their arrival?

This brings me back to the question with which I started, and that is: Must the U.S. economy go through the wringer? Having destroyed two-thirds of the value of our money, two-thirds of the value of life insurance, and two-thirds of the value of accumulated savings, are we going to continue along lines which obviously will destroy the remaining third?

Perhaps the most significant feature of these proceedings is the choice which they pose to all of us. It is a choice between continuing on with the departure into which we were misled in the early 1930's, or making a change in course and starting in the direction of a self-renewing economy. It is a condition, not a theory, which confronts us. The way to resume is to resume. Politicalization must stop. The time has come to quit beating around the bush and to meet the problem squarely with a sound method of placing a statutory limit on annual expenditures.

Then, gentlemen, someone ought to get busy on devising measures which will stop the degeneration, release the vast potential of our people, and begin to restore some of the value of our money which has been lost.

That there are forces which can paralyze a veritable giant in one generation, and that an open economy could be superseded by a command economy, as has been the effect of the politicalization of the United States would be incredible if not a fact. But there is still hope. Despite such a prodigious setback, we can still work our way out. We really do have instruments for use to such an end that were not available in any previous civilization.

The intellectual elite will not believe it or like it, but private enterprise and the private sector will take up the slack and lead us in the right direction if given the chance. However, the beginning must be a firm assurance by the Congress that it will maintain its constitutional position and responsibility, restore the executive branch to its proper functions, and stay with sound policies of Federal spending, reducing taxation, and paying off the debt.

Thank you.

The CHAIRMAN. Thank you very much.

Senator CARLSON. Mr. Chairman, just one comment, or question, at least.

Mr. Jones, you are one witness that has called the attention of the committee to the dangers of inflation. I discussed that at some—I was going to say at some length, but not at great length. I brought it up when the Secretary was present, Mr. Dillon, in which I mentioned the fact that prices are increasing and it looks like we might be at the beginning of another inflationary binge or drive and what I thought might have some bad effects.

Now, I believe we have had some history to base these inflations on in Europe during the last century. I believe we had one in Russia, one in Germany, and I think probably the most recent one was in France.

Do you have any comments on those before you conclude?

Mr. JONES. Well, with respect to the German one, I would read two short paragraphs from Shirer's book on the "Rise of Hitler." These two paragraphs were in the Reader's Digest of March 1962:

The strangulation of Germany's economy hastened the final plunge of the mark.

Notice the word "strangulation."

On the occupation of the country by the Allies, it fell to 18,000 to the dollar. By July 1923, it had dropped to 160,000; by August 1 to a million; by November, when Hitler's party had struck, it took a billion marks to buy a dollar. Thereafter, the figures became trillions.

German currency had become utterly worthless. The life savings of the middle and working classes were wiped out. But something even more important was destroyed, the faith of the people in the economic structure of German society.

What good were the standards and practices of such a society which encouraged savings and investment and solemnly promised a safe return and then defaulted? Was this not a fraud upon the people?

In the case of France I would point out that the great French inflation started in August 1914. This was supposed to have come to an end in December 1959. At that time, they said that they had stabilized the franc. When they stabilized it, they did so at a value which was about four-tenths of 1 percent of its value in 1914.

In other words, in 44½ years, they destroyed 99.6 percent of the value of their money.

The extraordinary feature of this 44.5 year French inflation was the fact that at its crucial stage after World War II, there was little or no resistance to it. According to the study made by an eminent authority on such matters, Melchior Palyit, the French creeping inflation was kept going by the following:

> (1) A system of exorbitant taxation with its burden distributed in a highly unjust fashion; (2) by governmental deficits, with the double effect of preempting the capital market and monetizing huge portions of the national debt; (3) by the nationalized central bank pouring out rediscount credit as well as 5-year "construction" credits, the latter totaling 574 billion francs; this on top of direct loans to the Government; (4) by squandering the billions of American aid and their counterpart funds; (5) by incurring foreign debts of well over a billion dollars; (6) by debauching the currency to the tune of several trillion francs; (7) by a vast expansion of a bank credit to industry, commerce, farmers, and consumers; (8) by dissipating the $6 billion gold reserve of the Bank of France; (9) by virtually wiping out at least 30 billion gold dollars' worth of liquid savings of the French people.

Thus, after 44.5 years, the franc was worth but one two-hundredth of what it was worth in 1914.

Now, I have one other example, and that is China, where Time had an article that was very impressive. It said:

> Red China this winter was like a ravenous giant. From the snowy plains of Manchuria to the humid mountains of Yunnan, to the dimly lit neon waterfront of Shanghai, there was only one absorbing subject—food.

Thank you.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Jones.

You have made a very interesting statement.

Senator DOUGLAS. Mr. Jones, how long have you been president of the National Economic Council?

Mr. JONES. About 6 months.

Senator DOUGLAS. Who was president before you?

Mr. JONES. Merwin K. Hart. He died November 30, 1962.

Senator DOUGLAS. Thank you.

The CHAIRMAN. Thank you very much.

Next witness is Mr. Robert A. Gilbert, of Intercontinental Research & Analysis Co.

Mr. Gilbert.

STATEMENT OF ROBERT A. GILBERT, MANAGING DIRECTOR, INTERCONTINENTAL RESEARCH & ANALYSIS CO., NEW YORK CITY

Mr. GILBERT. My name is Robert A. Gilbert. I am managing director of the Intercontinental Research & Analysis Co. with offices at 19 Rector Street, New York City.

My company specializes in research on international investment trends. I also happen to be chairman of the International Investment Division of the Investors League, Inc., with offices at 234 Fifth Avenue, New York City. I am accompanied here today by Mr. Russell P. Moore, my counsel.

Mr. Chairman and members of the Senate Finance Committee; I would like to draw your attention to a number of international comparisons which have a direct bearing on the question of whether is is good for the United States to pass H.R. 8363.

In calling your attention to these very important facts I wish to say that I have been considering the bill as a whole in its effects upon our economy rather than any specific features of it.

While there may be some sections that seem to have merit, the international position of the United States is much more likely to be affected by the cost of the total legislation rather than any one of its features. It is the tremendous cost of H.R. 8363 not only in money but also in our reputation as a nation willing to join without much thought the ranks of those risking fiscal folly—it is this cost in all its aspects that makes the proposal seem a very bad step for our country.

Behind this legislation is the theory that enormous Federal deficits are not really important. One has only to look abroad to see that Mr. Kennedy's theory of spending oneself rich is not new to his administration, but has been tried time and again by other countries only to fail miserably.

It seems to me that your committee must take into account the proven experience of others who have played with Keynesian theories of deficit financing. One of the outstanding examples of the fallacies of the Kennedy-Keynes theories that a deficit now can create enough economic activity to balance the budget later is that of France.

You have just heard something about that. May I embellish it further?

On September 27, the leading French financial paper, La Vie Francaise, published a study of the deficit trends in France since 1945. The table below shows the amount of the annual deficits in terms of percentages of receipts:

	Percent		Percent		Percent
1945	52.0	1952	21.0	1959	9.0
1946	16.0	1953	18.3	1960	9.4
1947	1.3	1954	9.3	1961	7.7
1948	[1] 2.8	1955	12.8	1962	7.8
1949	[1] 19.6	1956	16.4	1963	8.1
1950	11.8	1957	11.5	1964	[2] 5.1
1951	13.6	1958	4.5		

[1] Surplus.
[2] Estimated.

The surpluses occurred in 1948 and 1949. If deficit spending ever produced a surplus or even a balanced budget, France by now should have the best balanced budget in the world, because it has had such a long series of deficits.

In 1964, they expect another deficit.

You can plainly see that one deficit only led to another deficit. Now what was the effect of all this pump priming on the average Frenchman? The cost of living index in France in 1948 was 60. In 1962 it averaged 144 so that Government, as it turns out, has merely fooled the people.

The next table is a comparison of 11 nations and the United States with reference to their accumulations of debts since 1950 and the courses of the costs of living. It will be noted that in no nation did an increase of debt result in lower priecs. In fact, even among the thrifty nations, such as the Netherlands, Portugal, and Switzerland there were some advances in prices, but where debt accumulation was not restrained these advances assumed painful proportions.

In view of this evidence we can only conclude that it is very foolish for the United States to assume that it can have a stable economy without some attempt to balance the budget fairly closely. We have already shown, you know, that the new deficit to be incurred will not lead to a more closely balanced budget.

In the table in my prepared statement, of the six nations with increases in cost of living of over 50 percent; that is, Australia, France, Ireland, Spain, Sweden, and the United Kingdom, in none of them did an increase in debt result in lower prices.

In view of this evidence it seems foolish to assume we can have a stable economy without some attempt to balance the budget very closely.

We have already shown, you know, that new deficits in France incurred only more deficits later rather than a balanced budget.

Internationally the position of the United States must be said to appear clearly to be one of stagnation. As the next comparison shows our gain in industrial production since 1953 is the least of any of the large developed nations. At the same time we have the highest debt per capita and we pay far the highest hourly wages.

If you look at this table, you can see our industrial production is up 30 percent, but it is lower than any of the others, which range from 31 up to 274 percent. We are in competition with nations paying 81 cents an hour average wages—we pay $2.39—and having an average debt of 49 percent of their national income.

Ours is 68 percent.

If, from the nations that I have compared the United States with, we eliminate the United Kingdom, which has a particularly difficult situation on its debt, we find that we are up against average wages of 78 cents an hour compared to our $2.39 and an average debt of 39 percent compared to our 68 percent.

The high costs in the United States have built-in defenses instead of free market machinery to adjust them to competitive levels. And the higher we push the debt the more difficult it is going to be to control these costs.

The United States is now vulnerable in international trade yet it is being tempted by very powerful forces to jump into an inflationary spiral, thus compounding its vulnerability.

Our exports in 1962 $21.6 billion or only slightly more than those of 1957 which were $20.8 billion. In these same years the total exports of the world rose from $100 to $124.4 billion—a gain of about 24 percent.

The exports of Western Europe rose from $41.8 to $58.4 billion, a gain of fully 39 percent. In the Orient, Japanese exports rose from $2.8 to $4.9 billion, a gain of 75 percent.

If we now throw caution to the winds and raise our high costs even higher by destroying the purchasing power of the dollar, we shall begin to look with reference to the rest of the world somewhat the way France appears in comparison with West Germany. As you know, the West Germans have adhered to sound enterprising economic policy with the result that their currency has actually gone up 4.7 percent in value in recent years while during the same time the franc went down over 17 percent. Both nations have about the same population but in many basic industries France remains about half the size of Germany and, this is the most interesting point of comparions, seems unable to catch up.

While most considerations of the effect of tax policies on our balance-of-payment problem seem to turn around the administration's idea that an equalization tax on foreign investing will be helpful, actually the passage of H.R. 8363 will do far more damage to our dollar reserves than any credits the equalization tax would possibly produce, if indeed it produces any.

Over a period of time the currency of a nation can only be supported in international banking transactions if there is some interest by its government in not diluting this currency.

Not to bore you with another table, I am sure you all know the course of the French franc which is now only about 4 percent of its value 15 years ago. As you have heard before, it is a lower percentage.

To prove the same thing by an opposite example, the Swiss franc is the only currency in the world now worth more than it was in 1929 in terms of the dollar, and this nation you will note from our preceding table has in recent years reduced its debt by 30 percent, more than any other developed country has done.

One might assume that conditions in Switzerland must be very terrible in view of the fact that they have not had the commonsense to unbalance their Federal budget as often as possible. Actually the Swiss are extremely prosperous. Instead of our nagging unemployment problem there is negative unemployment in Switzerland. At the end of 1962 there were only 600 people out of work in Switzerland—so small a number that the percentage cannot be figured and there were job openings for more than that number. Thus the Swiss now import workers from adjoining countries, such persons amounting to fully 25 percent of the labor force at a recent date. The national income of the country rose from 20.7 billion francs in 1953 to 39.4 billion francs in 1962, an increase of 90 percent. During the same years our national income rose by 34 percent.

The Swiss have been concerned about their debt. In fact, their present attitude seems to closely resemble the one we had in the 1920's. We were worried then about the total debt of $25 billion. Today we give practically no thought at all to the meaning of a debt of $309 billion. In 1924 Lenin said—this is a direct quote:

> We shall force the United States to spend itself to destruction.

We did not take him seriously until a few years later when we recognized the Soviet and then this very same idea somehow seems to have come into vogue in Washington fiscal circles.

Fiscally speaking, we are in a Red channel—we are burying ourselves under a mountain of debt, assuring our bankruptcy and making it unnecessary for the Communists to fire a shot to change our system.

We must change back to our original principles to assure our prestige abroad. We must treat capital fairly in the United States to set an example to the rest of the world of what capitalism really means.

We must stop telling the rest of the world that we will defend to the death the trends toward higher and higher costs and debts. Let us tell the world something different, and tell it soon.

(The complete prepared statement of R. A. Gilbert is as follows:)

STATEMENT BY INTERCONTINENTAL RESEARCH & ANALYSIS CO.

My name is Robert A. Gilbert. I am managing director of the Intercontinental Research & Analysis Co. with offices at 19 Rector Street, New York City. My company specializes in research on international investment trends. I also happen to be chairman of the International Investment Division of the Investors League, Inc., with offices at 234 Fifth Avenue, New York City. I am accompanied here today by Mr. Russell F. Moore, my counsel.

Mr. Chairman and members of the Senate Finance Committee, I would like to draw your attention to a number of international comparisons which have a direct bearing on the question of whether it is good for the United States of America to pass H.R. 8363. In calling your attention to these very pertinent facts, I wish to say that I have been considering the bill as a whole in its effects upon our economy rather than any specific features of it. While there may be some sections that seem to have merit, the international position of the United States is much more likely to be affected by the cost of the total legislation rather than any one of its features. It is the tremendous cost of H.R. 8363 not only in money but also in our reputation as a nation willing to join without much thought the ranks of those risking fiscal folly—it is this cost in all its aspects that makes the proposal seem a very bad step for our country.

Behind this legislation is the theory that enormous Federal deficits are not really important. One has only to look abroad to see that Mr. Kennedy's theory of spending oneself rich is not new to his administration, but has been tried time and again by other countries only to fail miserably. It seems to me that your committee must take into account the proven experience of others who have played with Keynesian theories of deficit financing. One of the outstanding examples of the fallacies of the Kennedy-Keynes theories that a deficit now can create enough economic activity to balance the budget later is that of France. On September 27 the leading French financial paper, La Vie Francaise, published a study of the deficit trends in France since 1945. The table below shows the amount of the annual deficits in terms of percentages of receipts:

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The next table is a comparison of 11 nations and the United States with reference to their accumuations of debts since 1950 and the courses of the costs of living. It will be noted that in no nation did an increase of debt result in lower prices. In fact, even among the thrifty nations, such as the Netherlands, Portugal, and Switzerland there were some advances in prices, but where debt accumulation was not restrained these advances assumed painful proportions. In view of this evidence we can only conclude that it is very foolish for the United States to assume that it can have a stable economy without some attempt to balance the budget fairly closely. We have already shown, you know, that the new deficit to be incurred will not lead to a more closely balanced budget.

	Debt [1]		Percent increase	Cost of living		Percent increase
	1950	Recent		1950	Recent	
Australia	A£2, 285	A£2, 987	+30	68	125	+83
Belgium-Luxembourg	BF220, 000	BF326, 300	+48	91	113	+24
Canada	Can$14, 632	Can$18, 778	+28	89	113	+26
France	Fr41, 330	Fr111, 220	+169	77	144	+87
Ireland	£148	£531	+259	81	126	+54
Netherlands	f20, 900	f19, 400	−7	[2] 100	128	+28
Portugal	Esc9, 390	Esc10, 890	+16	100	119	+19
Spain	Pts90, 900	[3] Pts199, 400	+119	92	158	+71
Sweden	SKr12, 357	SKr19, 531	+58	79	142	+80
Switzerland	Sw F7. 7	Sw F5. 4	−30	94	115	+22
United Kingdom	£25, 600	£28, 600	+12	81	129	+59
United States of America	$257	[4] $298	+16	90	113	+25

[1] Millions.
[2] 1952.
[3] Latest, but not recent.
[4] At a time comparable to other debt figures shown.

Internationally the position of the United States must be said to appear clearly to be one of stagnation. As the next comparison shows our gain in industrial production since 1953 is the least of any of the large developed nations. At the same time we have the highest debt per capita and we pay by far the highest hourly wages:

	Percent gain in industrial production [1]	Debt [2]		Average hourly wages [3]
		Per capita	Percent of national income	
United States	30	$1, 574	68	$2. 39
United Kingdom	31	1, 492	130	. 98
France	92	375	33	. 49
West Germany	99	179	16	. 88
Belgium	43	443	75	. 52
Italy	122	790	34	. 40
Netherlands	65	456	45	. 56
Canada	44	1, 173	76	1 88
Australia	67	335	26	1. 30
Japan	274	30	8	. 31

[1] Total since 1953.
[2] Most recent comparable figures.
[3] 1962 average for manufacturing.

The high costs in the United States have built-in defenses instead of free market machinery to adjust them to competitive levels. And the higher we push the debt the more difficult it is going to be to control these costs. The United States is now vulnerable in international trade, yet it is being tempted by very powerful forces to jump into an inflationary spiral, thus compounding its vulnerability. Our exports in 1962 were $21.6 billion or only slightly more than those of 1957 which were $20.8 billion. In these same years the total exports of the world rose from $100 to $124.4 billion—a gain of about 24 percent. The exports of Western Europe rose from $41.8 to $58.4 billion, a gain of fully 39 percent. In the Orient, Japanese exports rose from $2.8 to $4.9 billion, a gain of 75 percent. If we now throw caution to the winds and raise our high costs even higher by destroying the purchasing power of the dollar, we shall begin to look with reference to the rest of the world somewhat the way France appears in comparison with West Germany. As you know, the West Germans have adhered to sound enterprising economic policy with the result that their currency has actually gone up 4.7 percent in value in recent years while during the same time the franc went down over 17 percent. Both nations have about the same population but in many basic industries France remains about half the size of Germany and, this is the most interesting point of the comparison, seems unable to catch up.

While most considerations of the effect of tax policies on our balance-of-payment problem seem to turn around the administration's idea that an equalization tax on foreign investing will be helpful, actually the passage of H.R. 8363 will do far more damage to our dollar reserves than any credits the equalization tax would possibly produce, if indeed it produces any. Over a period of time the currency of a nation can only be supported in international banking transactions if there is some interest by its government in not diluting this currency.

Not to bore you with another table, I am sure you all know the course of the French franc which is now only about 4 percent of its value 15 years ago. To prove the same thing by an opposite example, the Swiss franc is the only currency in the world now worth more than it was in 1929, in terms of the dollar, and this nation, you will note from our preceding table, has, in recent years, reduced its debt by 30 percent, more than any other developed country has done. One might assume that conditions in Switzerland must be very terrible in view of the fact that they have not had the commonsense to unbalance their Federal budget as often as possible. Actually, the Swiss are extremely prosperous. Instead of our nagging unemployment problem there is negative unemployment in Switzerland. At the end of 1962 there were only 600 people out of work in Switzerland—so small a number that the percentage cannot be figured and there were job openings for more than that number. Thus, the Swiss now import workers from adjoining countries, such persons amounting to fully 25 percent of the labor force at a recent date. The national income of the country rose from 20.7 billion francs in 1953 to 39.4 billion francs in 1962, an increase of 90 percent. During the same years our national income rose by 34 percent.

The Swiss have been concerned about their debt. In fact, their present attitude seems to closely resemble the one we had in the 1920's. We were worried then about the total debt of $25 billion. Today we give practically no thought at all to the meaning of a debt of $309 billion. In 1924 Lenin said—this is a direct quote—"We shall force the United States to spend itself to destruction." We did not take him seriously until a few years later when we recognized the Soviet and then this very same idea somehow seems to have come into vogue in Washington fiscal circles. Fiscally speaking, we are in a Red channel—we are burying ourselves under a mountain of debt, assuring our bankruptcy and making it unnecessary for the Communists to fire a shot to change our system. We must change back to our original principles to assure our prestige abroad. We must treat capital fairly in the United States to set an example to the rest of the world of what capitalism really means. We must stop telling the rest of the world that we will defend to the death the trends toward higher and higher costs and debts. Let us tell the world something different, and tell it soon.

Mr. GILBERT. May I supplement my statement with something else that I would like to say in view of some of the testimony that has taken place in the last few days?

This is very brief.

I would like to comment on the recent statement from the Office of Secretary of the Treasury, Mr. Dillon, that we shall have bigger deficits if we do not cut taxes by means of a deficit at the present time. This statement places the logic of the Treasury's thinking in a rather peculiar posture in the eyes of the world.

The Secretary of the Treasury says he will simply not listen to suggestions for thrift, to appeals for good government housekeeping, that we must have loose control of expenses, that we will never study with equal interest plans to pare the budget in the same way that we dream up plans to spend more and more for less and less; that we must always have deficits of one kind or another and that we only have a Hobson's choice of two bad fates—large or larger inflation.

What a blow to international confidence in the American dollar.

I would also like to comment on the oft repeated assertion that the debt is getting lighter in terms of the gross national product. One cannot tell about these correlations over a short period of time. The paper money created by the Keynesian theories may well be dormant over a time but eventually this excess of dollars in relation to goods will have its inflationary impact. To illustrate the folly, the absolute impossibility of trying to spend oneself rich, let me point out that in 1925 the gross national product of the United States was $90.3 billion, a little less than one-sixth of the estimated figure for 1963.

However, in 1925, the Federal debt was $25 billion or less than one-fifteenth of what is today.

The debt accumulation over these years has not produced an equivalent percentage increment in gross national product. In effect, the burden of the debt has inevitably increased.

The CHAIRMAN. Thank you very much, Mr. Gilbert.

You have made a very good contribution.

Senator DOUGLAS. May I ask you some questions about your tables? I want to thank you for your tables.

Mr. GILBERT. Yes.

Senator DOUGLAS. You show an increase in the national debt of the United States since 1950 by 16 percent. This is slightly greater than the increase of debt in the United Kingdom, just the same as the increase in debt in Portugal. Switzerland and the Netherlands had an actual decrease. It is less, however, than the increase in debt of Australia, is it not, which is 30 percent?

Mr. GILBERT. Yes.

Senator DOUGLAS. Belgium-Luxembourg, which is 48 percent.

Mr. GILBERT. That is true, but——

Senator DOUGLAS. Canada, which is 28 percent; France, 169 percent; Ireland, 259 percent; and Spain, 119 percent.

Now, of these countries, Portugal is virtually outside the defense system of the free world, making very little contribution to it. The contribution of the Netherlands is not large. Switzerland has abandoned or never had any responsibility under the system of collective security.

Is that not true?

And Canada has not felt any real obligation to take part in collective security.

Mr. GILBERT. I am under the impression that Canadians do allocate something.

Senator DOUGLAS. But the percentage of men under arms and the percentage of gross national product devoted to defense in Canada is relatively slight compared to the United States, where we are contributing about 10 percent of the gross national product for defense.

And the average in all these countries, even including those in NATO, is less than 5 percent. So we bear twice the relative burden of these other countries.

Now, similarly, on the increase in cost of living, the increase of 25 percent——

Mr. GILBERT. May I say something on defense?

United Kingdom, of course, has a substantial defense budget.

Senator DOUGLAS. Yes; but not as great as ours.

Mr. GILBERT. Well, their percentage of gross national product is almost as much as ours.

Senator DOUGLAS. I think it is about 7 percent.

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Mr. GILBERT. The last time I figured ours, it was not too far from that.

Senator DOUGLAS. If you take the cost-of-living increase, the American figure of 25 percent is about the same as the Belgium-Luxembourg 24 and the Canadian figure of 26 and is in excess of the Portugal figure of 19, slightly in excess of the Swiss figure of 22, but much less than the United Kingdom figure of 59, the Spanish figure of 71 percent, the Swedish figure of 80 percent, the Australian figure of 83 percent, the French figure of 87 percent, and the Irish figure of 54 percent.

Isn't that true?

Mr. GILBERT. Yes.

With reference to this table, may I ask, if I may, why you are going over these figures? Do you think that the correlations are not exact at this time?

Of course, they work out very gradually over a period of time and I thought the United States was on the verge of a very dangerous inflation.

The fact that we have not yet had similar increases in the cost of living has little bearing on what is going to happen in the future if we really pile up mountainous deficits from now on.

Senator DOUGLAS. Well, the general implication of your statement is that in comparison with other countries, we are going to hell in a handbasket, so to speak.

Mr. GILBERT. I didn't mean that.

Senator DOUGLAS. I simply wanted to introduce these figures to indicate that the percentage of the increase in the debt had been less in the United States than in most industrial countries and the increase in cost of living less and that this has largely occurred in face of the fact that we have borne a very heavy burden of defense.

Mr. GILBERT. Well, the fact that the money is spent even for a good cause like defense has little bearing on its effect on the economy.

Senator DOUGLAS. Are you proposing that we reduce defense spending?

Mr. GILBERT. No sir; I am suggesting a defense in the economic field before we do what Lenin says and spend ourselves into nothing.

I do not think defense is military entirely.

Senator DOUGLAS. I will simply remark on the table. These figures are on debt per capita rather than debt as a percentage of gross national product.

You will find if you take debt as a percentage of gross national product that whereas in 1946, the ratio was roughly $270 billion of debt to $220 billion of gross national product, there is a ratio of 130 to 100, that now it is a figure of $306 billion debt to $587 billion gross national product, or about 52 percent, or the ratio of the debt to the gross national product has fallen, taking 100 as the bench mark, from 130 to just a little over 50. So it is easy to be pessimistic, Mr. Gilbert, but it is also important to have one's comparisons appropriate.

Mr. GILBERT. Well, I think that you have chosen just one year, which is a peculiar year, after the war; and I certainly would not want to base an economic forecast on a 1946 comparison with the debt.

It is sort of irrelevant.

Actually, before I prepared this testimony, I compared every year since 1900, debt to gross product. That is why at the end of this statement, I made a little reference to what had happened since 1925.

Senator DOUGLAS. If you want to take as a basis for comparison when Truman left office, the debt was $267 billion. It increased to $287 billion in the 8 years that President Eisenhower was in. It has since increased to $306 billion.

So there has been an increase of roughly $40 billion during the 11 years. But that is an increase of one-sixth, a little less than one-sixth, about 15 percent.

But during that time, the gross national product has increased enormously.

Do we have an Economic Indicators here?

If so, could I get the last copy? I have it here.

Thank you very much.

Gross national product listed on page 2 of the September Economic Indicators, which is the most recent one, in 1952, the total gross national product in terms of constant prices, 1962 prices, was $413—$414 billion.

The second quarter of 1963, $571.6 billion and the press announcement of yesterday made the figure $587 billion, or the increase has been from $414 to $587 billion, or an increase of $173 billion, which in turn is slightly over 40 percent, whereas, according to your figures—according to reality, the national debt has increased from $267 to $306 billion, or by about 16 percent.

So we have been gaining ground in the last 12 years.

It is very easy, Mr. Gilbert, to pick out figures which give a distorted appearence of calamity and the net effect is to cast disrepute on what has happened, unjust disrepute, and to contribute to an ill-based feeling of economic sickness.

Mr. GILBERT. Well, Senator, I suppose you are aware of the fact that the OECD, which is the European Economic Association, does not figure gross national product in the manner in which we do. They figure that our real gross national product is about $80 billion less.

Senator DOUGLAS. They are speaking of national income.

Mr. GILBERT. No, sir; this is gross national product at factor cost. National income is something less.

I have figured my table on national income rather than gross product. This is one reason why I did it.

Then again, the Federal Reserve Bulletin recently published an article criticizing the method of computing the gross national product.

Senator DOUGLAS. If anything, it understates the gross national product, because it does not take into account quality changes.

But let's take that figure. The figures on national income are given on page 3 of Economic Indicators, if you will look at the tables. It is the first column on page 3. This gives a figure of total national income for 1952 of $292 billion and a second quarter of 1963 as $474.6 billion—really $475 billion. That is an increase of $183 billion, which is an increase of over 60 percent as compared to a 16-percent increase in debt.

So that even as—so that the decrease in the ratio of the national debt to the national income is even greater than the decrease in the ratio of the national debt to the gross national product.

Now, you may not want to believe those figures, but they seem to be accurate.

Mr. GILBERT. I am quite sure they are accurate but I think they have taken a limited period of time and I do not think they vitiate economic law.

Senator DOUGLAS. If you go back to 1946, it will be even more marked. In 1946, as I remember, the national income was just around $200 billion. Then the debt was $260 billion—that is 130 percent. When it was $270 billion the ratio of debt was 135 to 100. Now, it is only 132 to 100.

Mr. GILBERT. If you wish to hang the argument on that 10-year period, will you allow me another one?

Let us take 1930–40. Did we gain by the debt accumulation then?

Senator DOUGLAS. What happened was we had a great world war in which the liberties of all of us were at stake and which necessarily involved not only the loss of life and the loss of blood that some of us experienced, but also the expenditure of money.

If you think that we should not have defended ourselves against Hitler and Mussolini, I suppose you are entitled to that opinion.

Mr. GILBERT. Do you have the right to read that sort of interpretation into my statement? I was never for Hitler. I was not for Stalin.

Senator DOUGLAS. I did not mean that. I simply said that the primary debt was incurred as a result of the war.

Mr. GILBERT. Between 1930 and 1936, there was no war.

Senator DOUGLAS. No; we then had 18 million unemployed.

Mr. GILBERT. Why?

Senator DOUGLAS. Well, it is quite a story. We could talk for a long time this afternoon. But whatever the reason may have been, we had those conditions and we determined to try to save them from starvation and to try to furnish as much work as we could for them.

Now, a great many people differ on that, but I think if this had not been done, we would have had millions of people starving and probably we would have had a revolution inside the country.

Mr. GILBERT. Well, I thought we had just discussed revolutions in terms of inflation of the currency and I fail to see where these debt incurments are going to lead us any place in the United States.

Senator DOUGLAS. I am not arguing for the deficits, but I say these gloomy figures you produce to justify your opinion that we are going to the economic devil are loosely based, that in comparison with other great industrial countries, we have been doing quite well. But in comparison with the product of the country, the debt has been diminishing, governmental expenditures are just about a constant fraction of the gross national product, around 17 percent.

There has been a very slight decrease, but no real increase.

And you have to take these things into comparison with the world around us and what has been happening to our country itself.

I say this with all charity, but I think that these facts, and they are facts, should also be entered into the record.

Mr. GILBERT. I appreciate your mentioning these things and may I make a suggestion to your committee?

Senator DOUGLAS. Surely.

Mr. GILBERT. I suggest you do some research on the background of gross national product. A great many people think now these figures are fictitious and not real and such sums do not exist.

You can find the U.S. gross national product calculated by this European organization each year and it is quite different from ours.

Senator DOUGLAS. We have a Subcommittee on Statistics of the Joint Economic Committee that has been going into this. As I read the Federal Reserve Board figures, they feel the figures tend to minimize growth because they do not take into account improvements in quality, nor did they measure sufficiently and quickly enough the new and growing industries, and new and growing plants, which develop before reporting can catch up to them. So as far as the Federal Reserve Board is concerned, they tend to say that the present figures minimize growth and maximize price increase.

That is the point, maximize price increase. Because some of what is regarded as an increase in price is an improvement in quality.

The CHAIRMAN. Thank you very much, Mr. Gilbert.

The committee is adjourned until 10 o'clock tomorrow morning.

(Whereupon, at 4:45 p.m., the committee recessed, to reconvene Wednesday, October 23, 1963, at 10 a.m.)

REVENUE ACT OF 1963

WEDNESDAY, OCTOBER 23, 1963

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

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, Douglas, Gore, Talmadge, Ribicoff, Williams, Carlson, Bennett, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The first witness this morning is Dan Throop Smith, professor of finance of Harvard Graduate School of Business Administration.

Mr. Smith, you have been before this committee many times. I am glad to welcome you here again, sir.

STATEMENT OF DAN THROOP SMITH, PROFESSOR OF FINANCE, HARVARD GRADUATE SCHOOL OF BUSINESS ADMINISTRATION

Mr. SMITH. Thank you, Mr. Chairman.

I recall earlier sessions with this committee with very great pleasure. I appreciate the opportunity to appear before you again.

The tax bill before you, though it contains several good features, seems on balance to be a bad piece of legislation. In the absence of more determined control of expenditures than we have seen thus far, the loss of revenue from the tax reduction bill would be likely to involve the country in continuing deficits for many years. According to some responsible estimates, the budget would not be balanced for another decade. Even though one might not favor an absolute reduction in expenditures or an increase in tax rates to overcome the existing deficit, a deliberate increase of a large existing deficit in relatively good times, with a prospect of continuing deficits for a long period seems foolhardy. The country cannot afford economic experiments which are almost certain at some time or other to weaken confidence in the dollar, both internally and externally.

Section 1 contains an admirable statement of policy regarding control of expenditures. But even the best statement of congressional policy is not sufficient to assure restraint in actual expenditures. When tax reduction is proposed by the administration as an alternative to an increase in expenditures, one can only infer that deficit spending is the principal objective. This was the policy which was tried and presumably discredited in the 1930's when after almost a decade of deficits we had over 10 million unemployed just before World War II.

A reduction in taxes with a large existing deficit is less bad than an increase in expenditures under the same conditions. But in either case there is an increase in a large existing deficit to be financed by borrowed funds. Therein lies the error in policy and the danger.

No statement of intent regarding expenditure control can be an adequate safeguard under existing conditions. Tax reduction should not be adopted until there is evidence of accomplishment in control of expenditures.

Advocates of tax reduction cite the increase in revenues following the tax reduction in 1954 as evidence that tax reductions will actually speed the restoration of a balanced budget. But they invariably fail to note the even more important fact that expenditures were reduced by $10 billion from fiscal 1953 to fiscal 1955. This was a reduction in actual expenditures, not a paper reduction from some previously projected level.

A reduction in revenues which is less than a reduction in actual expenditures is a responsible fiscal act and may be expected to encourage activity in an environment of general confidence.

A reduction of taxes at a time when expenditures are being increased, with statements that there will be some restraint in the increase in expenditures, cannot be put in the same category of fiscal responsibility.

Not only is a large tax reduction foolhardy, it is also likely to be futile in dealing with the most serious aspects of our very real problem of unemployment. In recent months there has been increasing recognition of the fact that unemployment is concentrated in particular groups of the population. Age, experience, education, race, even marital status, have an important bearing on employment. The distinction between general and structural unemployment has by now become familiar. The former is due to a general deficiency of consumer demand and investment, the latter to shifts in demand among industries and regions. As an economy becomes increasingly prosperous, the probability of structural unemployment becomes greater. The further we are above a subsistence level, the greater our choices and discretion in spending, and the greater the likelihood that there will be changes from time to time in the relative appeals of new clothing, housing, house furnishings, automobiles, vacations, hobbies, and savings. As consumption patterns fluctuate, there will inevitably be pockets of unemployment in those industries and areas which are temporarily or even permanently out of favor.

In addition to structural unemployment, which is primarily economic in its origin, we should now recognize various sorts of social unemployment. The school dropouts, the completely unskilled, those prevented from full consideration for employment because of race, and those who find welfare an easier way of life now appear to make up our most critical groups of unemployed. Without new aptitudes and new attitudes, many of them appear to be unemployable as well as unemployed. For many the attitudes seem at least as important as the aptitudes.

Monetary and fiscal measures cannot solve the problems of structural and social unemployment. Increases in the general availability of credit or artificial increases in general demand will not seek out the pockets of unemployment and unutilized productive equipment.

Rather, attempts to reach the pockets of unemployment by artificial increases in total demand will lead to bottlenecks, to shortages, and to increases in costs and prices in areas where there are no significant shortages.

Those who stress fiscal and monetary policies have greatly oversimplified the analysis of our problems, and the action they call for is likely to undermine our currency and thereby weaken the base for the economic well-being of our country and everyone in it.

Selective action is needed to deal with particular problems in many fields. Undue reliance on general remedies distracts attention from the need for specific cures and may actually weaken a general system. An attempt to relieve a deficiency of a particular vitamin in a diet simply by eating more will probably continue the deficiency and weaken the patient by obesity. The very dry sections of the country need irrigation for agriculture; a doubling of total rainfall in the entire country, if that could be achieved, would still leave the arid regions too dry for farming, while creating floods in much of the rest of the country.

Similarly, as a matter of economic policy, a large increase in the deficit through a tax cut now has only a slight chance to do much good and a great chance to do much harm.

Our tax structure, however, is very bad. It represses and distorts effort and investment. It diverts attention away from productive activity which would increase the real income of the country and into maneuvers and manipulations to reduce individual and corporate taxes which are socially unproductive.

In case there is any doubt as to the reference there, I am referring to maneuvers and manipulations which are unproductive. I am not saying that taxes are unproductive. It has put a premium on the devious and the roundabout instead of the direct and the straightforward.

The state of the Union message last January properly criticized our tax system on the grounds that it exerts—

> too heavy a drag on present purchasing power, profits, and employment * * *. It discourages extra effort and risk. It distorts the use of resources.

These were welcome words. They built up hopes for the sort of revision and reform which would remove or at least substantially reduce the drags, the discouragements, and the distortions. The program actually proposed, however, was a great disappointment. It was directed primarily at increasing purchasing power. It would have done little to reduce the discouragement to extra effort and risk. Nor would it to any great extent have gotten at the distortions in the use of resources.

The discouragement and distortion from taxation arise primarily from excessive tax rates. It seems improbable that the beginning individual income tax rate of 20 percent discourages extra effort or risk or distorts personal decisions on employment or activity. Reduction in the bottom bracket rate increases purchasing power and is, of course, welcome on personal grounds. But on economic grounds it is hard to see how it can do anything more than increase purchasing power.

The basic defeat in the original tax proposal was shown in table III of the tax message. The last column of that table showed that while the combined effect of the proposed changes in rates and structure would be to reduce tax liabilities in the bottom bracket by 39 percent, the tax liabilities in the middle and upper brackets would be reduced on a descending scale with a net rdeuction in the bracket of $50,000 and above of only 9 percent. The net effect of the proposals would thus be to make the middle and upper brackets carry a higher proportion of the reduced total burden. Essentially, the effect would be to make the tax structure more progressive. The program seemed inconsistent with the stated objectives of reducing discouragement and distortions.

The bill before you, as passed by the House, is only slightly less objectionable from this standpoint than the original proposal. The combined effect of rate and structural changes gives a reduction of tax liability of 38.3 percent in the bottom bracket, decreasing to a reduction of 26.2 percent for incomes of $3,000 to $5,000, 19.9 percent for incomes of $5,000 to $10,000, 16.4 percent for incomes of $10,000 to $20,000, 15.1 percent for incomes of $20,000 to $50,000, and 12.6 percent for incomes above $50,000. Thus the relief at the bottom is more than three times as much as that for the larger incomes. This discrimination makes our tax system commensurately more progressive. When relief discriminates against those who are most likely to be discouraged and whose actions are most likely to be distorted, it is bad economics.

The discrimination against middle and upper incomes also seems unfair. One would have expected that tax relief would have at least been proportional in all tax brackets. This standard appears to have been accepted by Secretary Dillon when, in his statement supporting a substantially proportional reduction in rates, he said to the Committee on Ways and Means:

> The proposed across-the-board reduction in individual rates * * * will reduce tax liabilities by $11 billion (at 1963 levels of income). This reduction will be fairly spread at all income levels (p. 36, committee print of the House Ways and Means hearings).

If an across-the-board reduction in rates is recognized as fair, then a composite package which gives less than one-third as much proportionate relief to larger incomes would seem to be distinctly unfair.

As is well known, the progressive rates in the middle and upper brackets produce relatively little additional revenue; the entire scale of progression provides only about one-sixth or one-seventh of the total yield of the individual income tax. Roughly, the progressive feature of our tax system could be cut in half for the same revenue loss as a reduction in the bottom bracket by one and a half to two percentage points, that is from 20 to 18 or 18½ percent. Since it is the progression which leads to the discouragement and the distortion, it seems almost inexcusable not to meet the problem forthrightly. Instead, the bill before you reduces the bottom rate from 20 to 14 percent with a declining relief in the middle and upper brackets and a top rate still at 70 percent.

The disadvantages of excessive rates was well recognized in the state of the Union message last January. President Kennedy criticized the present corporation tax rate "which gives the Government a majority interest in profits." This is a valid criticism, but if true when applied to inanimate corporations, how much more valid it must be when applied to the income of sentient human beings with their deep personal feelings.

An argument in favor of at least proportionate tax relief for middle and upper bracket incomes must not be taken as approving or even condoning all uses of such income. Conspicuous consumption is distasteful. Much expenditure even seems offensive to me, but these are matters of individual taste. Each of us, at all income levels, probably has what others regard as extravagances and penuries. The question is not whether we might have a more esthetically and socially satisfying use of the national income by a highly progressive tax system. It is rather whether we can afford to continue to have the disincentives and the distortions in activity and investment through tax rates that make it more important to save taxes than to earn income. The answer seems clear that we can ill afford the bad economic effects and the continued strain on taxpayer morale and morals.

If the bill before you were simply one in a series of reductions, one could perhaps be reconciled to it as an unfortunate step, with the hope that the next one would be more useful and fairer. But in view of budgetary prospects, it seems likely that, if enacted, this will be the only tax reduction for the foreseeable future. The wrong sort of tax reduction now will preclude the right sort of reduction for many years to come.

Fortunately, the additional revenue loss from proportionate rate reduction would not be great. Or the pattern of rate reduction could be revised. A net proportionate reduction in tax liabilities across the board, and with a maximum rate of 50 percent, should be the objective, with the extent of the reduction determined by the extent of risk one is willing to take from increased deficits.

As an alternative, an optional tax rate schedule with a maximum rate of 40 or 45 percent should be authorized for those who renounce all deductions. To prevent manipulation, a taxpayer should be required to use one rate schedule or another for a considerable period, perhaps a minimum of 4 or 5 years. A reasonable rate scale with no deductions would simplify the law immensely and would create an atmosphere in which people would concentrate on productive work instead of tax shenanigans. No reform of the individual income tax could be so fundamental or appealing. I urge its adoption. If added to the existing bill, the legislation would become so great a tax reform as to justify the risk of a substantial increase in the existing and prospective deficits.

The preceding paragraph was written as it stands more than a month ago prior to the news stories of Senator Long's proposed amendment. The objective of this amendment holds tremendous promise. My principal concern is that if its application would be confined to very large incomes, it will leave a broad range of incomes subject to excessive marginal tax rates well above the overall ceiling rate. The people subject to these excessive marginal rates would include many of those whose activities and investments are so important and are so distorted by tax considerations. The optional rate scale should cover the full range.

I assume that capital gains would be included only after the general percentage reduction, as they must be to prevent a major penalty on investment, and that the credit for foreign income taxes would still be allowed as it must be to prevent an absolute penalty on income from foreign sources.

One small interjection: As I have continued to think about this, the one point that does concern me is the possible impact upon charitable contributions.

I am so tremendously impressed with the importance of private donations to get the diversity and variety of educational activities and charitable activities that we have, that I do wonder if perhaps the rate scale might not be somewhat higher under the optional thing, still leaving it open for charitable contributions as a deduction. This is a close issue, but I think a very important one, however.

The proposed reduction in the corporation income tax is eminently desirable. This tax is coming to be recognized, regardless of its incidence, as a penalty on efficient producers. As international competition becomes more severe, the adverse effects of this penalty on efficiency becomes more serious. The tax rate should be reduced as far as possible in view of revenue requirements.

More fundamentally we should consider the adoption of a value-added tax on business as a partial or complete substitute for the corporation income tax. A value-added tax falls on all those who use resources in production, but without penalizing those who do so efficiently. Tax reforms in Europe where the value-added tax seems to be in process of wide adoption increases the urgency of our consideration of it if we are to remain competitive.

The substitution of a value-added tax could be made without revenue loss. It would increase efficiency of production. It would improve our balance of payments in the long run through this increase in efficiency. More significantly, it would improve our balance of payments almost immediately because a value-added tax can and would be rebated on exports while the corporation income tax cannot be rebated. A tax rebate would make our exports more competitive in world markets.

The value-added tax is currently of great interest to many economists, though opinions are by no means uniform as to its desirability. I urge that this and other committees of the Congress give prompt attention to it as a partial or complete substitute for the corporation income tax.

I come now to the third part of my statement with reference to the specific substantive changes. Many of the proposed substantive changes in the law are inherently desirable and, in another context, should be adopted.

Restrictions on the sick pay exclusion are reasonable; complete removal of the provision as originally recommended by the Treasury would be preferable.

The limitation on casualty losses is good, but a percentage minimum, as recommended by the Treasury, rather than a dollar minimum would seem fairer and simpler. A $100 casualty loss hardly seems to justify tax relief for a man with a large income.

The elimination of the deduction for State and local excise taxes is also reasonable. This was done in 1942 for Federal excise taxes. It broadens the base and simplifies tax returns and records.

Abuses in some sorts of real estate transactions have been quite flagrant, with a succession of owners taking depreciation against ordinary income followed by sales with capital gains. The treatment adopted last year for tangible personal property should be extended to real estate, with gains up to original purchase price being taxed as ordinary income. The Treasury recommendations themselves seemed unduly mild in this area. The provisions in the bill before this committee will leave room for manipulation of the sort which is deplored by both outside critics and many participants in the real estate industry.

Rules on aggregations of oil properties have needed to be brought in line with those which were developed for mining properties by this committee in 1958.

Tighter rules on perosnal holding companies and on interest deductions in connection with life insurance policies are desirable.

Stock options when properly used are good in that they assure that executives will be personally interested in business policies leading to long-term growth. Options have, however, been abused. The Treasury proposal for repeal of the provisions on restricted stock options was not justified and seemed inconsistent with the major objective of more rapid growth. But the additional restrictions contained in the bill before you are reasonable and desirable.

The new provisions on income averaging and moving expenses would make the law fairer and are not unduly complicated.

The elimination of the penalty on consolidated returns is desirable. Abuses of the corporate surtax exemption by multiple corporations should be prevented. The provision in the bill before you is inadequate because it simply prevents the existing abuses from being enlarged by the proposed change in corporate rates. I certainly believe something more should be done in tightening on abuses of multiple surtax exemptions. At the same time the tax on intercorporate dividends should be removed. This package of three parts would restore tax neutrality to intercorporate relations by preventing abuses and removing penalties.

The Treasury proposal for a 30-percent inclusion of capital gains was good, and a requirement for a longer holding period not unreasonable. The additional category of capital gains in the bill before you may use useful, but the percentage of inclusion and maximum rate should at least be lowered in proportion to the reduction in the income tax rates themselves. A tax on reinvested capital gains is a capital levy rather than an income tax. Ideally, a tax-free rollover should be permitted for reinvested capital gains, similar to the tax-free sales and purchases of residences, with any unreinvested gains taxable in full as ordinary income. I emphasize "as ordinary income." I see no reason for a differential tax rate on consumed realized capital gains.

Until that is done, it would be desirable to give a low-percentage inclusion for very long-term gains, perhaps those held for more than 10 years, which seem most likely to be regarded as an integral part of capital and hence reinvested. As it stands, the pending legislation, by reducing the percentage of inclusion only from 50 to 40 percent and the ceiling rate from 25 to 21 percent further discriminates against capital gains in the middle and upper brackets in comparison to regular incomes in the lower brackets. This discrimination is not consistent with the national policy to encourage growth which in turn requires capital and minimum restraints on its mobility and effective use.

In spite of the foregoing favorable remarks about several of the structural changes, others appear to be bad; one of them seems very bad.

The proposed ceiling on group life insurance is both discriminatory and complicated. Some restrictions may be desirable to prevent excesses in the use of this heretofore tax-free fringe benefit. But a limitation should not discriminate for or against particular income groups. A limitation related to compensation at perhaps double the annual compensation would be fair and avoid the resentment which the proposed ceiling fixed at a specific dollar amount must inevitably cause. Alternatively, the basic concept of group insurance should be followed by spreading the cost of the insurance over all beneficiaries in proportion to their insurance rather than on the basis of age.

The new authorization to treat iron ore royalties as capital gains seems to be without merit. The inclusion of annual operating income of this sort in capital gains brings the whole concept into disrepute.

The repeal of the Long amendment to the investment credit is undesirable. That amendment—I am referring to the amendment last year on the Revenue Act of 1962—made the investment credit less of a handout and maintained to some extent the integrity of the tax system. Rather than repeal the amendment, it would seem preferable to follow it to its logical conclusion and convert the investment credit into a special first-year depreciation deduction all of which must be applied against the tax basis of depreciable property. If this were done, the percentage of the deduction could be about doubled with no loss in aggregate revenue, and total deductions would be limited to cost, as they should be.

Since the investment credit and depreciation has been opened up for consideration by the proposed repeal of the Long amendment, it may be appropriate to note the truly splendid depreciation guidelines issued by the Treasury last year. They are a major longrun reform, but their effectiveness will be seriously limited by the reserve ratio test which they contain. I urge that this test be repealed. No other country has a similar rule, to the best of my knowledge. It is a tax barrier against the new investment in capital equipment which is needed to make our business competitive with industry abroad. The reserve ratio test should be removed.

Though the House rejected the proposal for a presumptive realization of gain at death, the matter has been raised again in Treasury statements and thus, I presume, becomes relevant in these hearings. The whole idea of presumptive realization of carryover of basis seems inappropriate. It stems from an abstract concept of income, comparable to the proposals to include the presumed rental value of owner-occupied houses in income. But only in the most theoretical sense is there any realization of income by death.

The entire value of an estate is capital. The estate is subject to a capital levy in the form of an estate tax. Surely after this capital levy, a family should be permitted, once a generation, to start afresh in its relation with the tax authorities. Neither presumptive realization nor carry forward of basis accords with popular concepts of income or equity; the law should not be unduly complicated and the tax on capital increased because of an abstruse concept which has become fashionable among some theorists.

Treasury statements that a presumptive realization of gain at death is necessary to justify a reduction in the capital gain tax rate seem, frankly, to be illogical. The lower the capital gains rate, the less the benefit of the step-up in basis at death. As the potential tax burden becomes less, the significance of nontaxability would appear to be less rather than greater. But a reduction in the potential burden, through lower capital gains rates, is no reason to adopt an unrealistic concept of income. The proposal for presumptive realization seems to be bad from the standpoint of both equity and economics and an attempt to relate it to the desirable reduction in the capital gains rate seems illogical.

Last and worst among the structural changes is the proposed repeal of the dividend credit. Dividend income is the only form of income subject to double taxation under our combined corporation and individual income tax. All other corporate payments are deductible to the corporation and hence subject only to tax at the individual level.

The incidence of the corporation income tax is, to be sure, uncertain. Traditionally, it was thought to rest entirely on the corporation; that is, ultimately, on its stockholders. During the past generation, opinions of both economists and businessmen have changed and it is now thought that the tax is, to a considerable extent, shifted forward in prices. If the tax were completely shifted, there would, of course, be no double tax burden if dividends were fully taxed. Full shifting, however, is seldom if ever considered likely. To an appreciable extent the corporation income tax does rest on the corporation and hence some element of double taxation is real and relief is in order. If as much as one-twelfth of a corporation income tax of 48 percent is borne by the corporation, the 4-percent dividend credit is necessary to prevent discrimination against equity investment.

The nature of the dividend credit is sometimes misstated. It gives the greatest proportionate relief from the double tax to the lower income brackets. The 4-percent credit gives relief from one-fifth of the second tax, that is the individual income tax, against the present bottom bracket tax of 20 percent. The 4-percent credit gives relief from only one-twelfth of the second tax at the 48-percent bracket and from only one twenty-secondth at the 88-percent bracket. The extent of the relief as a fraction of the second tax thus falls off rapidly under the progressive income tax. And lest there be any remaining uncertainty as to the difference between a credit against tax and a credit against income, the credit against tax also gives a higher proportionate relief to the lower brackets. A credit against the tax gives the same absolute amount of relief for a given amount of dividends. As one moves higher in the tax brackets, the given amount of relief becomes a lesser fraction of the additional tax, as noted above. By contrast, a credit against income would mean much more to the higher bracket than the lower bracket taxpayer. The credit against the tax was selected because it did not discriminate against the lower bracket stockholders. It cannot properly be criticized as discriminatory against smaller investors; on grounds of discrimination, it can only be criticized as giving inadequate relief to middle and upper brackets.

The dividend exclusion gives full relief from the double tax to those with no more than $50 to $100 of dividends. For those with appreciable amounts of dividends, the relief from the double tax is trivial, almost insultingly so. For a retired couple with $7,000 of income, all from dividends, the 4-percent credit amounts to $156 against a tax of $780, on the assumption that they are both over 65, each owns some stock, and deductions are 10 percent of gross income. Under the proposed legislation, they will lose the $156 credit and receive instead an additional exemption involving a tax saving, at present rates, of only $20. At the proposed new rate scale, the tax saving from the exemption becomes even smaller.

The substitution of an additional dividend exemption for the dividend credit is thus discrimination, one might even say gross discrimination, against the middle and upper income brackets. It emphasized the discrimination in the pattern of rate reduction.

In summary, the bill before you involves a loss of revenue which is dangerous in view of the strain to which the dollar is already subject. An increase in disposable income is not likely to be effective in relieving the pockets of structural and social unemployment which are so very real and serious.

If I might interject, I hope nothing here will indicate that I am not tremendously impressed with the importance, the seriousness of our problem of unemployment. I noticed an adjective used in one of the papers last week, I believe it was a statement made by the Chief of Police of the District of Columbia, that the unemployment problem was in fact terrifying as a social problem. I think it is a terrifying situation, but I think we, in this bill, are proceeding in the wrong way to deal with the particular problems that we have.

If the tax reduction were of a sort which would be a major reform to encourage long-run growth, one might accept the risk of the larger immediate deficit. But the pattern of rate reduction discriminates against the middle and upper income brackets. It makes our tax system even more progressive than it is.

The bill before you fails to deal forthrightly with the ways in which the tax system discourages extra effort and risk and distorts the use of resources, to quote for the last time the valid criticisms made in the state of the Union message.

Several of the structural changes are desirable but they should not be used to make the tax system more progressive. A few of the structural changes are inherently bad and should not be adopted in any case, regardless of the schedule of rate reduction.

The House Ways and Means Committee made great improvements in the recommendations of the administration, but much remains to be done by your committee.

With a revision of the pattern of rate reductions and the elimination of a few of the structural changes, the long-run advantages of a real reform in rates and structure would justify the risk of some increased deficit if there were really earnest efforts to control expenditures. Without such changes and such efforts, the bill before you would involve excessive risks for limited benefits, and its adoption would preclude the prospects for real reform in tax rates and tax structure for many years to come.

Unless substantial but not difficult changes are made, I respectfully but strongly urge that the legislation be rejected.

In any case, I urge that action on it be postponed until the facts on future expenditures become clearer after the next budget message has been received and examined.

Thank you very much, Mr. Chairman, for this opportunity to present my opinions.

The CHAIRMAN. Thank you very much, Mr. Smith.

Senator Douglas?

Senator DOUGLAS. Mr. Smith, in your statement you speak of the numerous manipulations which are devious and roundabout, and later you refer to tax shenanigans. I wondered if you would be specific as to what you think the devious and roundabout maneuvers and manipulations are and the tax shenanigans which are carried out under present law.

Mr. SMITH. I do not know how much time you want me to take, Senator Douglas. I wrote a rather long book on the subject a year or two ago.

Senator DOUGLAS. I know. Would you summarize this very briefly for the sake of the record?

Mr. SMITH. Yes.

Senator DOUGLAS. Would you regard the depletion allowance on oil as a case of tax shenanigans?

Mr. SMITH. That seems to be a rather straightforward thing that has been put in by Congress. I do not believe there is much deviousness on that.

Senator DOUGLAS. Would you regard it as a shenanigan?

Mr. SMITH. No. The shenanigans I am referring to are when people proceed in the roundabout fashion.

Senator DOUGLAS. You do not object to the depletion allowance?

Mr. SMITH. That is not the question you asked me, sir, and that is not the answer I gave.

Senator DOUGLAS. I now ask you that.

Mr. SMITH. I have said on various occasions that I have in fact been greatly annoyed at what seemed to be many of the arguments that are advanced in favor of depletion—that they seemed to be somewhat specious. I am referring in this case to the fact that there is a presumption apparently that the value should be recouped rather than the cost. That does not seem to me to be a valid point.

On the other hand, from the standpoint of the economic consequences, I have never yet been able to get sufficiently on top of facts to be quite sure.

There is a publication coming out shortly based upon a conference at the Brookings Institution—this has been well publicized in the past; perhaps some of you have already seen it—based on a conference about a year ago on this very subject.

The thing that impressed me in that was that the emphasis seemed to be shifting rather from matters of equity, which concerned me greatly in this respect, to matters of the misallocation of resources.

If the net effect of the depletion allowance is to have the price of gasoline a cent or a cent and a half lower than it is otherwise, there are no equity problems. This then seems to me to be somewhat of an esoteric problem to deal with as a matter of tax policy.

On the other hand, I am bothered very much by what seemed to me the opportunities for the passive landowner to fall into what seemed to me extreme windfall gains with the differential tax effect.

The problems is also complicated by the fact that some of the products in the industries benefiting from depletion are homogeneous products with world markets. We are tied up here with matters of import quotas and the like. For certain products like sand and gravel, on the other hand, I see no justification whatsoever.

I am sorry to give a long rather than an immediate answer.

Senator DOUGLAS. I am trying to find out just what you answer has been on this question.

Do you approve of the 27½-percent depletion allowance deduction, 27½ percent of gross income up to 50 percent of net income?

Mr. SMITH. I am not sufficiently informed on the facts, and I have not found sufficient research work to be——

Senator DOUGLAS. Mr. Smith, if you are not informed, who is?

You were the tax expert for the Treasury for what was it, 4 years or 8 years?

Mr. SMITH. Right between. Six.

Senator DOUGLAS. Six. You are certainly one of the two or three best informed men in the country on the technique of taxation, and yet you say you are not sufficiently informed about this fact to give an opinion. That is astounding, Mr. Smith.

Mr. SMITH. I am sorry to astound you, Senator Douglas.

I am perhaps astounded myself that I have not managed to get on top of all aspects of the tax law, but this is one I frankly am puzzled as to what the implications are on pricing as compared to net profits.

Senator DOUGLAS. What are these tax shenanigans that you referred to?

Mr. SMITH. I think the capital gains concept has been very greatly abused by maneuvering and manipulating what most of us would consider straightforward income into capital gains.

Senator DOUGLAS. That is fine. I agree with you thoroughly. How would you check this?

Mr. SMITH. I would tighten very drastically the definition of capital gains. As I have indicated here, I would go much further even than the Treasury recommendation on taking away the capital gains provision on the gain to the extent of previous depreciation on reals.

Senator DOUGLAS. Very good. What other shenanigans would you try to check?

Mr. SMITH. There are some problems in the personal holding companies that certainly need tightening.

Senator DOUGLAS. Setting up a corporate shield?

Mr. SMITH. Precisely.

Senator DOUGLAS. To stand between the individual income and taxation?

Mr. SMITH. Precisely.

Senator DOUGLAS. Do you regard the provisions in the present bill as adequate?

Mr. SMITH. This is another one—I am not a practitioner, as you know; I am an economist—I have not been able to get on top of all the things.

My impression is that this is a darn good one.

Senator DOUGLAS. You are one of the greatest authorities in the country, Mr. Smith.

Mr. SMITH. Thank you for those very gracious comments, Senator Douglas.

Senator DOUGLAS. I attribute this to you as a technician.

Mr. SMITH. I think the holding company provisions, to the best of my knowledge, are adequate at least for the time being, but I suspect this is an area the committee may well want to look at again in another 5 years. I am not critical of these as I am of the real estate gains. There I am explicitly critical because it seems, as I have said, that even the Treasury recommendations——

Senator DOUGLAS. Are there other shenanigans that you think are going on that should be checked?

Mr. SMITH. Yes; there has been a great deal of abuse over the years in borrowed funds for life insurance, even to the point I understand in some instances of having a loan officer on the other side of an office of a life insurance salesman.

I am not sure that the present provisions go quite far enough there. They certainly do not go too far.

Senator DOUGLAS. Now that is a new one for me at least.

Mr. SMITH. There is something in the bill on it, sir.

Senator DOUGLAS. No; I mean these borrowed funds for life insurance.

I wonder if you would describe that a bit.

Senator BENNETT. It is in the bill.

Mr. SMITH. There is a provision in the bill tightening the present treatment, sir.

Senator DOUGLAS. I understand, but about the present abuses?

Mr. SMITH. Well, it is a matter of taking what is ostensibly a life insurance policy, I believe they frequently are sold in multiples of hundreds of thousands of dollars or even up into the millions, with a very nominal first premium to get it together. The additional premiums are advanced on a loan which is related to the increase in the cash surrender value of the insurance.

I believe, though I am not certain, that in some instances these are nonrecourse loans, so the policy itself is the only security for the loan.

Now the point, of course, is that the interest on the loan is currently deductible, it will be reducing the net cost, and the higher individual bracket, the lower the net cost.

What this works out to is a situation whereby an immediately deductible interest at 4 percent might even be a useful way, a reasonable use of funds, even though the insurance policy is only compounding at 3 percent. That is, it would be especially true if the policy could be realized as capital gains.

Now the Congress a few years ago, at the instigation of the previous administration, did some tightening on that and we got rid of the capital gains realizations on most of the policies. But this is something that arises in only a very, very minor fraction of the insurance industry.

I know many of the leaders of the industry are much embarrassed by what is going on, but it is an area that needs I think further tightening.

If I might amplify this to show how things happen, this point was first tightened in the Internal Revenue Code of 1954. The Treasury, with a few experts that it is able to have to deal with the vast variety of problems, thought, we thought, we had everything handled, and within 2 or 3 months a very small insurance company, but one with a large advertising budget, was advertising another way of defeating this same device, and had the effrontery to say "approved by the Treasury Department" because the then legislation had not managed to close the loophole completely.

Senator DOUGLAS. Do you think the provisions in the present bill meet this difficulty?

Mr. SMITH. Again, I am not on top of all of it. I am not aware that it is significantly deficient as I think the real estate provision is, but I suspect this is a problem of continuing concern, even to the point, Senator Douglas, where, as in various other things I have written, we may get to the point where the complete denial of the interest deduction of personal interest may be appropriate.

Senator DOUGLAS. Now later on in your paper, in discussing the dividend credit——

Mr. SMITH. Yes.

Senator DOUGLAS. You speak of the dividend credit as being progressive, I believe, that is, that the dividend credit is greater for the lower incomes than for the supper incomes proportionately, that is, the 4 percent you say is one-fifth of the 20 percent tax.

Mr. SMITH. Correct.

Senator DOUGLAS. And only one-twelfth of the 48 percent.

Mr. SMITH. And so on, yes.

Senator DOUGLAS. But that ignores the fact that the people in the 20 percent bracket do not own much corporate stock. That is, with $2,000 of taxable income, those people really do not own corporate stock.

Mr. SMITH. Of course, for those who own no corporate stock it gives no relief, but they have no double tax.

Senator DOUGLAS. I know, but so far as you are saying that this is a progressive feature, this is not true so far as income classes are concerned because it is the upper income classes which own corporate stock.

Mr. SMITH. The whole problem of the dividend credit is designed to give relief from the double tax for those who are subject to it, and for those who are not subject to the double tax there clearly is no point of relief.

Senator DOUGLAS. That is not the sole purpose of the different dividend credit.

Mr. SMITH. Senator, I beg to suggest, you referred to the fact that I once had something to do with Treasury activities. I had a good deal to do with this one.

The whole justification was the fact of a certain amount of double taxation.

Senator DOUGLAS. Since you have referred to your part in the original formulations of the plan and the putative paternity which you gave to it, you started out with a 15-percent dividend credit, did you not?

Mr. SMITH. Exactly.

Senator DOUGLAS. In the original recommendations.

Mr. SMITH. That is right, and I still think it was unfortunate that it was not adopted.

Senator DOUGLAS. So you would favor increasing the dividend credit to 15 percent.

Mr. SMITH. I would favor increasing it up to the first bracket individual rate, whatever that rate is.

Senator DOUGLAS. Twenty percent?

Mr. SMITH. Twenty percent as it now stands.

Senator DOUGLAS. Now, this is a straight deduction against taxes, not against taxable income.

Mr. SMITH. But Senator, I devoted half of a paragraph to emphasizing why the credit against tax does not give the larger relief to the upper brackets which the deduction against income would give. We selected the credit against taxes for the very specific reason that it did not give the higher relief to the upper brackets.

Senator DOUGLAS. Now, this leads to your whole philosophy of taxation.

As I take it, you want to retain the 20-percent tax on the lowest bracket of taxable income.

Mr. SMITH. No; I did not say that I favored that, sir.

Senator DOUGLAS. I thought you did.

What would you favor in the lower brackets?

Mr. SMITH. My statement was, I believe, that the objectives would be for a proportional reduction of tax liabilities of tax rates across the board with a ceiling of 50 percent, the amount to be taken now dependent upon how much we can afford, given the budget situation.

Senator DOUGLAS. How much would you reduce the lower bracket then?

Mr. SMITH. I first decide how much revenue loss I can afford, and I do not think it is anything like $10 or $11 billion. Then I would do it proportionately, but, perhaps following the suggestion based upon the news stories of Senator Long's proposed amendment, I would find a way to have a ceiling rate of 50 percent.

Senator DOUGLAS. That would mean then a reduction of 41 points in the upper income group, or a reduction of approximately 45 percent for the upper group.

Mr. SMITH. It seems to me it is very much——

Senator DOUGLAS. That would not be a proportional reduction.

Mr. SMITH. That is correct.

I make an exception to my proportionality, as I said, to get a ceiling of 50 percent, which I think is very much in the national interest.

Senator DOUGLAS. If this does not bring in enough revenue, you would propose a tax on value added in manufacturing?

Mr. SMITH. That, it seems to me, is the best, though I am proposing that, Senator, as a partial substitute for the corporation income tax in any case.

Senator RIBICOFF. Will the Senator yield?

Senator DOUGLAS. Yes.

Senator RIBICOFF. Do you not outline it?

You point out that for the lower bracket which Senator Douglas is talking about, you would lower it from 20 to 18 or 18½ percent instead of 20 to 14 percent.

Mr. SMITH. No, Senator.

Senator RIBICOFF. I mean, do you not list this yourself?

Mr. SMITH. Senator Ribicoff, this was not a proposal, and I believe that is indicated by reading.

I was merely trying to give the order of magnitude of the revenue impact of changes in the top bracket rates and the bottom bracket rates. This was not a proposal.

Senator BENNETT. It is an example.

Senator RIBICOFF. But if you were to go through with the type of proposal that you suggest, then you would take the 20 percent, the lowest bracket, and reduce it to 18 or 18½ percent. This would be your philosophy?

Mr. SMITH. No.

I would say that we could have a larger reduction in the lower bracket, I think with a real tax reform in rates and other things, we could afford enough revenue loss to go somewhat further in the reduction at the bottom bracket.

Now, since this point of the top bracket has been raised, there are various ways, as I have at length described in some things I have written, various ways of looking at the impact of changes in rates in terms of income after taxes, in terms of tax rates themselves.

The thing that I urge this committee to think back on is what happened in 1932 when the rates were changed. The previous pattern was from one and a half at the bottom to 25 at the top, and in order to get more revenue, the rates were changed. It was the bottom rate that had to be changed principally to get the revenue because that is where the income is. The bottom rate was raised from 1½ to 4 percent. At that time the top bracket rate was raised from 25 to 63 percent, which had the effect of cutting net income by more than one-half.

The previous net income after the top bracket rate was 75, after the tax of 25, after the tax of 63 it was only 37 percent. It cut income more than half.

Senator GORE. You are speaking now of taxable income?

Mr. SMITH. I am speaking of taxable income, Senator Gore. That, it seems to me, was really the greatest catastrophe in the history of tax legislation in this country. Ever since then we have been operating under these excessive rates which, I submit, Senator Douglas, so long as we have them we will have people maneuvering, manipulating, looking for shenanigans.

Senator GORE. In this same context, Mr. Smith, would you now tell us the effect on after tax income, based on taxable income, of the proposed change in rates?

Mr. SMITH. I have not run them. I believe various others have done it.

Let's see, I can do it by mental arithmetic here.

If we go from 91 to 70, that increases the net income in that incremental marginal bracket from 9 to 30 cents, and that is an increase of what is it, three and a third, I guess, if my mental arithmetic is correct, which is inevitably the thing that has to happen if we are going to get away from the mess that we got into in 1932 and have been struggling under ever since.

Senator GORE. Would you mind—I will not ask you to do it now—would you mind, as a service to this committee, to supply for the record at this point the percentage of increase in after-tax income by applying the proposed rates on taxable income—you discussed the change in 1932 in terms of rates applied to taxable income.

Would you please give us a table showing the percentage increase in aftertax income with respect to taxable income affected by the rate changes?

Mr. SMITH. This sounds like a rather formidable statistical task for one professor to have to make a whole table.

May I submit two or three examples, and I assure you it will cover the full range, and I am sure your staff has already provided them for the committee.

Senator GORE. Yes. Mr. Stam's staff has already prepared it.

Mr. SMITH. I am sure they have.

Senator GORE. You can just verify their calculations.

Mr. SMITH. If you would like to have them over my name, I would be very glad to do so.

Senator GORE. I think it would add distinction to them.

Thank you.

(The information referred to follows:)

HARVARD UNIVERSITY,
GRADUATE SCHOOL OF BUSINESS ADMINISTRATION,
GEORGE F. BAKER FOUNDATION,
Boston, Mass., October 31, 1963.

MRS. ELIZABETH B. SPRINGER,
Senate Finance Committee,
Washington, D.C.

DEAR MRS. SPRINGER: This letter is in reply to Senator Gore's request to me during the hearing on H.R. 8363 of October 23, 1963, that I review staff calculations of various changes in tax liability and taxable income after tax as a result of H.R. 8363. The following comments are addressed to tables 1 and 2 dated October 4, 1963, prepared by the staff of the Joint Committee on Internal Revenue Taxation under the title "Individual Income Tax Liability."

Though the arithmetic calculations appear to be correct, as one would, of course expect them to be, it is notable that the tables include only the effect of the rate changes and that a more accurate indication of the impact of H.R. 8363 is contained in table 3 of the report of the Committee on Ways and Means of the House of Representatives to accompany H.R. 8363, dated September 13, 1963, page 17. Even this table does not include the effect of the changes in the treatment of capital gains.

Yours very truly,

DAN THROOP SMITH.

Senator DOUGLAS. I take it basically, Mr. Smith, that you do not place much emphasis on the progressive theory of taxation so far as it applies to the individual income tax. I do not say that you throw it out completely.

Mr. SMITH. I am certainly glad you said I do not throw it out completely because I do not.

Senator DOUGLAS. Yes, I understand.

Mr. SMITH. I most profoundly believe, Senator, that 50 percent should be the top marginal rate.

Senator DOUGLAS. That is 50 percent top marginal rate?

Mr. SMITH. Top marginal rate.

Senator DOUGLAS. What would that be in terms of an average rate, about 35 percent, 30 to 35 percent?

Mr. SMITH. It depends on the size of one's income.

Senator DOUGLAS. Yes, I understand.

Mr. SMITH. It depends on where you reach the top bracket, of course. If we were really to have a top marginal rate of 50 percent, I would not be too concerned to have the brackets spread wider than they they are now.

It is my feeling, Senator, that it is the marginal rate, not the aggregate tax burden, that is so important.

If there would be some way, if some way could be devised, not necessarily to relieve the amount of tax paid by the top bracket individuals but to keep them from having their decisions so distorted by having the marginal rates as high.

Senator DOUGLAS. I notice that you endorsed the suggestion which Senator Long has made, and perhaps indeed preceded him in making it. Senator Long's proposal, as I remember, it did not include the giving up of capital gains, the capital gains provision.

Mr. SMITH. I have gotten only what I have seen from the newspapers and that was not clear to me.

Senator DOUGLAS. And also, it did not propose the plugging of any loopholes or truckholes. People could still retain those, but if they gave them up, they would be limited to 50 perecnt.

Mr. SMITH. Right.

Senator DOUGLAS. Would you support a proposal to eliminate all of these loopholes and then impose a top of 50 percent?

Mr. SMITH. All of these loopholes——

Senator DOUGLAS. Instead of making them optional, make them mandatory across the board and then fix a top of 50 percent, because otherwise this is a heads-I-win, tails-you-lose proposition. Those who can cut their taxes much below 50 percent by the shenanigans which you describe will still use the shenanigans. Those who are not able to find protection can, therefore, turn to 50 percent.

Mr. SMITH. We each have our own definitions of "loophole."

Senator DOUGLAS. That is why I started off asking you about the shenanigans. That is your phrase. I have used it too, but I was glad to see that you used it.

Mr. SMITH. Thank you. I am delighted to be in your company, Senator.

Now I do not consider a differential tax on capital gains, on really long-term gains that are reinvested, as a loophole. This is a matter of individual concept.

Senator DOUGLAS. Let's eliminate the capital gains question.

Let's take the other devices or what you call shenanigans to reduce taxes. Suppose they are abolished for everybody, and then a top of 50 percent is imposed.

Senator BENNETT. Will the Senator yield?

Senator DOUGLAS. Not quite. I would like to have the witness reply to that.

Senator BENNETT. I am trying to get a definition of another area that might be a loophole.

Senator DOUGLAS. I appreciate my good friend's interjection, but I would like to have the witness reply to this question.

Mr. SMITH. Yes. I would certainly be sympathetic to the elimination of all deductions, with the possible exception of the charitable deduction. Now there was, I indicated, a matter of social policy on that. But down with all the deductions. That, of course, would keep the personal exemptions.

Senator DOUGLAS. Yes, I understand.

We may be getting together, Mr. Smith. We may find ourselves in happy company on this.

Mr. SMITH. I hope it will not be too much of a surprise to either of us if we found ourselves in agreement, Senator Douglas.

Senator GORE. Do not shock any of the rest of us.

Mr. SMITH. But note that in my reference to Senator Long's proposed amendment, it would have I think, it would have to have a marginal rate of 50 percent. He has a provision in which there would be many people paying 60, 65, and 70 percent, and then come down.

Senator DOUGLAS. That is right.

There are many more questions I would like to ask, but I think I have taken up more time perhaps than I should.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. Mr. Smith, in your report at the bottom of the page you have this paragraph:

> The new authorization to treat iron ore royalties as capital gains seems to be without merit. The inclusion of annual operating income of this sort in capital gains brings the whole concept into disrepute.

My question is this: Did we not have this same problem before us while you were working in the Treasury Department?

Mr. SMITH. We certainly did, in 1954, and I was as emphatic then in representing the Treasury as I am now as an individual in opposing it.

Senator WILLIAMS. If I recall correctly, at that time the Secretary of the Treasury stated that he was not only opposing it on behalf of the Treasury Department but also as one who would personally benefit in this and familiar with the situation.

Do you recall that?

Mr. SMITH. I believe so, Senator, and on this particular point of my statement, on the basis of very recent discussions with the former Secretary of the Treasury, I am authorized to say that he still holds that position as an individual citizen and is opposed to this particular provision of the bill.

Senator WILLIAMS. I appreciate that because my next question was going to be if you had talked with Secretary Humphrey recently.

Mr. SMITH. Yes.

Senator WILLIAMS. What is his position? I understand that his companies would be the primary beneficiaries under this particular proposal.

Mr. SMITH. That I do not know as to what companies would or would not benefit, but Mr. George M. Humphrey is opposed to this provision.

Senator WILLIAMS. I remember that in 1954 he took a very strong position that it was inequitable and that there was no justification for it at all. I commended him at the time, and I commend him now for taking the similar position that this is an unwarranted benefit.

I was surprised that the administration recommended the expansion of the benefits under this depletion proposal rather than a contraction.

I thank you for that clarification.

The CHAIRMAN. Senator Gore.

Senator GORE. I am going to yield to my friend from Georgia who has not had an opportunity to ask questions.

Senator TALMADGE. I am grateful to the Senator from Tennessee. Mine will be very brief.

I notice on page 2 of your statement, Mr. Smith, dropouts, the completely unskilled, those prevented from full consideration for employment because of race, those who find welfare an easier way of life, now appear to make up most of the critical groups of the unemployed.

You state:

Without new aptitudes and new attitudes, many of them appear to be unemployable as well as unemployed. With many, the aptitudes seem at least as important as the attitudes.

How would you deal with this question of school dropouts, the completely unskilled and so forth that you make reference to there?

I think you have put your finger on the most critical problem of the unemployed.

How would you approach that question?

Mr. SMITH. Senator Talmadge, that is a pretty appalling problem.

I think reeducation, some adult reeducation, is important and useful. I do not know how you create an environment that people are willing to move from a particular area of the country to another area.

For instance, if large-scale agriculture is taking over from small-scale agriculture, we see the statistics about the fact that many people born on farms will not find a basis for livelihood on farms. That means they have to move into other lines of activity. I am afraid much of it is a matter of passage of time. Perhaps it is a matter of successive generations that are called for.

I think a great deal can be done by local entrepreneurship in getting new industries in an area. This does not necessarily mean, in fact I think perhaps it does not mean, that there needs to be Federal assistance on it.

We had problems in many of the New England textile towns in the thirties where the overwhelming bulk of the employment was with a single company which, in effect, folded up, and with considerable enterprise new sorts of light industries were brought in. Training programs were provided for the former textile workers to move.

I shall make a statement also which I know is a dangerous statement to make politically, but I am afraid that we have, in a fair number of instances, welfare growing up as a way of life for two or three generations. I think stricter control on the recipients of welfare are necessary.

This is an area where, frankly, I do not in any sense pretend to be an expert. I am concerned with two things: One, that to try to do it by aggregate demand by a big tax reduction first will not be effective, and secondly, that if the tax reduction is played up so much as the way of dealing with our problems, we actually will relax and not look at the sort of specific things which people who are familiar with this area much more than I am can, I hope, come up with.

This is not a very satisfactory answer, Senator Talmadge, and I would be the first one to say it.

Senator TALMADGE. Thank you, sir.

No further questions.

Senator RIBICOFF. Would the Senator yield on just that point?

Senator TALMADGE. I am delighted to yield.

Senator RIBICOFF. Is this not going to cost money?

Mr. SMITH. Some parts of it will cost money, but I have a profound belief, and based upon my observation of what happened in New England that I referred to earlier, that much of it needs to be local activity not directed from the top.

Senator RIBICOFF. Are the local factories going to train the skilled workers?

Mr. SMITH. They may in some instances.

Senator RIBICOFF. How many do?

Mr. SMITH. I am not an expert on this, Senator. I cannot say.

Senator RIBICOFF. I know, but you come here with a philosophy, sir.

Mr. SMITH. Yes.

Senator RIBICOFF. And you say you are not an expert on this phase of the problem and I would say you put it mildly. You are not when you come to this field. Yet you come here with a philosophy to try to influence a committee.

Now, the distinguished majority leader, the minority leader, the Senator from Kentucky, and myself have joined in a bill which would commit the Federal Government to spend $50 million to help the States and the municipalities to train and put people on welfare now, on work programs where they could be trained.

Do you think this would be a bad expenditure of $50 million?

Mr. SMITH. I do not know whether it needs $50 million or $5 million or $500 million. That is what I mean by saying——

Senator RIBICOFF. How many people do you think are on relief in America today?

Mr. SMITH. Senator, may I deal with the first part of your question just a moment?

Senator RIBICOFF. Yes.

Mr. SMITH. I do hold myself out and I will hold myself out as an expert in the field of monetary, fiscal, and tax policy and it is in that connection that I am appearing before you.

Now, as to how to get the localities to do things, I did have some experience some years ago. I was, as a matter of fact, a member of the Council on Aging or I was the Deputy for the Secretary of the Treasury on that, and I was much impressed with the way that operated as a catalytic agent to bring in experience from the different States, the different localities, to get an exchange of information, to encourage action at the lower level.

On the basis of that experience, I am impressed with the fact that it is not necessarily the amount of Federal money that is being spent, but the attitude in the Federal Government, the dramatizing of the importance of the problem, and the encouragement of local people to do things.

Now, the retraining of skills, I think, is a very important one, but I certainly do not know to what extent that should be financed by the Federal Government or the local government. But I can well imagine, sir, that in many of these areas some increase in expenditure, if directed to the core of the particular types of social unemployment we have, can be very useful.

Senator RIBICOFF. How much is the Federal Government today spending toward welfare, do you know?

Mr. SMITH. I do not know, sir.

I have an economic report here and could doubtless get it out.

Senator RIBICOFF. It becomes very important, sir, because I think that Senator Talmadge placed his finger on a very, very important point, especially as it relates to the tax bill which is supposed to be able to stimulate employment.

Now, would it surprise you to know that there are 7 million people in this country on welfare?

Mr. SMITH. No, certainly not, if you tell me that. That seems about right.

Senator RIBICOFF. This country is spending $4 billion on this on State, local, and Federal levels.

Mr. SMITH. Yes.

Senator RIBICOFF. Basically you are right when you have said that in some cases we have two and three generations in America on relief. You are talking about social unemployment and you put your finger on it. There is social unemployment that will not be solved by the tax bill. Yet you are against spending money to correct it, and unless we spend money to correct this condition, you are going to have a continuing generation after generation on social——

Mr. SMITH. Senator, I did not say I was against spending money to correct it. I said I did not know the most appropriate way or the amount of Federal as compared with State moneys which should be put into this.

Senator RIBICOFF. But the Federal Government is now committed through Federal law that has been in existence a long, long time under our social security laws where we pay an average of 50 percent of every dollar that is spent in this field. The Federal Government does have an interest in getting people off relief, in having them employed.

Mr. SMITH. I certainly share your sentiments on the desirability of spending more money to get people off relief, which will have the effect of cutting down on the amount of continuing relief you will have to have, and also give us a much better social system.

Senator RIBICOFF. Yes, but you would restrict the Government from spending further funds, because with reduced taxes you would have no new expenditures. What you are doing thereby, by limiting expenditures on the Federal level, is to make it impossible to train these people in order to get them off relief.

Mr. SMITH. I think there might well be desirable changes within the category of Federal expenditures. It may well be that we will have to spend a little bit more in the aggregate.

Senator RIBICOFF. What I am trying to do is to get a man like yourself to think about these problems with a sense of perspective. They are not all easy, and you raise a problem, but you do not go into the depths of how you are going to solve the problem.

Mr. SMITH. There are many problems in the world that I would not presume to solve. I am here to testify, and I do testify most emphatically, that I believe the emphasis upon increase in aggregate demand from tax reduction is definitely the wrong way to solve the very great problem that is before the country.

Senator TALMADGE. No further questions, Mr. Chairman.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Mr. Chairman, the question I was going to ask, which Senator Douglas did not let me get into that discussion——

Senator DOUGLAS. Just a minute.

Senator BENNETT. Just a minute. You yielded to your colleague but you would not yield to me.

[Continuing.] Was the question that you yourself have already mentioned.

I was going to ask you if you felt that charitable deductions were an exclusion which you would forbid under your proposal that these loopholes should be closed, if you felt that charitable deductions were loopholes. But you have already answered that question.

You feel that they are not loopholes.

Do you feel that joint returns are a loophole? Would you eliminate joint returns?

Mr. SMITH. No. I would be sympathetic, and I have said this before, Senator Bennett, if we would have a situation in which each individual could pay his own taxes on his own income without having discrimination in favor of community property States. Then at that point I would not insist upon joint returns. But until the benefit of the community property States is eliminated, it seems to me that we must have joint returns to avoid geographic discrimination, and one other point, because the proposal is often made that there be compulsory joint returns with a single rate scale.

That, I have said, is the most immoral, inappropriate proposal that could be made in the whole field of taxes. To put an annual tax on the maintenance of the legal state of marriage seems to me to be completely scandalous, and that is a proposal that was made by many previous administrations, but not since 1953.

Senator BENNETT. These rights to deduct State taxes are reduced in this bill, but not eliminated?

Mr. SMITH. Yes.

Senator BENNETT. Do you consider them to be loopholes?

Mr. SMITH. No. I do not think loophole is the appropriate term for the deductions anyway. They have been put in by act of Congress, and there is no way that a person maneuvers and makes devious conversion of income into something else by the use of the State tax.

So I certainly do not think that is a loophole. But I think they might very well be cut back, the deductibility be cut back as part of a package with a top ceiling rate of 50 percent.

Senator BENNETT. Turning the question around the other way, what would you leave in if this top 50 percent were allowed?

Mr. SMITH. Nothing except the possibility of charitable deductions.

Senator BENNETT. You would leave the personal exemption?

Mr. SMITH. Oh, yes. That is not considered as a deduction. We need to have that to keep the tax from being entirely too onerous at the very bottom bracket.

Senator BENNETT. And in light of our last discussion, you would leave the joint return unless something else happened?

Mr. SMITH. Yes.

Senator BENNETT And would you eliminate everything else?

Mr. SMITH. In the way of deductions, yes.

Senator BENNETT. These expense deductions for moving expenses contained in this bill?

Mr. SMITH. I was referring to deductions from adjusted gross income to get taxable income.

Now, there are certain other deductions that are peculiarly related to earning income. I suppose the extreme example is the salesman's expense of driving around. I think on matters of fairness that those would have to be continued as deductions with reference to getting income. But it is personal deductions below adjusted gross that I am referring to.

Senator BENNETT. That clears it up for me.

Then those things which represent costs of acquiring income?

Mr. SMITH. Yes.

Senator BENNETT. You would still leave in there?

Mr. SMITH. Yes, and perhaps we would want to take an awfully good look at the present demarcation between deductions for adjusted gross, from adjusted gross and taxable, and see if there are not some things in the wrong category on both sides on that.

Senator BENNETT. On this question of the deduction of insurance payments by individuals, you have come to that one—of interest payments.

Mr. SMITH. Yes.

Senator BENNETT. You take the position, with which I agree, that in this particular instance, the use of interest payments to reduce the cost of insurance, this should not be allowed. But what about other interest payments?

Mr. SMITH. I would be willing to go all the way and remove the deductibility of personal interest as distinct from interest associated with carrying on a business activity.

Senator BENNETT. Including interest on mortgages?

Mr. SMITH. Yes, sir.

Senator GORE. For home purchase, I take it.

Mr. SMITH. Yes.

Thank you, on owner-occupied houses.

Senator BENNETT. You would include interest on mortgage on a home? You would not permit the owner of a home that has a mortgage on it to deduct the interest on his mortgage?

Mr. SMITH. Correct, I would not.

Senator GORE. Would the Senator yield?

Senator BENNETT. Yes, sure.

Senator GORE. But you would permit it if it were interest on a mortgage or debt for the purchase of a business property or an income producing property?

Mr. SMITH. Oh, certainly. This is part of the cost of finding out what the net income is.

Senator BENNETT. Of course, we would get ourselve into some gray areas when you have a single proprietorship making a business return as a personal return, just as we now have the gray areas on the proprietorship in connection with the owner's yard expenses.

Senator GORE. And the man who uses the front room of his house for an office, uses his automobile a certain part of the time?

Mr. SMITH. And even professors, one of whom I heard of had the effrontery to claim as a business expenses one-quarter of the cost of his eight-room house on the ground that he needed an upstairs study and a downstairs study, and asked the university so to certify, and the university promptly, of course, refused.

Senator GORE. I would like to get clear in my own mind this question of alternatives, with a fixed ceiling that you suggest of 50 percent, for those whose rates are now above that figure.

Would you establish that as a single fixed ceiling, so that a man who might have 2 percent of his income above 50 percent would have very little benefit from that alternative, while the man who had the 91-percent rate applied to him would have a great benefit, or would you have a series of graded alternatives?

Mr. SMITH. I think, Senator, that it is absolutely essential that there be a series all the way up of rates, so that there would not be the sort of notch provision that we had in the law for the small corporations at one time way back in the thirties, so that nobody's marginal rate should be more than 50 percent. If there is not the sliding scale all the way up, most of the benefit I am afraid would be lost.

Senator GORE. Have you done any computation to figure out approximately what relation those various fixed rates should bear to the top marginal rate of a taxpayer?

Mr. SMITH. I would tie it in with whatever pattern of rate one has for those who do not take the option. I would set a rate such that most of those itemizing would find it beneficial to come under the rate.

Senator GORE. Roughly, probably not less than half of their top marginal rate, perhaps not more than two-thirds or three-quarters?

Mr. SMITH. Of that order of magnitude.

I have had in mind something of the two-thirds to three-quarters.

Senator GORE. Two-thirds to three-quarters?

Mr. SMITH. Yes, of that order of magnitude.

Senator GORE. And as I read your testimony, you would require a man making a choice to stick with his choice for 4 or 5 years?

Mr. SMITH. Otherwise, we would create a new shenanigan, I am afraid, of the lumping and timing of deductions.

Senator GORE. I am sure that is right.

Senator BENNETT. I was very much interested in your reference in your statement to the value added tax approach to corporate taxation. I do not think this committee has ever seriously studied that particular proposal.

I wonder if you could either prepare a memorandum for us, a brief memorandum which would enable us to understand the basic features of the tax, or refer us to a publication that would give us that information which we could put in the record.

Mr. SMITH. I would be very glad to prepare a memorandum.

(The information referred to follows:)

MEMORANDUM ON A VALUE-ADDED TAX

A value-added tax is imposed on all producers at each stage of production, preferably at a flat rate. The tax base for each company is its total sales less purchases of all sorts from other companies or suppliers which are themselves subject to the tax. Thus the tax for each company is based on the value which it adds, measured by its costs (other than purchases from those who are paying their own value-added taxes) plus profits.

A value-added tax might be considered as a partial or complete substitute for the corporation income tax, as a substitute for the selective excise taxes (other than the excises on liquor, tobacco, and gasoline), or as an additional revenue source.

In contrast to the corporation income tax, a value-added tax does not discriminate against efficient producers. Since the tax is based on total internal costs plus profits, a high-cost low-profit company would have the same tax as a low-cost high-profit company, if they both sold the same amounts at the same prices and had the same purchases from outside suppliers of material and capital equipment. Accordingly, any saving in costs through increased efficiency would be reflected fully in profits (or reduced selling prices) and any increase in costs would reduce profits by an equal amount.

Whereas the corporation income tax cushions the impact of increases in costs and thus in a sense subsidizes inefficiency, a value-added tax is neutral with respect to efficient and inefficient producers.

Adoption of a value-added tax as a partial or complete substitute for the corporation income tax would redistribute the burden of the existing income tax. If the rate of a value-added tax was just sufficient to secure the same amount of total revenue, the more efficient firms would find their tax burden reduced and might under competitive pressures reduce their prices. Analysis of the probable effect on prices of a substitution of value-added taxation for corporate income taxation is complicated. The result depends on the extent to which the existing corporation income tax has itself been reflected in prices.

It seems now to be believed by most economists and businessmen that the corporation income tax is to a very considerable extent shifted forward in prices. This opinion differs from the stated in economics textbooks of a generation or two ago when it was generally believed that a tax on profits could not be shifted and rested on the corporation and its shareholders. Neither theoretical nor statistical analysis has yet given conclusive answers regarding the incidence of the corporation income tax. The extent of shifting doubtless depends on the industry, the position of a company within an industry, and the passage of time.

To the extent that the existing corporation income tax has been shifted forward, a substitution of a value-added tax should not increase prices and may, in fact, lower prices, since the total tax burden on the more efficient firms will be reduced and these firms may be the price-setting companies.

The timing of a substitution of a value-added tax for part of the corporation income tax should be carefully planned to avoid an interim increase in total tax on the more profitable companies. It has been argued that though higher corporate income taxes have come to be reflected in higher prices, a reduction in the tax would not necessarily lead to lower prices. In the economist's phrasing, tax-induced price increases would be sticky on the down side, as are wages and other price increases. There seems to be enough validity to this reasoning to make it important that the combined value-added and corporation income tax should not be larger for any period during a transition from one to the other than the corporation income tax alone would have been for an efficient profitable company. Unless the timing is properly handled, there might be a pressure to increase prices to cover a value-added tax whenever it is imposed, without a corresponding pressure to reduce prices when the corporation income tax is reduced at a prior or subsequent time.

A substitution of a value-added tax for the corporation income tax without an increase in prices (and with the possibility of a decrease in prices) could have several economic advantages, both domestically and internationally. First, and most directly, a value-added tax can be rebated for exports, which cannot be done for a corporation income tax under the GATT agreements. This opportunity to rebate part of the total tax on business would reduce the net cost of our products in world markets, increase our exports, and improve our balance of payments.

A value-added tax would also appear to be preferable to a corporation income tax because, as noted above, any savings in costs would in the first instance be fully reflected in profits. Thus the inducement to greater efficiency would be stronger than it is under our income tax. Greater efficiency is a principal source of economic growth. And though reflected in higher profits in the first instances, competition is likely to shift much of the benefit of increased productivity into higher wages or lower prices.

Finally, a value-added tax would not deter capital investment as the corporation income tax does by increasing the cutoff point for investment decisions. Corporate investments in plant and equipment and in the development of new products are ordinarily made against some sort of standard involving an expected rate of return, a period for recovery of the investment or other more sophisticated forms of analysis such as discounted cash flows. Virtually all standards involve calculations of profits before taxes and after taxes, with the after-tax return the critical one. The higher the corporation income tax, the higher the before-tax return must be to justify any particular investment. A value-added tax would be included among all other costs and would not constitute a specific barrier to investment by requiring a higher prospective rate of return.

To the extent that the corporation income tax has not been shifted forward in prices, the advantages of a substitution of a value-added tax would not be so decisive. A bad effect of the substitution would be that the tax would tend to raise prices. Since the tax would be rebated on exports, however, the price rise would not adversely affect exports or the balance of payments.

But in spite of this disadvantage, the tax burden would be shifted away from the more efficient producers, more funds would be left in the hands of such producers for expansion, and all factors of production would tend to shift into more productive employment with consequent improvement in productivity, the national income and the rate of economic growth. The greater general productivity in turn would tend to reduce prices.

The most serious adverse effect of a partial or complete substitution of a value-added tax for a corporation income tax is that it would impose a new tax burden on new businesses which in their first years may be unprofitable even though they later become very successful. This impact, however, is significant only to the extent that the corporation tax has been shifted. The substitution of a value-added tax, if properly timed, should result in no general increase in prices, and the loss or no-profit companies would have a new tax cost which they must absorb.

If the value-added tax causes an increase in prices, that is, if the corporation income tax has not already been reflected in prices, then the burden of the new tax cost will be borne by all producers and the marginal firms will be in the same relative position in comparison with the profitable firms. In view of the social and economic importance of new companies, it would seem desirable to try to develop some basis for a lower tax or tax postponement for new firms if this could be done without inviting abuse.

The major policy decision which has to be made in adopting a value-added tax is the treatment of purchases of capital equipment. As noted above, all purchases from other companies subject to the tax must be deducted to avoid pyramiding of the tax and an incentive for vertical integration. The simple and straightforward procedure is to allow current deductions for all purchases, both of material and capital equipment. An alternative would be require amortization of the cost of capital equipment over its life. The former method seems highly preferable because it encourages capital investment and increased efficiency.

France, which is the major country using the value-added tax, secures the effect of immediate deduction for all purchases by a very simple administrative procedure which has a major incidental advantage of self-policing. Each company computes and adds to its invoices the value-added tax on its total sales price. The tax paid by any company for a period is the sum of the value-added taxes billed to its customers less the value-added tax included in the invoices of all of its purchases for the same period.

By allowing current deduction for all purchases in computing the value added by each company, a company might have no net tax if it is building up its plant and capital equipment rapidly. The current deduction gives a strong incentive to investment which is generally recognized as desirable for both long-term growth and as a recovery measure.

In France this feature is recognized as a major advantage of their value-added tax. Until 1963, the value-added tax stopped at the wholesale level, with a subsequent 2¾ percent retail tax. The value-added tax is now being substituted for the retail tax with the specific intent of securing the inducement which the tax can give to increased investment, greater efficiency, lower costs and, hopefully, lower prices.

Discussions in Great Britain about a possible substitution of the value-added tax for the profits tax appear to assume that the tax on all purchases would be currently deductible. It would seem unfortunate for any country to fail to secure the inducement to investment which is offered by this aspect of a value-added tax.

In addition to its use as a partial or complete substitute for a corporation income tax, a value-added tax might also be considered as an alternative to other forms of taxation or as a new revenue source. It is clearly preferable to a turnover tax which, by taxing each stage of production gives a strong inducement for vertical integration by imposing a greater total tax on a succession of independent stages of production.

Value-added taxation at a flat rate is preferable to a capricious selection of excises on specific products because of its nondiscriminatory application. If adopted here as a partial substitute for the corporation income tax, it might also be used as a substitute for our selective excises other than those on liquor, tobacco, and gasoline, each of which has its own good reason for special high taxation.

A value-added tax is somewhat more complicated than a uniform flat rate of tax at a single stage of production, such as a manufacturers', a wholesale, or a retail tax, but it has the great potential advantage over any of them of encouraging investment, if all purchases from other taxed producers are currently deductible.

For the reasons already given, the value-added tax would appear to be less bad as a new tax source than any alternative tax or any increase in existing taxes. However, in view of the very high total tax burden, even the adoption of the least bad tax of all with no reduction in existing taxes would increase the total tax burden with adverse economic effects. The possible availability of a new revenue source should not be considered as justification for relaxation of expenditure control.

A final major issue in the adoption of a value-added tax would be the extent of its application. It might, as discussed above, be used as a substitute for part of the corporation income tax. Alternatively it might be extended over all forms of productive activity, including services, conducted by all forms of organizations, including partnerships and proprietorships. Such extensions, with proper adjustment in individual and corporate rates, would give greater neutrality in the tax burden on all forms of consumption goods and services and all types of business than we now have. It would thereby be a better system than our present one. If the tax were introduced at a low rate of 1 or 2 percent it might be applied generally from the start. However, the clear and immediate advantages of using it as a partial substitute for the corporate income tax suggest that it might, at least in the first instance, be applied only to corporations with an assurance that the transition problems would thus be minimized.

DAN THROOP SMITH.

OCTOBER 31, 1963.

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The following two papers were delivered at the annual symposium meeting of the Tax Institute of America, Washington, D.C., October 10, 1963. They will be published in a forthcoming symposium volume and are available for interim committee use if desired.

Slitor, Richard E., "The Value-Added Tax as an Alternative to Corporate Income Tax."

Smith, Dan Throop, "Tax Alternatives for the Next Decade."

The following papers were all presented at a Conference on the Role of Direct and Indirect Taxes in the Federal Revenue System, sponsored by the National Bureau of Economic Research, Inc., and the Brookings Institution, Washington, D.C., October 17–18, 1963, and will be published in a forthcoming volume. They presumably could be made available in the interim for committee use.

Eldridge, Douglas H., "Equity, Administration, Compliance, and Intergovernmental Relations With Greater Federal Reliance on Indirect Taxes."

Musgrave, Richard A., and Richman, Peggy Brewer, "Allocation Aspects, Domestic and International."

Eckstein, Otto, with the assistance of Vito Tanzi, "European Experience With Direct and Indirect Taxes and Their Significance for Economic Growth."

Harberger, Arnold C., "Taxation, Resource Allocation, and Welfare."

Smith, Dan Throop, "Comments on European Experience With Direct and Indirect Taxes and Their Significance for Economic Growth."

Mr. SMITH. I made two trips to Europe last month, as a matter of fact, just to participate in discussions on value added taxes, because of my own great interest in it. There was a meeting of the Brookings Institution and the National Bureau of Economic Research at the end of last week where a series of splendid papers were presented on this. This will not be published for several months, but I presume the committee might request those papers, and I would urge the committee to do so.

Senator BENNETT. Since they will not be available perhaps before we have to come to a decision on this bill, Mr. Chairman, I would like to ask your permission to ask Mr. Smith to submit a memorandum briefly outlining the concept.

The CHAIRMAN. Without objection.

Senator TALMADGE. Will the Senator yield briefly at that point?

Senator BENNETT. I will be happy to yield.

Senator TALMADGE. By a value added tax, do you mean something similar to a transactions tax by which there would be a tax levied every time a dollar changed hands?

Mr. SMITH. It is like a transactions tax, Senator Talmadge, but with one tremendously important difference. There is a deduction allowed for the tax paid by the suppliers of material, capital equipment, and whatnot, to avoid any pyramiding, and that is, I really believe, essential because the transactions tax, the turnover tax, gives a strong inducement to vertical integration within industry.

Under a turnover tax, a company is better off to start with the raw material and sell only the final product. The value added tax has complete neutrality between many stages of production and a single stage of production. It has complete neutrality between costs and profits, and it may have—and this is I think the tremendously important thing about it—it may be used to give a strong inducement to capital investment.

When I was in France last month, as a matter of fact, the French were just extending their value added tax to retailing. Previously it had stopped at the wholesale level and they had a 2¾-percent retail tax. They are substituting the value added tax for the retail sales tax to get the same amount of revenue.

The way they operate and the way it is being contemplated if it were adopted in England, they would allow the immediate deduction of the tax component on capital equipment.

One of the purposes of adopting the value added tax in France is to encourage improved efficiency in retailing, which is an area of the French economy that is notoriously inefficient.

Excuse my long answer.

Senator TALMADGE. Thank you.

I appreciate the Senator from Utah yielding.

Senator BENNETT. Let me come back. You have answered the Senator's question. But I think we on the committee, and I am sure the people in the audience, would appreciate a brief affirmative statement of the theory behind the value added tax.

Mr. SMITH. I will be delighted to present one, and I will also take——

Senator BENNETT. Would you do it verbally in a minute or two now?

Mr. SMITH. Oh, yes, certainly.

The value added tax is on gross receipts less purchases from others who have been subject to it.

Senator BENNETT. The tax?

Mr. SMITH. The value added tax.

Senator BENNETT. So it ends up that any given company pays the value added tax only on that amount of the sales price which was added within that company?

Mr. SMITH. Exactly so, and another way of putting it is to say that the tax base consists of the costs incurred within the company, as compared to purchases from outside, plus the profits.

Senator BENNETT. That is right.

Mr. SMITH. One advantage here is that you have neutrality, as I have said, between profits and costs.

If you can cut cost and it goes to profits, there is no increase in tax. If you cut profits and it goes to costs, there is no reduction in tax. There is no tax subsidization for inefficiency, which we now have under the corporation income tax.

Senator BENNETT. If a man wants to reduce his tax under the value added tax concept, he has got to increase his efficiency and lower his prices?

Mr. SMITH. That is the point.

Senator BENNETT. Or lower his margin of profit?

Mr. SMITH. That is it exactly, the lowering of the price, which will have such tremendous importance in the very severe international competition that we are confronted with.

Senator BENNETT. It is interesting to me that you tell us our trading partners who are our competitors abroad are moving to this device, which presumably will help them improve their competitive situation against us.

Mr. SMITH. Yes.

Senator BENNETT. Where we have this tax on profits.

Mr. SMITH. And at the risk of repetition, let me emphasize also that under the GATT agreements the value added tax can be rebated on exports while the corporation income tax cannot be.

There is a basis for a further decrease in our prices for international competition.

Senator BENNETT. Would it not be much simpler to administer, much more simple for the taxpayer to calculate and much easier to verify?

Mr. SMITH. It would be much simpler, and I confirmed this by talking both to Government people and business people and accountants.

In France where they have both the income and the value added tax, they all agree that it was appreciably simpler. It could be still simpler if you had a flat rate.

In France they have a lot of different rates and there are problems of under which category a particular thing comes. Hopefully, the only proposed reform in France would be to have a flat rate on everything. It cannot be more complicated and it almost certainly will be much simpler than the corporation income tax.

Senator BENNETT. Those are all my questions, Mr. Chairman.

Senator GORE. Mr. Chairman, I yield to the Senator from Illinois.

Senator DIRKSEN. Mr. Smith, very little has been said about the financing of the effects of the proposed tax bill. I asked Mr. Dillon to put something in the record about it. But as it occurs to me, we will have a deficit in fiscal 1964, a deficit in 1965, a deficit in 1966, although he did not estimate what it was, and Dr. Burns, formerly of the Council of Economic Advisers, thought it would be 1972 at the earliest before we might secure a balanced budget.

Now that means that the Treasury is going to have to finance and refinance a good many of its issues, not only for new money but for issues that fall due after being refinanced in that period.

It is stated that this tax bill is designed as an incentive to get the country moving again. Well, I have some doubt that there are internal financial resources sufficient at any time to make the material gain in that field; that is, the corporate entities of the country go to into the market for money where they will be going into the same market as the Treasury to secure funds, unless, instead of going into the private sector, they want to operate through the Federal Reserve and through the banking system. But when you do that, you begin to toy with the possibility of increased interest rate and inflation, and it is aggravating enough to holders of Federal bonds who are likely as not to dump some, at least if there is a more attractive interest rate in the private sector.

It looks to me like that is not a small problem by any means.

I would be glad if you made some comment on that for the record.

Mr. SMITH. I think it is a very serious problem, as you have indicated in your statement. There is in a sense a dilemma before the Treasury, if there is net borrowing, as to whether it tries to tap the flow of private savings, which has the unfortunate effect of diverting funds from private use, which is the area that they are trying to stimulate, or alternatively relying on the banking system for expansion, the commercial banks in the first instance by selling short-term bills to them and ultimately the Federal Reserve having to provide the base by an expansion of credit. The latter has the danger of setting the inflationary spiral into effect.

I think it is very significant, as you have said by your question, that there has not been as much attention given to the debt management as there probably should have been. One can have even with a balanced budget certain inflationary action if you pay off, for instance, savings bonds by borrowing from the Federal Reserve to do so, even though there is no net deficit.

Conversely, one could have a deflationary effect if one were to retire bills held by the banks and the Federal Reserve in turn would restrict its credit base, by selling more savings bonds to individuals, taking private savings out of the stream of private income flows where presumably it is needed in an expanding economy.

This is a tremendously complex subject. I do not want to take an undue amount of time of the committee to go through all the ramifications. But I think I would just like to conclude, if I may, by emphasizing the dilemma which you pointed out that the Treasury is confronted with, as to whether it will tap private savings or resort to expansionary, with the danger of inflationary, bank financing.

Senator DIRKSEN. The bill could become self-defeating.

Mr. SMITH. I think it can.

Senator DIRKSEN. Now, little has been said about what the effect might be of this bill as far as confidence abroad is concerned.

I think I have seen at least a score of statements by central bankers and others who pretend to know the monetary problems over in Europe particularly, who look with some misgiving upon the fact that we refuse to face up to our tax problems here at home in relation to debt and deficit.

I saw two or three just a day or so ago. These are ostensibly responsible people. It certainly is important to us, in view of these recurring deficits, when you stop to consider the number of short-term obligations that are in the hands of the central banks and other individuals in Europe which would be convertible into dollars and gold.

I recall years ago while on the House Banking Committee, the unnamed White House spokesman that they used at that time mentioned the fact that we could stand a $55 billion debt. Marriner Eccles was Chairman of the Federal Reserve Board, as I recall, and, of course, everybody rushed in to say that this was a $55 billion country and obviously we could stand a debt of that size.

It seems an interesting postscript to history that at the present time our debt ceiling is $309 billion, not $55 billion. But it has occurred to me if you can stand that kind of debt, a deficit, at a point confidence not only here but abroad runs out and then you are in trouble.

It would occur to me that if they refused to hold their marbles and said, "This does not look good from where we sit," then obviously we are in trouble.

It goes to the question of increasing debt and increasing deficits, and how they interpret it as a refusal to face up to an austere program. Have you some comment?

Mr. SMITH. Well, we certainly are not following, we certainly are not taking the medicine which we advise other countries to take under similar circumstances and conditions. I am greatly concerned about it. It was for that reason that in the last sentence of my first paragraph of my statement I said:

> The country cannot afford economic experiments which are almost certain at some time or another to weaken confidence in the dollar, both internally and externally.

If we do, unfortunately, go along this line, I certainly do not want to say anything that would help weaken confidence.

On the other hand, I think in this consideration it must be recognized that that is a very real and continuing problem.

Who would do what differently and at what time, that is awfully hard to predict. These are matters of psychology on which one cannot be confident in advance as to the timing of the direction of the action. But I was impressed, as you apparently were also, by that projection of Dr. Burns; in fact, it was the one I had in mind without identification where I said some responsible estimates have the budget unbalanced for as long as a decade.

I just do not believe that we should or can with any assurance embark upon a pattern of financing that runs that, to me, very, very grave risk.

Senator DIRKSEN. Now, many statements have been made, and while the Secretary of the Treasury hedged this statement, I think one can use it as it appeared to the effect that unless the Congress approves this tax bill in substantially its present form, we might have a recession, and to counter that your outlay would cause your deficit to increase very materially, and make it necessary to shift the debt ceiling even beyond where presently they indicate we will have to put it some time before the 30th of November.

Mr. SMITH. Well, obviously intelligent and intellectually honest people are saying that and I am sure they believe it. I just think they are wrong. There has been over the decades, over the generations really, sort of a sequence of what I guess are currently fashionable ways of solving all problems.

In my graduate student days in the late twenties, we were not going to have any more depressions because we had the Federal Reserve System. Then the 1930's came along. Then the currently fashionable thing was if we just get interest rates down far enough, we will get rid of all problems.

I remember even in 1935 a very eminent world-famous economist, a British economist, said when I called on him that the real trouble is interest rates are not down low enough.

Good heavens, they were already down to virtually a nominal figure. That was the fashionable thing for a while. Now we seem to be in a mood that aggregate demand is the way to solve all problems.

I think, as I have said in my paper, that that is based upon a gross oversimplification of an appraisal. I think the attempt to deal with our problems that way may well do more harm than good. But I may be wrong. That seems to be the temper of the times so I hope I am wrong. But I am afraid I am not.

Senator RIBICOFF. You refer to the alternative or optional rate schedule?

Mr. SMITH. Yes.

Senator RIBICOFF. As Senator Long has suggested, have you worked out an overall program on that?

Mr. SMITH. No; I have not.

Senator Bennett asked if I had any specific figures on it. My comment there was, which I must repeat here, my thought is that the optional rate scale should be keyed into whatever is the basic rate scale, so it depends then upon what is adopted as the underlying rate scale.

I would have the optional rates so set that most, but not all, of those itemizing deductions would come under it.

Senator Bennett suggested this in the order of two-thirds or three-quarters of the rate scale that you have for the others. That is about the order of magnitude that I had in mind.

Senator RIBICOFF. You have not worked one out?

Mr. SMITH. No; I have not, sir.

This again is a thing that takes a sizable clerical staff to do, and I frankly, as one professor, am not in a position to do.

Senator GORE. Dr. Smith, as always, I have found you stimulating, interesting, and now and then provocative.

One thing I can always expect from your testimony is the display of a keen intellect, and I respect you and appreciate some of your suggestions, but deprecate others.

I suppose if I made a speech and you were in the audience, you might have similar views or sentiments.

Mr. SMITH. Thank you, Senator.

Senator GORE. I think that in response to the questions of Senator Talmadge and Senator Ribicoff, you have touched an extremely sensitive area.

The great needs of our society are directly concerned not with the upper 25, but the lower 25 percent of our people, many of whom are in poverty, some in abject poverty and want, none of whom are above the subsistence level.

Now, Senator Ribicoff cited some striking figures as to the number of people on relief. You talk about the nature of our unemployed. I have been unable to see how the proposed tax bill is going to solve this acute problem of the unemployed or the unemployable.

Would you mind telling us if you think this bill can provide a solution to that?

Mr. SMITH. Why, Senator, if I thought this bill would deal with that problem, I would take a terrific risk on the dollar. I do not think this bill will deal with that problem. That is the reason I am here opposing it. I think it involves entirely too much revenue loss and will not be effective in dealing with the problem.

Senator GORE. I must say that I find myself in agreement with that statement. This is one reason I am so unhappy with the program that is advocated by the administration of my own party, and I must say this is not a pleasant position for me to be in.

I would much prefer to feel otherwise.

I believe that there are ways to solve our problems. I think we must find solutions to our social and economic problems. We must find them within the realm of social justice and political morality, I think, and also within the boundaries of fiscal soundness.

Do you agree with that?

Mr. SMITH. I most certainly agree with that.

I may say I hope this is not taken as a frivolous remark, the problems are too serious to be left to the monetary and fiscal policy experts such as myself. It is only those who are immersed in the particular area, who are aware of all of the human and individual problems, the attitudes, the aptitudes of those who are unemployed, that can deal with them.

Senator GORE. Without reference to you, I must say that I consider it a very basic error to leave the solution of these problems primarily to the Department of the Treasury.

We have with us a former member of the Cabinet. I have not put him on the witness stand. But I am informed that the degree to which the Treasury Department has imposed its will upon programs designed to solve these social and economic ills has been, to me, alarming.

Mr. SMITH. You are of course well aware that as an outsider I know nothing as to who is saying what within the administration, but I would say, if I were still in the Treasury I would not want to have passed to any Treasury of which I was a part the major responsibility of dealing with these social and structural problems.

Senator GORE. You said you came to testify as an expert on monetary, fiscal, and tax policies?

Mr. SMITH. Yes, sir.

Senator GORE. I recognize that and shall not pursue the questions dealing primarily with sociopolitical problems.

Secretary Dillon agreed with me the other day that the three principal means by which the economy could either be stimulated or contracted were monetary policy, fiscal policy, and tax policy.

Would you agree with that?

I mean by fiscal policy programs of our Government in the public sector of our economy.

Mr. SMITH. I am afraid I cannot quite agree with that.

I think all of those are significant, Senator Gore, but I believe there is also a matter of, oh, for want of a better way of putting it, that the attitude of entrepreneurship—this is kind of a fancy term—I do not believe that those who are responsible for decisions on production, on investment, on modernization, on employment, are merely automatons who respond to the pushing of a button of this, that or the other sort.

Senator GORE. I would agree with you, and please understand that I regard the private sector of our economy as the mainspring of our economy.

I agree with you thoroughly that the private sector does not make automatic responses as the result of Government action. We made more investment capital available by the investment credit. But we do not find it is all used by any means. But to the extent that the Government can stimulate the private sector by tax policy, this would be one of the means of either stimulating or repressing the economy.

Mr. SMITH. Oh, certainly that, and I think tax policy is tremendously important in this regard.

Senator GORE. Yes.

I do not think there is any disagreement between us. I have not the facility for expressing myself in academic terms as you and Senator Douglas have, but maybe I can struggle along with my thoughts.

Now, as for monetary policy, Secretary Dillon and the Federal Reserve Board, operating in unison, have deliberately promoted and brought about by conscious and deliberate action higher short-term interest rates, and it has been so testified.

Not long ago the junior Senator from Georgia asked Secretary Dillon how long they could deliberately push higher short-term rates without this having an effect on long-term rates. I do not recall exactly the answer. I will not undertake to state it. But suffice it to say, in Secretary Dillon's speech to the bankers the other day he forecast that the passage of this bill would bring higher long-term interest rates.

Now, with a deliberate high interest rate policy and a tight money policy, you could not exactly say that monetary policy was used to stimulate the economy, could you?

Mr. SMITH. No; I will not say it was used to stimulate, but I would not say that an increase in short-term rates or even some increase in long-term rates would have a significantly repressive effect, because I am impressed by the fact that so much investment, certainly in the industrial field, is made where the spread between the cost of borrowed money and the projected rate of return is very large.

We economists in all the textbooks show where the lines cross and you push investment to the margin. But in point of fact, I do not believe many industrial investment decisions are marginal in the sense that a little more cost of interest or even substantially more cost of interest would be significantly repressive.

Senator GORE. Of course, some things are directly affected and quickly affected by the interest rate level. Long-term mortgages, home mortgages, and purchases of home appliances, refrigerators, television sets, long-term consumer credit, are directly and immediately affected.

Mr. SMITH. But I doubt if many decisions are affected differently.

If I may, I would make the distinction, in residences, yes, the purchase of a residence, but there we have the various forms of Federal subsidy and encouragement for debt.

On the other hand, on installment credit, in view of the fact that people do not even know what the interest cost is, and I am looking at Senator Douglas with considerable sympathy for what he has in mind if it could be done.

Senator DOUGLAS. Thank you very much.

Mr. SMITH. And handled in a feasible fashion.

Senator GORE. You are a prospective witness before that committee?

Mr. SMITH. I really do not believe on installment purchases that an increase in the interest rate would have any significant effect.

Senator GORE. Let us take automobiles.

The situation has come to the point that automobile dealers make more money selling the mortgage than they do selling the automobile.

Mr. SMITH. But we also have the variation there, will it be on 36 months or 30 months.

Senator GORE. Yes.

Mr. SMITH. And I submit that a change of terms that way could be more significant than the interest rate.

Senator GORE. And some people buy automobiles now not so much on the basis of total cost, but on how much per month it is going to cost. So these things have immediate bearings upon our economy.

Now you and I might disagree as to the degree of contractual or stimulative effect which a given monetary policy might have, and economists would disagree, but at least I think you and I will agree that a deliberate policy of increasing interest rates, both short term and long term, and restricting availability of credit is in no way stimulative of the economy.

Mr. SMITH. Senator, I am afraid I cannot go all the way on that because, if the increase in interest is a necessary condition or even helpful in maintaining confidence, in external confidence in the dollar, then I submit that even though the immediate cost of some purchases may go up, that the attitude of those who are making the large investments may be sufficiently improved because of a feeling of confidence that they would do more even at the higher cost.

Confidence is so tremendously important in this area, and I am afraid that to keep interest rates artificially low would have a serious impact upon confidence, and hence upon total economic activity.

Senator GORE. Do you think very large deficits over a period of years is also a factor in that confidence?

Mr. SMITH. I most certainly do.

Senator GORE. I had not intended to take you into the reasons which are given for a tight-money, high-interest policy. Suffice it to say that there are reasons given as to why this is advocated.

I think they are inadequate because there are ways to handle the outflow of capital and gold more effectively than this, more beneficially than this.

But from my point of view, of these three main weapons, the proposed policy of Secretary Dillon is to use only one stimulatively and the other two repressively, winding up with somewhat holding the Government in, I have thought, a position of more repression of the economy than stimulation. Perhaps a position of neutrality might be a more nearly correct appraisal.

Do you understand?

Mr. SMITH. Yes, I do.

I am disposed to agree with you unless that means that I am saying that I disapprove of the monetary policy in the sense of interest rate policy, because there I am sympathetic to what has been done.

Senator GORE. Doctor, I have no trick questions.

Mr. SMITH. I fully appreciate that, Senator.

Senator GORE. I am seriously trying to examine how this bill—if it does—reaches the real economic and social problems of our country.

Now you have said it does not?

Mr. SMITH. That is right.

Senator GORE. And I am trying to show you why I think it does not by this interrogation.

Mr. SMITH. Yes; right.

Senator GORE. One can feel that any given monetary policy is justified or unjustified, but so far as monetary policy being used to stimulate the economy at this time, no one has yet made that argument.

Mr. SMITH. No, sir.

Senator GORE. I think it currently represses the economy.

Now, with respect to the programs of action in the public sector of our economy, you have read the statements of Secretary Dillon and of President Kennedy. It is proposed to reduce dependence upon the public sector of our economy for the solution of economic and social ills.

Now I happen to feel that the unemployed people in the mountains of West Virginia are not going to be helped by a tax cut. They do not owe any taxes. What they really want is the opportunity to become taxpayers, and help is needed either to develop their communities so that industry can be attracted, or through a retraining program.

Now, either type of program is going to require some money, by grant or by loan. We are told now that the administration is opposed to continuing the accelerated public works program.

This is one of the ways by which the Government, through loans, most of which will be repaid with interest, and by grants, helps communities which are in depressed conditions to build pure water systems and sewage disposal plants and thereby either to build up indigenous industry or to attract industry into those communities.

Therefore, it seems to me that in this respect we are now being repressive. We are contractual in the promises and the forecasts.

Where are our greatest needs, social needs, economic needs, in the field of education or entertainment?

Do we need more hotels or hospitals, more office buildings or school buildings, more railroads or highways?

The pent-up needs in our society are in the public sector of our economy.

Now, this does not mean that I want to deprecate private enterprise. I still say and repeat that private enterprise is the mainspring, but I should be listening to your lecture, not you listening to mine.

If you will comment, I would appreciate it, and then I shall desist.

Mr. SMITH. Yes.

Well, I have great sympathy with much of what you say, Senator Gore.

Senator GORE. If I may just go on.

Mr. SMITH. Yes.

Senator GORE. Is not the answer the proper mix?

Mr. SMITH. Of course it is the proper mix.

Senator GORE. It is not the repudiation of the one and leaning too heavily on the other. That, I think, would not adequately do the job.

Mr. SMITH. Yes.

Senator GORE. Excuse me.

Mr. SMITH. Of course, much Government expenditure is highly productive socially and highly productive from the standpoint of providing the base for the private sector of the economy to operate.

On the other hand, I would like, if I may, just in complementing your statement——

Senator GORE. You mean complementing or supplementing?

Mr. SMITH. I was wondering how I would say it with an "e" and not an "i", to emphasize the importance of an environment in which the private sector will have free play.

Senator GORE. You do not mean free play?

Mr. SMITH. Under proper restraints, of course.

Senator GORE. Yes.

Mr. SMITH. I recall it was almost 10 years ago before this committee, as a matter of fact, the question was asked of my chief in the Treasury, Secretary Humphrey, as to how he could justify what was then being discussed, the double rate declining balance depreciation, at a time when there was certain idle capacity.

His response was in no sense an academic one, but it seemed to get to the heart of the problem wonderfully.

He said the American economy, paraphrasing roughly here, never got to its present level by having businessmen sitting back waiting for orders to come in. The possibility of being able to keep more than you pay out, the possibility of being able to concentrate upon, as I have used it, getting on with the world's work instead of the shenanigans that Senator Douglas and I so much deplore, that we all so much deplore.

I think that some parts of this bill can be useful. I think, with certain modifications, including the development of the Long amendment as it is described, could do a great deal to, well, getting the wraps off, to get on with productive enterprise and productive activity.

Now there are, of course, things where government can be very helpful, but I do believe that the measure of the success—I think this is the final point I would want to make—the measure of the success of the program is not the amount of money that is appropriated to it, but the wisdom with which it gets really at the people who are immediately concerned. And building up a large Federal superstructure is not necessarily the way to get the people in the mountains of West Virginia or the textile towns of New England or some of the rural areas of the West thinking, doing, acting the way they want to do.

Senator GORE. This must occur in the communities in which they live, or reasonably within that vicinity.

Mr. SMITH. Precisely that; it has to take place there. That is the reason I say that I think the Federal Government should be a catalytic agent and not the one that does everything.

Senator GORE. You are making a very fine argument for the area redevelopment program, and I dare say if you were in an official position, you would continue to make such an argument.

What I cannot see is how reducing governmental revenue as proposed in this bill is going to solve this problem at all.

Mr. SMITH. "All I know is what I read in the newspapers," to use Will Rogers' old phrase.

But I have seen some particular functions of the area redevelopment activities described in the newspapers which did not seem to me to be particularly useful for dealing with the problems that seem to me the serious ones, so I do not want to give a blank check to area redevelopment.

Senator GORE. I did not intend to imply——

Mr. SMITH. Yes.

Senator GORE. Well, you have been extremely helpful, so far as one member of this committee is concerned, and if I may say so, I have heard other memebrs of the committee—I will not identify them; they are not too far away—express appreciation for your erudition and your frankness.

Mr. Chairman, I thank you.

Senator DIRKSEN. May I ask Dr. Smith one quick question?

Suppose you were chairman of the board of a fair-sized corporation, and you had an abundance of cash in the treasury, and on your desk were a number of products on which the research and development had been made, and it required substantial plant expansion.

Would you, if this bill were enacted into law, find the incentive enough to go ahead with this program?

Mr. SMITH. Not very much, sir.

Senator DIRKSEN. Thank you.

Senator DOUGLAS. Thank you very much.

Mr. SMITH. Thank you, Senator.

The committee has been very patient.

Senator DOUGLAS. We have three more witnesses, but we normally recess at 12:30.

Mr. Magill will undoubtedly have quite a long statement.

Mr. McDonald, would you prefer to start testifying now for 15 minutes, with the understanding that if your testimony is not completed——

Mr. MCDONALD. Mr. Chairman, I think I can complete in a very few minutes.

Senator GORE. Does that mean that Mr. Magill will come at 2:30?

Senator DOUGLAS. Yes. Thank you very much.

The next witness is Mr. Angus McDonald, representing the National Farmers Union. I may say a statement by Mr. Edward Hollander will be made a part of the record.

(The statement referred to follows:)

STATEMENT OF EDWARD D. HOLLANDER, CHAIRMAN, EXECUTIVE COMMITTEE, AMERICANS FOR DEMOCRATIC ACTION

Americans for Democratic Action supports, in principle, H.R. 8363 as a step toward a positive program of economic expansion and economic growth. In so doing, however, Americans for Democratic Action recognizes that the bill as passed by the House has serious weaknesses which must be corrected if the bill is to serve adequately the purposes for which it is intended.

Americans for Democratic Action position on the policies posed by H.R. 8363 is longstanding as a matter of record, publicly declared and repeatedly stated before the Congress.

In our opinion, the case for tax reduction at this time rests on the need for and expansionary economic policy which will restore and sustain full employment in the United States. There are many inequities in the Federal tax system which need to be corrected, notably the excessive high rates on low-income taxpayers and the unconscionable loopholes favoring the higher income taxpayers. This is the case for tax reform. But the case for tax reduction rests on considerations of national economic policy.

On the question of the reform of the Federal tax system Americans for Democratic Action has consistently called attention to the excessively heavy burdens in the lowest income tax brackets which, in combination with the system of State and local taxation, gives a strong, regressive bias to our national tax system as a whole. Moreover, Americans for Democratic Action has repeatedly demonstrated that, both as a matter of economic policy and as a matter of simple equity, there is a compelling case in favor of closing the loopholes through which billions of dollars of income—almost all of it in the higher brackets—annually escape taxation. It has been Americans for Democratic Action position that the correction of these inequities is a necessary prerequisite to reducing the nominal tax rates on higher levels of income; that is to say, since the loopholes were created in the first place in order to mitigate the effects of the high rates in the high brackets, the lowering of those rates should be conditioned on closing the loopholes and making the new rates effective.

Americans for Democratic Action does not accept the thesis that American taxpayers, as a whole, are laboring under intolerable burdens of taxation, or that taxes are, in themselves, excessive or uneconomic. But we do recognize that the present configuration of the Federal income taxes, designed as it was to counter the inflationary aspects of the war and immediate postwar economic conditions, has a depressing effect on the present-day economy, and effectively inhibits the ability of the economy to reach full employment.

For this reason we support wholeheartedly the President's decision for the first time in history to use tax policy as a positive instrument for stimulating the economy and accelerating economic growth. By the same token, we recognize the debt which the country owes to the members of the Ways and Means Committee and the Members of the Congress who have joined in bringing the tax bill before the Senate.

At the same time, we recognize that the tax policy is only one of the two basic ingredients in fiscal policy. The other is Federal expenditure policy, and the relation between revenues and expenditures determines, to a considerable degree, whether Government fiscal policy will tend to expand the economy or to contract it.

It is clearly the purpose of this bill to bring about an expansion of the economy, which is now operating with a slack of unemployed manpower and idle productive capacity. Stripped of all pretty phrases and sugar-coating, what is involved in this tax program is a purposeful, temporary increase in the deficit in order to increase total demand and enlarge incentives for private expenditures. If the policy is successful, the effect will be not only to increase the demand and the rate of activity in the private sector but, through higher personal and business incomes, to increase the Government's revenues as well. It is not too much to say that in no other way can the budget ultimately be brought into balance.

This being the case, it follows clearly that any attempt to offset the loss of revenues from tax reduction by a reduction of Government expenditures will weaken of frustrate the invigorating economic effects of the tax reduction. Those who say that they favor tax reduction only if there are reductions or curtailments in public expenditures are in fact opposed to an expansionist fiscal policy. If they believe that reducing taxes, per se, will so increase the incentives to invest as to preclude the need for a temporary Government deficit, we say to them that repeated experience through the 1950's has demonstrated the fallacy of this belief. We remind them that the investment boom which followed the incentive taxation of the 1954 bill was short-lived because it was not accompanied by a corresponding increase in aggregate demand.

To those who favor a reduction in public expenditures as a means of shifting resources from public to private purposes, we respectfully call attention to the enormous unmet needs of the Nation for increased public outlays for schools, public welfare, housing, urban redevelopment, water supply, mass transit, highways, health facilities, recreational facilities—the list is almost endless. We therefore urge this committee and the Congress to face the fact that, in order to be effective, the tax reduction should not and cannot be accompanied by curtailment of public expenditures.

Indeed, as we look at the enormous unmet needs confronting this Nation, we of Americans for Democratic Action would prefer an expansionist fiscal policy that depend primarily on increases in public expenditures for urgent social purposes, combined with tax reform and with less emphasis on tax reduction. This is not because we are not in favor of public spending as such. Like everyone else we would like our taxes to be lower. Neither are we advocating unnecessary projects just to spend money for the unemployed. We believe simply that it makes eminently good sense to put the idle capacity and manpower to work on public investment and public services which at the present time are being massively neglected. It was such conditions as these that led the national board of Americans for Democratic Action at its meeting a month ago to state that "We cannot support a policy of buying tax reduction at the price of neglecting essential public investment and public services."

These have been Americans for Democratic Actions positions on fiscal policy for many years. As applied to H.R. 8363 they lead to the following conclusions.

First, in order to quicken the pace of economic growth a large and prompt net tax reduction is needed at this time.

Second, if Government expenditures were to be reduced or curtailed, the amount of the net tax reduction required to stimulate the economy would be increased by at least as much as the reduction in expenditures and possibly more.

Third, that a tax reduction will be most effective in expanding the economy to the extent that it is concentrated among the lower income taxpayers. This is true simply because it is well established that the propensity to consume and spend is greatest in the lower income tax classes, with the result that every dollar of net tax reduction available in these classes will add more to the total demand than a dollar of tax reduction in the higher income classes. Conversely, tax relief in the higher income classes, while it has some stimulating effect on demand, also aggravates the chronic tendencies in the economy to oversave relative to the requirements for investment.

Fourth, by the same token we believe that there is little case to be made for net tax reduction for very high income taxpayers and corporations, and that reduction in tax rates for these taxpayers is justified only to the extent that they can be offset by long overdue tax reforms.

ADA supports H.R. 8363 in principle, despite the fact that the amount of the tax reduction is insufficient for the purpose and the distribution of benefits inadequate. Frankly, if we were faced with a choice between this bill, now, and a better bill a year from now or no bill at all, we would support this bill now.

Many of the most serious problems which confront the country and the Congress will, we believe, prove to be difficult if not impossible of solution unless we are able to regain a high level of economic activity. Not only unemployment but the problems of urban poverty and depressed areas which have proved so stubborn will never yield to solution in an underemployed economy. The problem of persistent Federal deficits which sincerely troubles so many Members of the Congress, likewise is not capable of solution until the economy is operating at a high level; neither increasing taxes nor reducing expenditures can possibly bring about a balanced budget in an economy operating at 10 or 15 percent below its capacity. The problem of juvenile delinquency stems in great measure from the shortage of jobs which freeze out so many of our young people. Even the problem of discrimination in employment, so important to the civil rights issue, derives in large measure from competition for too few jobs.

Judged by these standards the bill before you falls short in several respects of what is necessary for the maximum economic effect. The benefits are too heavily concentrated in the high income groups to be fully effective in increasing total demand. Some of the most urgently needed tax reforms have been bypassed. The amount of the net tax reduction is less than needed and too long deferred to bring about a quick economic recovery. Even the bill's most earnest defenders no longer claim for it that it can restore full employment but only that it may avert a recession and perhaps lower by a little bit the unemployment rate in the next 2 years. We respectfully submit that this is not good enough.

Specifically, to remedy these defects we respectfully recommend the following amendments to H.R. 8363:

First, that it provide an increase in the personal exemption from $600 to $800.

Second, that the first taxable bracket be divided into two brackets of $1,000 taxable income each, with the applicable tax rates of 10 percent and 15 percent respectively.

Third, if these changes are not made at the very least the bill should be amended to increase the minimum standard deduction from $300 to $400 for each taxpayer, and from $100 to $200 for each additional dependent.

Fourth, that in addition to the dividend credit the dividend exclusion should be repealed in its entirety. We see no justification for any preferential treatment for dividend income.

Fifth, that the further liberalization of the investment tax credit of 1962, be removed from the bill. The investment credit as enacted, plus the liberalization of depreciation allowances has already made available enormous incentives and increased the flow of funds available for investment beyond the demand so far evident. Further liberalization can only lead to further windfalls.

Sixth, that the full benefits of the net tax reduction become effective January 1, 1964, in order that the maximum impact on the economy may be felt as soon as possible. In any event, if the bill is not passed by January 1964, the tax cuts should be retroactive.

In conclusion we reiterate the position which ADA took before the Ways and Means Committee:

"ADA would prefer an expansionist fiscal policy which would include increased expenditures for essential public facilities and services along with a reduction in taxes. We favor an immediate expansionist policy of at least $10 billion. We prefer reform along with tax reduction, but the growth of the economy must be given priority and while we would hope that both reform and reduction can be accomplished speedily, we favor the reduction under any circumstances. Finally, we believe priority should be given to tax cuts which will permanently strengthen the consumption base of the economy and thereby provide built-in stimulus to expansion in investment which is needed for economic growth."

Senator DOUGLAS. We are very glad to welcome you, Mr. McDonald. You are an old friend.

STATEMENT OF ANGUS McDONALD, ASSOCIATE DIRECTOR, LEGISLATIVE SERVICES DIVISION, NATIONAL FARMERS UNION

Mr. McDONALD. Mr. Chairman and members of the committee, my name is Angus McDonald. I am associate director of the legislative services division of the National Farmers Union. I have here a statement of our national president, James G. Patton. If it pleases the committee, I will read this statement.

National Farmers Union is in complete support of the proposals of the President of the United States in regard to tax reduction and reform which were presented to the Congress in 1962 and again in 1963. We feel that the President has analyzed the economic situation correctly. The economy, laboring under a system of wartime taxes, has not functioned efficiently. Increase in population, automation in industry, and increasing efficiency in agriculture have resulted in unemployment.

Because our gross national product has not kept pace with the steadily increasing population, a large amount of available manpower and industrial plant capacity has been wasted. The problem of mass unemployment, we feel, stems primarily from the inability of at least half of the wage earners of the Nation to purchase the goods and materials which they produce. The basic cause of unemployment is underconsumption and inability to distribute the goods of our affluent society to all our citizens.

Let us look for a moment at what we consider the real cause of unemployment and the lack of demand. Nearly one-sixth of U.S. families have annual incomes of $10,000 or more, one-fifth of all families still have incomes of less than $3,000 a year, 50 percent of all families in the United States have incomes below $5,700. Four million families living in rural areas have incomes of less than $2,500 a year.

These figures are especially significant when considered in the light of the fact that in millions of families there are two wage earners. There is a vast untapped reservoir of purchasing power in the lower 20 percent and even in the lower 50 percent. If in some way this potential demand could be realized there would be no idle capacity in industry; there would be no Federal deficit and there would be no unemployment in this country except possibly a relatively small amount which is usually referred to as technological and seasonal.

We approve the provision in the bill which will permit farmers and others to average their income over a period of years. This legislation is needed particularly in arid and semiarid areas in the uper Missouri Basin where many of the members of our organization experience periodic crop failures due to prolonged drought. The provision allowing a man and his wife a flat deduction of $300 and $100 for each additional child will help not only low income groups in agriculture, but those engaged in other occupations. This provision, together with the reduction of the tax rate from 20 percent to 14 percent, will do much to take up the slack in purchasing power, put men to work and bring about utilization of a larger proportion of plant capacity.

Underutilization of existing plant capacity and expansion of the industrial plant in proportion to increasing population, is one of the causes of unemployment. The fantastic increase in efficiency of machines should be of great concern to this committee and the Congress. Estimates vary, but some economists contend that automation will eliminate about 2 million jobs a year. This figure, together with the net million workers annually added to the labor force, means that we must in some way create 36 million new jobs in a period of 10 years.

A part of our problem of unemployment stems from the fact that the number of those reaching an employable age is at an alltime high—about 1 million more youths reached the age of 16 in 1963 than in 1942. About 800,000 young people are unemployed at the present time.

Agriculture is expected to continue to contribute to the number of those seeking industrial employment. More than 250,000 workers leave the farm annually. Only 1 out of 10 boys on the farm at the present time is expected to be engaged in agricultural production.

While we are in agreement with the objectives of the administration as implemented by parts of the bill before this committee, we feel that other parts of the legislation will not necessarily help unemployment, but perhaps bring about a further imbalance in our economy. This legislation has been characterized as a rich man's bill. Unfortunately, it goes too far, we feel, in relieving certain groups of their tax burdens. While 91 percent seems an excessive rate at which to tax those in the upper brackets, we are told that there are many loopholes in the law and that few, if any, pay this high rate.

Reduction of the tax rate on corporations likewise will probably do little to bring about increased plant expansion. Corporations are experiencing the highest profits in history. It is reported that they already have billions of dollars lying idle which they could use to build new plants and modernize old ones. Looking at the proportion of dividends and undistributed profits as represented by a chart in the October 1963 Economic Indicators it is apparent that corporations as a whole are not proverty stricken.

The part of the legislation related to capital gains is badly in need of revision. We are in accord with the views expressed by the Secretary of the Treasury recently on this part of the bill. We fail to see why capital gains should be reduced from 25 to 21 percent while at the same time capital gains on inheritances is largely allowed to escape taxation.

We also do not understand why the House of Representatives ignored the recommendation of the President in regard to wealthy individuals escaping taxes by using farm investments as a "tax haven." The practice of a wealthy individual investing in farm property to avoid payment of taxes on his off-farm income is common knowledge. The recommendation of the President would have only affected those with an off-farm net income of more than $15,000. We urge the committee to amend the bill to include this recommendation of the President.

The present bill also ignored to some extent the recommendation of the President in regard to the depletion allowance on minerals. This tax loophole should receive attention by this committee, despite the fact that oil, apparently, is considered an "untouchable." Billions of dollars of revenue escape taxation because oil companies are allowed a 50 percent net income deduction. Although the President's recommendation did not attempt to close this vast loophole, it did attempt to prevent corporations and individuals from lumping together poor and rich scattered properties with the result that the exemption actually was more than 50 percent of the net income of the separate properties.

Although this legislation, as indicated, contains many inadequacies and defects, our organization has supported it from its inception, feeling that a partial remedy is better than no remedy at all. We therefore urge the committee to approve the bill with the following amendments:

(1) Restoration of the capital gains tax from 21 percent to 25 percent;

(2) Implementation of the President's recommendation in regard to wealthy individuals using farm losses to escape payment of taxes on off-farm income; and

(3) Elimination of the provision in section 202(e) which would prevent Federal regulatory agencies from requiring regulated utilities to pass on to consumers tax savings resulting from the investment tax credit enacted in 1962. This provision is particularly obnoxious. If enacted, the Congress would be interfering in the affairs of State utility commissions whose function is to protect the public. It seems to us that those concerned with States rights should be offended by this provision.

Finally, we wish to call the committee's attention to two matters directly and indirectly concerned with taxes. Recently, Congressman Wright Patman, chairman of the House Banking and Currency Committee, after an investigation concluded that foundations which are tax exempt under our laws were receiving many billions of dollars of untaxed receipts. During the period 1951 through 1960, aggregate untaxed receipts of 534 foundations amounted to almost $7 billion.

This may be considered a major tax problem since there were 45,124 tax-exempt foundations at the close of 1960.

These foundations, it appears, escape taxation because of the laxness and irresponsibility of the Internal Revenue Service. The foundations not only do not pay taxes, but are subject to no penalties when it is found they are engaged in illegal activities. Foundations are rapidly becoming a way of life of wealthy individuals and corporations. They possess great economic power and enjoy competitive advantages which enable them to eliminate small businessmen. I call attention to President Truman's tax message to Congress on January 23, 1950, in which he said that charitable foundations were being used as a cloak for business ventures.

National Farmers Union has been invited to participate in the Treasury Department's informal Advisory Committee on Tax Exempt Foundation. We trust that the sessions of this committee may be fruitful and that eventually recommendations may be made to the Congress by the Treasury Department. However, we suggest that this committee interest itself in the problem of foundations as related to taxes and make a thoroughgoing study of the problem in addition to the study by the Treasury Department committee.

We also call attention to recent action of the Federal Reserve Board in raising the discount rate from 3 to 3½ percent which will undo in part the good effects of the tax bill and possibly result in additional unemployment. The Federal Reserve Board is under the illusion that raising interest rates would stop the out-flow of gold from the United States to other countries. In this connection, we call attention to a statement by Philip W. Bell, professor of economics, Haverford College, in hearings before the Joint Economic Committee of the Congress in August 1962.

Thank you.

Senator DOUGLAS. Thank you very much.

Senator GORE. I want to compliment you. It is a very good statement. You recommend the bill with some far-reaching amendments. I would not press you for an answer whether you would vote for this bill just as it is, take it or leave it.

My only conclusion is I could not possibly vote for that bill unless it is altered by far-reaching amendments. Would you know what the views of your organization would be, if none of these amendments which you suggest are adopted?

Mr. MCDONALD. Senator Gore, I appear before a number of committees, I have appeared for the last 15 years for the National Farmers Union.

Our procedure usually is to support or not support a bill or recommend changes which we hope will be adopted, and then come to a conclusion that even if our recommendations are not accepted, we would support the legislation anyway.

I have not discussed with Mr. Patton as to what our conclusion would be on this bill. I would hazard a guess that we would support it in its present form.

Senator GORE. But you would have to reserve judgment on that.

Mr. MCDONALD. We do the best we can, and if it does not come out like we want it to, sometimes we support legislation anyway.

Senator GORE. Thank you, Mr. Chairman.

Senator DOUGLAS. Mr. McDonald, I wish you would take under advisement and consult with your organization as to what its attitude would be toward removal of the reduction of taxes for the corporate income tax on the one hand, and then the increase in personal exemption by say $100 or $150 or $200 per person as a substitute.

In other words, switch from a decrease in the corporate tax to a decrease in the individual income tax primarily in the lower brackets.

Mr. MCDONALD. I would be glad to ascertain our position on that, Senator. In the past we have supported legislation—it seems to me one of you Senators introduced a bill to increase the exemption—I can't remember exactly, to $1,000, and we certainly would support that.

Now, the part we like, Senator Gore, about this bill, is increasing the exemption to $300, because some of these people are paying taxes—a single person I believe if he makes more than $600 or $700, he has to pay taxes, and the more we can push up that exemption, increase it, the more you will accomplish the purposes of this bill, because these lower income groups are going to spend every cent. If they get additional money, they are undoubtedly going to spend it. It is going into the flow of commerce.

Senator GORE. As I understand the theory of the personal exemption, a taxpayer or a family should be permitted a subsistence level of income even though it be on the fringe of poverty, before the heavy hand of the Government laid a tax on the income of that taxpayer or family.

In 1940 a married couple was given an exemption of $2,000. Now, it is only $1,200. Yet the cost of living is considerably more than twice as high.

Would you find out and so inform this committee in writing, whether your organization would support increasing the personal exemption for each taxpayer and dependent to a level, whatever it might be, which would allow a subsistence level of income before taxation.

Mr. MCDONALD. I would be glad to do that, Senator Gore, and submit a statement in writing. I think I can assure you that we would support such a proposal.

Senator GORE. As a substitute for many other provisions in the bill?

Mr. MCDONALD. Yes, sir.

(The following was later received for the record:)

NATIONAL FARMERS UNION,
LEGISLATIVE SERVICES,
Washington, D.C., October 28, 1963.

HON. ALBERT GORE,
Member, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR GORE: Responsive to your request that I ascertain the position of the National Farmers Union in regard to an increase in personal exemption of $1,000 under our income tax laws, I conferred with our national president, James G. Patton in Great Falls, Mont., on October 26.

Mr. Patton assured me that he was, and the members of our organization would be, in complete support of an amendment to the bill under consideration by the Senate Finance Committee which would increase the exemption from $600 to $1,000 per person. Mr. Patton furthermore asserted that such an increase in the exemption was consistent with the philosophy of the National Farmers Union as set forth in resolutions adopted over a period of many years.

I am, therefore, urging that your suggestion be presented to the committee for consideration. We will support such an amendment to the bill in every way possible.

Sincerely yours,

ANGUS McDONALD, *Associate Director.*

Senator GORE. Thank you. Mr. Chairman.

Senator DOUGLAS. We will recess until 2:30 this afternoon.

Mr. McDONALD. Thank you.

Senator GORE. Thank you, sir.

(Whereupon, at 12:30 o'clock, p.m., the committee was in recess, to reconvene at 2:30 o'clock, p.m., the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

The next witness is Mr. Roswell Magill.

Take a seat, Mr. Magill. We are very proud to have you, sir. We know the study you have made of matters relating to taxes and we are glad to have you and have any information and advice you would care to give.

Take a seat.

STATEMENT OF ROSWELL MAGILL, PARTNER, LAW FIRM OF CRAVATH, SWAINE & MOORE, NEW YORK, N.Y.

Mr. MAGILL. Thank you very much. I appreciate the opportunity to appear before the committee. I will try to make it short since you have already had lengthy and excellent discussion with my predecessor, Professor Smith.

If I may, I will put in a copy of what I am going to say and I would like to spend a few minutes summarizing it. I will offer this for the record.

The CHAIRMAN. Without objection.

(The complete prepared statement of Roswell Magill is as follows:)

STATEMENT OF ROSWELL MAGILL

My name is Roswell Magill, and I am a partner in the law firm of Cravath, Swaine & Moore, New York. I am also chairman of the Committee on Federal Tax Policy and of the Tax Foundation, but the views I express here are my own.

It is a great personal pleasure to appear before this distinguished committee. As I understand it, your task now is to answer two extremely difficult questions: First, is this the right time to cut taxes? and, second, if so, Is the bill before you the way to do the job? I should like to comment on both problems.

IS THIS THE TIME TO CUT TAXES?

In facing the question of whether taxes should be cut now, it is important to keep clearly in mind what we can hope to accomplish by a tax cut. In understandable but probably excessive enthusiasm, some persons have claimed that tax reduction is virtually a panacea that will do everything from easing juvenile delinquency to reducing the problems which grow out of automation. Even more restrained advocates offer a tax cut as a magic charm to bring what might be called instant prosperity, or at the least, to provide insurance against recession.

I fear this is overstating the merits of tax reduction. As the Committee on Federal Tax Policy has pointed out, modification of the tax system alone cannot solve today's unemployment. The latter has its sources in a variety of conditions, such as lack of training for the new job opportunities, shifts in consumer demand, difficulties the unemployed face in moving to other areas, the unattractiveness of some depressed communities for new investment by business, wage demands, competition from abroad, and so on.

No tax changes can eliminate all the problems involved in unemployment nor all the obstacles to job creation for the young people who will be seeking work. It would be wise not to expect modification of the tax system to accomplish such miracles. On the other hand, there are certain things—important things—that we can expect to accomplish by the right kind of tax change.

First and foremost is a reduction of the tremendous burden which finds the average American paying more than one-quarter of his income to government at all levels. The personal income tax, including payroll taxes, now accounts for 62 percent of total Federal tax revenues. This compares with 22 percent in the 1930's and 44 percent during World War II. A tax change which permits the individual to spend more of his money the way he wishes, instead of handing it over to government to spend, would in itself be a big accomplishment. A tax change which permits private choices to govern more spending decisions is desirable on its own merits. All of us know, of course, that we must pay out some of our earnings for the cost of government. But what we are now compelled to pay is greater than seems to me truly essential.

Secondly, we can expect the right kind of tax change to stir up new economic activity of all kinds. This Nation has grown great and prosperous through advances in the private sector. Reduction of tax burdens on the private sector is not only a valuable end in itself but also a means of aiding progress. The present Federal individual income tax, I am convinced, actively discourages all too many people from making their best contribution to growth and prosperity. The highest tax rates fall on men and women whose efforts are highly productive. The heaviest rates fall with greatest weight on the fruits of additional effort and additional saving. The burdens on business also act as a drag on progress.

It is not generally recognized that the individual income tax rates ranging up to 91 percent fall not only on individuals but also, in fact, on the earnings of most businesses. Of the 11 million businesses in the United States in 1960, 10 million were sole proprietorships and partnerships. The high rates of the individual income hit hard those which are successful. Earnings which their owners would use to finance growth and job creation go to the tax collector. A personal income tax which puts such obstacles in the way of business growth is not an aid to business expansion.

Though tax reduction will not work the wonders sometimes predicted, tax changes of the right kind will result in more private spending, saving, and investment, aiding economic expansion and job creation. In this connection, I repeat an earlier point: when Americans talk about "economic growth," we are, in fact, talking primarily about business expansion, because the productive part of our economy is overwhelmingly private. Business is so much a part of our economic life, that every dollar paid in any form in taxes will have some influence on business—and consequently on economic growth. General tax reduction, therefore, will make for a healthier, more efficient, more progressive economy.

Thus two results we can expect from proper tax changes are an increase in the ability of the taxpayer to spend more of his money as he sees fit—an enlargement of his freedom—and increased economic activity that would have the ultimate effect of raising further the American standard of living.

These are worthy goals. They do not have the immediate political appeal of eliminating unemployment or eradicating juvenile delinquency, but tax changes which help bring them about ought to have widespread appeal.

Basing a decision on these anticipated results only, the present is definitely the time to cut taxes. Unfortunately, there is one other weighty consideration—the general fiscal situation. Growth of Federal spending has outstripped population increases, the rise in prices, and the average rise in the national product. By some time next year, American governments will have spent $1 trillion since the end of fighting in Korea. Contrary to popular belief, the biggest spending increases have been in domestic programs, not defense. Accumulated Federal budget deficits in the past 10 years, after allowing for some surpluses, will total about $40 billion by next June 30. Should taxes be cut in the face of this history of deficits, especially if a tax cut would increase the probability of deficits for several years in the future? What Congress does now in reducing taxes cannot be reversed easily. You know better than I how hard it is to change the tax law. Rate cuts now are not likely to be restored if deficits persist and inflation increases. Tax reduction now should be planned with the long run in view, not chiefly the needs of the next few months.

I do not see how the problem of budget deficits can be dismissed as something which tax reduction will eventually eliminate. There is only one safe way to finance tax reduction for the years ahead. That is by restricting Federal expenditures.

I strongly agree with the recommendation of the Committee on Federal Tax Policy that Federal budget expenditures be held to $95 billion for the next 3 years—$7 billion more than 1962. This ought to be enough to buy the Federal Government services the country really needs. A ceiling of $95 billion seems to me to be in keeping both with the President's promise to keep spending down and with the admonition in the bill before you to take "all reasonable means to restrain Government spending."

A $95 billion level of spending can be achieved, despite the so-called built-in increases in spending. The Nation can take the tax reduction path to economic expansion instead of risking the expenditure-increase path, which, I am convinced, offers no assurance of healthy longrun economic expansion. We shall need to curtail and defer programs, large and small, that appeal to certain groups; adoption of new and expansion of old grant-in-aid programs for States and localities must be postponed or abandoned; we may need to check the growth of Federal payrolls. If the tax path is to take us where we want to go, we must do what needs to be done to hold down spending. I see no need for huge increases in public works spending or other deferrable programs which feed the budget deficit and invite inflation. Although it is said or implied that inflation is dead, the record of recent years in this country, and events today in some foreign countries must make us careful to avoid inviting inflation.

Responsible groups have looked closely at the facts on spending, and have concluded that the present level can be reduced and that the increase can be checked and controlled. Spending control is the ultimate responsibility of Congress, and there is encouraging evidence that Congress will resist requests for larger appropriations.

Federal spending is already so large that a standstill at $95 billion is far from "austerity." If coupled with tax changes that leave more money in the private sector, this goal is not unrealistic. When we urge the tax-reduction instead of the expenditure-increase approach, we implicitly endorse the principle that the Federal Government shall not play an ever-expanding, ever-more-dominating role in the economy; that the vast bulk of economic endeavors should be left in private hands; and that the States and localities should not become increasingly dependent upon the Central Government.

To answer my original question more directly, I believe that taxes can and should be cut now, provided clear-cut and effective restraints are placed on Federal expenditures. A carefully designed tax and expenditure program might achieve budget balance by 1966.

DOES H.R. 8363 OFFER THE BEST PROGRAM FOR TAX REDUCTION?

The second question posed at the outset of these remarks was: Is the bill before you the best way to go about reducing taxes? My answer is that it is not the best way.

I think the present bill is deficient. The amount of tax reduction involved raises issues which I do not wish to discuss now because I wish to focus on the kind of changes proposed.

As some of you may remember, I have said many times that tax burdens on low, as well as on high, incomes are excessive. In presenting the bill originally, the administration gave a somewhat different reason for concentrating revenue losses at the low end of the bracket scale. The President placed predominant emphasis on increases in consumer spending to solve the problems of unemployment and growth. The present bill reflects this view by providing that the bulk of tax reduction would go to the lowest income brackets to bolster consumer spending.

Whatever merit this approach may have had as a temporary expedient in what may have seemed a prerecession situation last winter, this merit has been largely dissipated by economic events since. National income and industrial production are high and show no signs of turning into recession. Under these circumstances, I believe that there is no reason to fashion a tax program which will be with us for many years with the predominant objective of giving the economy an artificial stimulant with real risk of inducing more inflation.

A stimulus to consumption may help raise the gross national product in the short run. For the longer run, however, growth of consumption depends on expansion of production—and this, in turn, depends on investment.

I do not see how consumer demand can lead to added investment unless the savings to pay for more investment are available. Consumer demand will not create good jobs by the hundreds of thousands each year unless the necessary capital is also available. The bill before you, it seems to me, does far too little to make more savings available for investment in relation to what would become available for consumption. Such a pattern cannot be best for long-run growth and job expansion.

In view of the investment needed now and in the future, I am astonished that more is not done in the present bill to reduce the highest tax rates. I am not enough of a mathematician to determine whether in a strict sense the bill would actually steepen progression. But the individual income tax rates are more graduated at the lower end of the scale. They are also more compressed at the top. Even under the New Deal, the rate graduation continued to $1 million and then to $5 million. During World War II graduation stopped at $200,000. Now the top level is pushed down to $100,000. Whatever the reasons given to justify progression, I can imagine no logical basis for such a rate scale.

Instead of the rates of H.R. 8363, rates ranging from 16 to a top of 50 percent, with much lower burdens than at present in the middle brackets, would be more conducive to economic expansion through savings, efficiency, and incentive for effort. Rates anywhere near 70 percent will inevitably damage the economy by forcing—and I do not think the word is too strong—persons with higher incomes to let tax factors govern much of their business, professional, and investment activities, as they do now. The tax rates which are important for revenue are those applying to the low brackets. The rates important for incentive are those higher up where the revenue involved is relatively slight and substantial relief is not costly.

Lowering tax rates on both corporations and individuals can be far more than a tax reduction. The right kind of rates will also comprise the most important tax reform that can now be made in the Federal tax structure. This kind of reform requires not only a sharp reduction in the top rates but substantial lowering of rates in the middle brackets. In my opinion, such reductions would be fully justified on grounds of fairness. Moreover, we find here the business, professional, governmental, scientific, artistic, creative, leadership whose incentives for the best of effort are so vital for progress. And, of course, much investment originates in these income ranges.

An increase in the dividend credit, not its elimination, is called for if we want to encourage job creation, plant modernization, and expansion through investment. A move in the wrong direction is worse than unfortunate and inequitable. It puts investors on notice that the excessive burdening of dividend income will continue, apparently without end. Corporate financing through equity securities will be more difficult.

The reversal of the normal and surtax rates for corporations has disturbing implications. At present, large corporations pay at a rate about 70 percent above that on the first $25,000. Under H.R. 8363, the extra burden is almost 120 percent. Such disparity is hard to justify. While we all look with favor on removal of burdens on smaller corporations, we must remember that larger corporations are important providers of jobs; that their owners include more small than rich investors; that big corporations make many of the products which are used by the vast majority of consumers. The proposed tax discrimination seems to me an unjustified burden on businesses of great importance; i.e., on their owners, employees, and consumers. Would it not also make later reduction in the 48-percent rate politically difficult?

"Economic growth" is to a large degree another way of saying "business growth." When it comes to creating new jobs, private business now provides some 60 million jobs, compared with the 9 million paid for out of taxes. About 81 percent of the net total of goods and services created in this country is produced by privately owned enterprises. The best way to achieve economic growth would be to eliminate some of the tax restraints on business. For revenue reasons the process cannot take place all at once. But gradual reduction of the corporate income tax to 30 percent (20 percent under $25,000) is possible.

Recent improvements in depreciation policies are to be applauded. They could be made even more constructive by removing doubts and restrictions growing out of the reserve ratio test. It would also be wise, I believe, to change the tax law to tax income earned abroad by American companies so as to let them meet the competition of foreign businesses in other countries.

These and other "specifics" on changing the Federal tax structure are given in more detail in the new report by the Committee on Federal Tax Policy entitled "Financing America's Future: Taxes, Economic Stability, and Growth." It would be a pleasure to provide copies of the report to any of you who have not seen it but would like to.

Although discussion of details has not been my purpose here, one matter must not pass unmentioned—complexity. The law now is much too complex. H.R. 8363 would add more complexities. Fortunately, the bill does not contain the President's proposal to treat transfer of property at death as occasion for realizing capital gains (or to provide carryover of basis). Regardless of the weakness of the arguments in support of the proposal, the complications involved should end the matter. As you study details of proposals of all types, you would serve the country well by simplifying where possible and avoiding the addition of new complexities.

There is one point I should like to mention in closing. If Congress should pass a substantial tax reduction bill, embodying major reforms in the rate structure, there is still the chance that expenditures will not be controlled to any appreciable degree. If the budget deficits get out of hand and, more serious, inflation threatens, I respectfully urge that you do not reinstate the destructive rates of the present income taxes.

As pointed out by the Committee on Federal Tax Policy, there are a number of tax alternatives including a value-added tax and various types of excises which would be better for the Nation than reimposition of present income tax rates. I mention these alternatives, but I really have faith that Congress will make them unnecessary by reasserting its constitutional control of the purse strings and keeping a tight clamp on spending increases. Despite the tremendous spending pressures to which all Members of Congress are subject, I would like to assure you that a great many Americans will applaud and support your renewed efforts to control Federal expenditures and thus make it possible to advance safely along the road to economic expansion via tax reductions.

Mr. MAGILL. What you are involved with, it seems to me, is primarily two or three fundamental propositions. The first has to do with whether or not this is the time when taxes should be reduced, having in mind the fact that there is already a budget deficit.

Then the next question is: Is this bill the proper way to do it? Is it the proper course of action to take, assuming you decide there should be a tax bill, is the proper course of action to increase the amount of money available for consumer spending, or would it be better to direct the tax bill more to the matter of providing additional savings for the taxpayers which they may invest, and thereby cause further business growth?

As to the first——

Senator GORE. Wouldn't you say that these propositions must be considered in the context of the total economic program of the Government?

Mr. MAGILL. Quite so; yes, sir. After the first question as to whether there should or should not be a tax bill at this time, I think the philosophy you come down to is whether or not this bill is so organized that there is reasonable hope that in due course it will produce additional revenue; and then No. 2, whether expenditures can be held in sufficient check so that the budget will be balanced even though this bill starts out by reducing the amount of the tax revenues.

I am a little doubtful about that, as to whether that will occur or not, for this reason: As it seems to me you go on from this proposition of reducing the tax load to the question of whether or not what you need to do is to increase money available for consumer spending; or whether what you want to do primarily is to work the tax bill out in such a way that there is more money available for investment, which in turn will cause more economic growth.

This bill is essentially directed toward the end of increasing amounts available for consumer spending. That is a short-run proposition rather than a long-run proposition.

The consumer may spend the money in the next year or so and that will promote economic activity. But there is no assurance that for the long run that is the best way to handle the tax situation.

On that score, looking at the long run, I would suppose that the wiser thing to do would be to reduce taxes in such a way as to promote additional saving and thereby additional investment, which in the end will also produce more consumer spending.

That is essentially what I have tried to say in the statement which I would like to file.

There is another document which I believe you gentlemen have had, and which I suppose should not be entered in the record because it is rather long.

This is the report of a tax foundation committee with respect to the economic situation and tax policy, and if I may, I would like to have the privilege of going through this and picking out parts and entering them in the record as part of my remarks.

The CHAIRMAN. Without objection, you will reduce the size of it.

Mr. MAGILL. I will reduce the size. Now, I will be very happy to answer any questions that you may wish to ask, although I am worried a little as to what these questions may be.

FINANCING AMERICA'S FUTURE: TAXES, ECONOMIC STABILITY AND GROWTH

(Excerpts from the report of the Committee on Federal Tax Policy)

The Committee on Federal Tax Policy was constituted in 1962 to undertake a study of the Federal tax system. Similar committees published two reports on "A Tax Program for a Solvent America" in 1945 and 1947, and issued additional studies in 1951 and 1954.

Members of the committee which prepared the most recent study, released October 7, 1963, are: Roswell Magill, chairman, attorney and former Under Secretary of the Treasury and now chairman of Tax Foundation; Charles A. Agemian, executive vice president, Chase Manhattan Bank; Alfred G. Buehler, professor of public finance, Wharton School, University of Pennsylvania; Leonard E. Kust, general tax counsel, Westinghouse Electric Corp.; and Leslie Mills, senior tax partner, Price Waterhouse & Co.

I. INTRODUCTION, CONCLUSIONS, AND RECOMMENDATIONS

Our Federal tax system is one of the most important influences affecting economic growth and the full employment of labor and the country's productive facilities. While it is not the source of all our economic troubles, the Federal tax structure is obsolete and wastefully complex. When tax rates and total tax burdens are as high as they are now, the tax system inevitably influences the economy adversely, in ways other than those directly involved in collecting dollars for the Treasury.

Tax revision is long overdue. To a great extent the structure has been shaped during periods of emergency—the depression of the 1930's World War II, and the Korean conflict—to meet "temporary" needs. Yet, a decade since the end of the fighting in Korea, no basic recasting of the system has taken place. Moreover, inflation has brought a rise of about 14 percent in the level of prices in this period and has made higher tax rates applicable at lower levels of real income. Thus in effect the progression of the individual income tax has been steepened.

The fundamental reason for taxes is to pay for Government expenditures. Federal taxes collected in the fiscal year 1963 were about $100 billion, equal to 20 percent of the net national product or 22 percent of national income. Even so, the system did not yield enough to carry the costs of Government.

The need for tax changes is no longer questioned, but the problem is not one of taxes alone. Federal expenditures must be considered along with tax revision—and the outlook for the control and reduction of Federal expenditures is not encouraging. Unless expenditures are controlled reasonably to match the revenues generated by a tax system with lower rates of income taxation, the people must make a clear national choice between a higher level of private spending and new taxes to support more Government spending.

CONCLUSIONS

1. Our Federal tax system has a pervasive influence on our economic life. As presently constituted, it is a significant impediment to the investment required for economic well-being today and future growth. The tax system urgently requires revision.

2. The current concern about the unfavorable balance of payments and the stability of the dollar as an international currency emphasizes the desirability of removing tax impediments to investment for business modernization and growth.

3. Jobs, income, and the goods and services we consume depend primarily upon the activities of private business. Corporations and unincorporated businesses are the source of the vast bulk of our national income. To advance economic welfare, we should minimize and endeavor to eliminate tax impediments to business expansion and efficiency.

4. Tax revision on any broad scale should be the best we can design not only for immediate needs, but for the long run. Current conditions cannot be ignored, but the principal emphasis should be on the needs of the decades ahead.

5. Excessive progression in the rates of the individual income tax and the unduly high rates of the individual and corporate income taxes are serious deterrents to initiative, saving, and risktaking. The extremely high rates exert a substantial distorting influence on business and individual decisions. They retard economic growth and attainment of adequate investment, employment, and consumption.

6. Whatever the conditions of the moment, longer run considerations call for tax reductions which encourage investment as a means of increasing consumption. The rate of economic growth will be governed to a large degree by the rate of investment for expansion and modernization, and the efficiency of its utilization.

7. The required revision of the tax system is inextricably related to Federal expenditures. Tax relief on the scale needed is possible only as Federal spending is reduced or as the economy grows and Government expenditures are held at a level which will permit reduction in tax rates without continuing deficits. The efficacy and the desirability of tax cutting without reduction in expenditures as a deliberate means of restoring the economy to full employment are viewed by the committee with great skepticism. Tax reduction which results in deficits for this purpose is a tenuous and uncertain means and can, at most, be condoned only temporarily. Deficits as a way of life invite uncontrolled spending, price inflation, and a further weakening of the dollar. Under present conditions of the economy, however, tax reduction which promotes faster economic growth can properly be advocated in spite of a resulting deficit, provided it is coupled with an orderly program to bring the budget into balance through expenditure reduction and control.

8. Substantial tax reduction is possible without continuing deficits if the administrative budget can be held to $95 billion for 1964 and if future increases in Federal expenditures are rigidly limited (table A). But even if spending is stabilized, tax reduction will unavoidably increase deficits until economic growth yields the revenue to match expenditures.[1]

9. The problems involved should not deter the Congress from prompt action to reduce taxes. The need for appropriate tax reduction is urgent. Expenditures can be controlled, and if they are, the prospects of a balanced budget by 1966 are good enough to warrant the acceptance of the initial deficits which will be incurred (table A).

[1] Note by L. E. Kust: "If the thesis is sound that the present tax structure yields a budget surplus before full employment is achieved, and the larger budget deficit can solve our unemployment problem, it should be noted that under the proposed rate structure and the assumed expenditures, a budget surplus would not be achieved until the GNP is approaching what should on this thesis be a full employment level."

10. The program of rate reduction of the individual and corporate income taxes should not be interrupted or reversed in order to raise revenues to finance increased Government spending. Any inadequacy of revenues from failure to control expenditures within the capacity of the new income tax structure should be covered by new tax sources; the alternative of continuing deficits and inevitable inflation is unacceptable. If the level of expenditures requires additional revenues, income tax rates should not be increased. The additional revenues should be derived from a new general excise, which would be less likely to impede investment or economic growth.

11. While the basic rate of the individual income tax is too high, the progressive rates, especially those applicable to the higher brackets, are not only punitive but have the greatest deterrent effect on capital formation. Thus, priority should be given to reduction of these rates; the revenue loss is not large but the national advantages would be great. Overall reduction in the entire rate structure depends in final analysis on the degree to which Government expenditures are held in check or alternative taxes are employed.

TABLE A.—*Estimated tax yield under recommended rate and bracket structure, selected levels of gross national product, 1964–66*

[In billions of dollars]

MEDIUM-GROWTH ESTIMATES, GNP INCREASING AT 5 PERCENT ANNUALLY ($607 IN 1964, $637 IN 1965, $669 IN 1966)

	1964	1965	1966
Revenues:			
Individual income tax	$47.0	$49.9	$51.1
Corporation income tax	23.8	24.1	24.3
Excise tax	10.9	11.5	12.0
Estate and gift tax	2.4	2.6	2.9
Customs receipts	1.4	1.5	1.7
Miscellaneous budget receipts	4.5	4.6	4.8
Total revenue	90.0	94.2	96.8
Expenditure assumption	95.0	95.0	95.0
Surplus (+) or deficit (−)	−5.0	−0.8	+1.8

LOW-GROWTH ESTIMATES, GNP INCREASING AT 4 PERCENT ANNUALLY ($601 in 1964, $625 IN 1965, $650 IN 1966)

	1964	1965	1966
Revenues:			
Individual income tax	$45.3	$48.5	$48.4
Corporation income tax	22.7	21.8	22.8
Excise tax	10.8	11.2	11.7
Estate and gift tax	2.4	2.6	2.9
Customs receipts	1.4	1.5	1.6
Miscellaneous budget receipts	4.5	4.6	4.8
Total revenue	87.1	90.2	92.2
Expenditure assumption	95.0	95.0	95.0
Surplus (+) or deficit (−)	−7.9	−4.8	−2.8

HIGH-GROWTH ESTIMATES, GNP INCREASING AT 8 PERCENT 1ST YEAR, 6 PERCENT THEREAFTER ($624 IN 1964, $661 IN 1965, $701 IN 1966)

	1964	1965	1966
Revenues:			
Individual income tax	$48.3	$51.7	$53.5
Corporation income tax	27.1	25.9	26.5
Excise tax	11.2	11.9	12.1
Estate and gift tax	2.4	2.6	2.9
Customs receipts	1.4	1.6	1.8
Miscellaneous budget receipts	4.5	4.6	4.8
Total revenue	94.9	98.3	101.6
Expenditure assumption	95.0	95.0	95.0
Surplus (+) or deficit (−)	−0.1	+3.3	+6.6

12. Elimination of inequities in the present tax structure and modification or elimination of unjustified special provisions should also be undertaken. There is merit in many of the proposals now before the Congress which are characterized as "structural reforms." Changes which will broaden the base of the income

tax and thus permit greater rate reduction are especially to be sought. Some of the proposals for structural reforms are eminently desirable in principle, but several are primarily designed to increase the tax, not to reform it. Furthermore, there are structural reforms which are not presently before the Congress but should be, since they have already been studied exhaustively by congressional committees in the past. However, controversy over changes to modify special provisions, eliminate inequities, or broaden the tax base should not be permitted to delay prompt reduction of the rates. Reduction of the great disparity between the highest and the lowest tax rates is the most urgently needed revision.

RECOMMENDATIONS

In general

1. The tax rates on both individual and corporation income should be reduced in progressive stages starting January 1, 1964.

2. The amount and the pattern of tax reduction should be designed to achieve the optimum permanent improvement of the rate structure. Short-term problems should not dominate action which will have long-run significance. Tax reductions should be planned so that budgetary balance by 1966 will be achieved.

3. The program of tax reduction and reform should be accompanied by control of Federal expenditures—by reducing some programs, avoiding or referring authorizations, eliminating some areas of Federal activity, and by holding spending programs to such levels that the budget will be balanced at lower levels of income tax rates as economic growth increases revenue yields.

4. If Federal expenditures are not reduced or controlled, neither the program of progressive reduction of income tax rates nor the ultimate goal for the income tax rate structure should be sacrificed. Rather, the revenues required to balance the budget should be obtained from a new general excise such as a tax on goods and services sold at the retail, wholesale or manufacturing level, or a value-added tax. We see no prospect of adding significantly to revenue by restricting deductions or by including in the income tax base receipts now excluded.

5. The present structure of selective excise taxes (other than those on alcoholic beverages, tobacco products and gasoline) should be revised to apply more broadly.

6. National policy to relieve small business entities from tax rates which will still be high even after the proposed reductions, should continue to be recognized by equal reductions in both the corporation normal tax and surtax rates.

7. The Congress over the past decade has developed a wealth of material on many needed reforms which have not yet been acted upon. A commission or similar body should be established with representation from the Congress, from business and professional groups, and from the public, to review and update this material, undertake any additional studies needed, and prepare recommendations in legislative form for congressional consideration. Efforts for tax reform should give emphasis to the simplification of the provisions affecting the determination of taxable income of business.

TABLE B.—*Recommended rate and bracket structure of the individual income tax*

Step 1		Step 2	
Bracket	Rate (percent)	Bracket	Rate (percent)
0 to $1,000	18	0 to $1,000	16
$1,000 to $2,000	19	$1,000 to $2,000	18
$2,000 to $4,000	21	$2,000 to $4,000	20
$4,000 to $6,000	23	$4,000 to $6,000	22
$6,000 to $9,000	25	$6,000 to $9,000	24
$9,000 to $12,000	28	$9,000 to $12,000	26
$12,000 to $15,000	31	$12,000 to $15,000	28
$15,000 to $20,000	34	$15,000 to $20,000	30
$20,000 to $25,000	37	$20,000 to $25,000	32
$25,000 to $30,000	40	$25,000 to $30,000	34
$30,000 to $40,000	43	$30,000 to $40,000	36
$40,000 to $50,000	46	$40,000 to $50,000	38
$50,000 to $70,000	49	$50,000 to $70,000	40
$70,000 to $100,000	52	$70,000 to $100,000	42
$100,000 to $150,000	55	$100,000 to $150,000	44
$150,000 to $250,000	58	$150,000 to $250,000	46
$250,000 to $500,000	61	$250,000 to $500,000	48
Over $500,000	65	Over $500,000	50

As to the individual tax

1. The rates of the individual income tax should be reduced from the present range of 20–91 percent to a range of 18–65 percent effective January 1, 1964, and to 16–50 percent effective January 1, 1966. (Table B.)

2. The brackets of the individual income tax should be broadened, the steps arranged in a more logical relationship, and the brackets extended to higher levels of income. (Table B.)

3. the personal exemptions should not be changed. Relaxation of the burdens on individuals and families with low incomes, in addition to rate reduction, should take the form of splitting the first bracket. (Table B.) Further relief for low incomes should be achieved not through the rate structure but through a credit against tax of a flat dollar amount, or alternatively a tax credit reduced by a percentage of taxable income in excess of the first bracket so that it "vanishes" as taxable income rises.[2]

4. The $50 dividend exclusion and 4 percent dividend credit should be increased. The present allowances are inadequate as a means of mitigating the double taxation of distributed corporate income. The objective should be an allowance at the initial rate of the income tax.

5. True capital gains should be taxed at progressively lower effective rates, the longer the holding period. Revisions should be made in the law to provide more rational bases for distinguishing between ordinary income and capital gains. A system should be devised which would permit disposition and investments and reinvestments without incurring tax, but with a carryover of basis and safeguards to insure that the transfers are between equity investments, or from debt to equity. This would recognize that mobility of capital is hampered by the tax liability incurred when investment capital is withdrawn from one enterprise and reinvested in another enterprise; this is a particular burden on availability of funds for new enterprises which need venture capital.

6. A system of income averaging for individuals should be implemented to avoid discriminatory taxation of fluctuating income.

7. The sick pay exclusion should be eliminated. As an alternative, a deduction of medical expenses incurred but now not allowable because of the percentage limitation should be allowed up to the amount of sick pay excludable under present law.

8. As a means of broadening the income tax base and to facilitate essential rate reduction, (a) the present deduction for taxes should be allowed only for taxes incurred in a business or in the production of income, plus State and local income, property, and general sales and use taxes; and (b) the deduction for casualty losses not incurred in a business or in the production of income, should be limited to the excess over some appropriate percentage of adjusted gross income.

9. The program of tax reduction should include a lowering of estate and gift tax rates. This step should be taken quite apart from the long-needed reappraisal of the estate and gift tax structure by the Congress.

As to the corporation tax

1. The corporate income tax should be reduced from the present 52 percent by 2 percentage points per year, one point each in the normal and surtax, commencing on January 1, 1964, and continuing until the combied rate is 30 percent.

2. The following changes in the taxation of business are desirable to encourage growth:

(*a*) Congress should provide a statutory basis for determining "guideline" lives for depreciable property, but the reserve ratio test should be eliminated.

(*b*) The base for computing depreciation should not be reduced by the investment tax credit.

(*c*) Intercorporate dividends should be freed from tax.

(*d*) The 2 percent penalty tax for filing consolidated returns should be eliminated.

3. Changes in the taxation of natural resources subject to percentage depletion and the amount of such depletion to be allowed should be considered in the light of present resource needs and reserves, and in the light of the desirability

[2] Note by Alfred Buehler: "It would be preferable, in my opinion, to meet the problem of burdens of taxes on the lower incomes directly through the rate schedule rather than by introducing another special tax differential. The tax rates on all incomes should be related to revenue requirements as well as to economic considerations."

of incentives for economic development and growth generally, such as incentives to research and development. Decisions concerning major changes in the taxation of income from natural resources should await the development of more factual information, particularly in view of the uncertain economic and revenue effects.

4. The gain on the sale of depreciable property, including depreciable real property, should be taxed as ordinary income to the extent of depreciation previously allowed.

5. The problems of taxing income from foreign sources have not been solved satisfactorily. The statutory changes made in 1962, by and large, added complexity and inequities in an already difficult area. The Congress should reexamine the basic philosophy of the 1962 amendments. This rests on an unsound concept which would require that income earned abroad by American businesses be taxed on the same basis as income earned at home, with an objective of discouraging investment in certain countries. We believe that income earned abroad by American companies should be taxed in a manner conducive to meeting the competition of foreign businesses in other countries. Such a policy would best serve the long-term balance-of-payments interests of the United States. A study should be undertaken to determine whether a solution can be found by means of international agreements for a rational allocation of income from international business.

Some interest has been evidenced in proposals for a so-called value-added tax, and in view of this the following section from the committee's report may also be pertinent:

Value-added tax.—The value-added tax may be thought of as a tax on business or as one on consumption. Value-added, in essence, is the worth or the value of what a business organization or other economic unit produces in a given period. Value-added, in its simplest form, is the difference between (*a*) the amount a company receives from the sale of its output and (*b*) the amount it paid for the raw materials and parts which went into the items sold. In general, a tax on value-added is a tax on the amount paid for labor and for the use of capital.

(1) Merits claimed: The tax appears to have advantages over other consumption or business taxes. The base would be large enough so that a modest rate would bring substantial revenues, without the distorting effects of high tax rates. Value-added appears to be a less complicated concept than net income, or even retail sale.

The tax paid at one stage of production would not enter the base for the tax at later stages. No tax-on-tax pyramiding would result if all previous taxes were excluded from the base.

Presumably the same tax rate would be imposed upon all values added. The tax would be designed to be neutral as among firms—incorporated or unincorporated, large or small, highly mechanized or relying predominantly on labor. The burden would not depend upon the relative importance of debt and equity financing. The total of value-added tax would be the same whether production is by several different firms performing the functions of successive stages or by a highly integrated business performing most of the total series of operations, provided the rate of taxation is the same.

A value-added tax would not penalize efficiency to the same extent as a net income tax may be said to do. No need would arise for averaging or for carryovers to offset the effects of fluctuating income. The tax base would be broader than profits. The lower the price at which goods are sold, the lower would be the tax per unit of sale.

The complete exemption of exports would generally be possible. Other types of output, e.g., books sold to public schools, could also be exempted.

(2) Problems: Most of the problems of defining the value-added base would involve payments for the values attributable to capital. One, for example, would be the treatment of rents, interest, and dividends among business firms, especially among financial institutions. The amounts could be included in the base of either the payee or the payor. With fully consistent treatment, the net difference in the results of the two methods for the economy as a whole would probably not be large.[3] Careful study should, of course, precede action.

New purchases of machinery, buildings, and equipment might be deducted in full in the year of purchase, or they might be deductible over a period of

[3] A bank, for example, might include in its potential base the interest it receives, as payment for the services it renders, while deducting the interest it pays. The borrowers who pay interest to the bank would deduct such payments just as they would deduct payments for materials, power, and inputs taxed to suppliers.

years. Over the long run, the two alternatives would yield much the same results. In the early years of the tax, however, the choice between the two would have some overall revenue importance—and even more significance for particular companies—depending upon the relative size of new capital outlays and depreciation.

Problems would arise when a firm produces capital equipment for itself, or both taxable and exempt products (perhaps exporting some of its output), or when it engages in both taxable and exempt activities (perhaps providing services to a State government). The building up or drawing down of inventories, refunds, and the sale of used capital assets would create problems of treatment from one year to another.

Among the deductions which would probably be allowed would be taxes paid. Certain activities—those of philanthropic organizations, for example—might be exempted. Inclusion of some of the activities of governmentally owned businesses, e.g., municipal electric systems, is conceivable.

(3) Base and yield: If the base were defined to include virtually all values produced except those in Government, private households, and nonprofit institutions, the total amount taxable (including goods and services now subject to Federal tax) would probably range from $300 to $325 billion if GNP were $600 billion. A tax rate of 5 percent might then yield around $15 billion. One must, however, expect pressures to reduce the base, perhaps by exempting small or unprofitable businesses or individuals with small professional incomes. Imports would be taxed at the same rate as domestic output.

(4) Evaluation: For the United States the value-added principal could apply to a base somewhat larger than that of the ordinary base of retail sales if services were included. Collection of the tax by allowing deduction of the tax paid by the previous firm aids cross checking of reports. The comprehensive exclusion of producers' goods would probably be somewhat easier than under a retail sales tax.

The tax would be largely hidden. It would be more neutral than the present corporation income tax. Nevertheless, the tax per dollar of sales and certainly per dollar of profit would vary greatly from one business to another.

In the short run, the ability of companies to shift the tax to consumers would not be uniform. This condition would exist even if the new tax were a substitute for part of the income tax. From one market to another, and throughout the economy, the demand and supply which determine price would not change at once on any great scale after the tax came into effect. Until the price structure fully reflected the tax, "loss" firms might have more than minor difficulty in passing the tax to consumers or in making other adjustments. If the rate of tax were high enough to yield substantial revenue, the burden on some companies might initially be onerous. The businesses hurt worst would tend to be those in the poorest position to absorb greater costs.

At first, therefore, the rate of any value-added tax should probably be not over 2 percent, even though a level of 5 percent or more may be contemplated after, perhaps, 3 years. A transition period would provide opportunity for working out details in the law and for business adjustment before any defects worked much harm. If income tax rates were being reduced, a value-added tax could be introduced when total burdens on business were going down. The process of adaptation would then present a minimum of serious difficulties except for loss companies.

The administration of a value-added tax would require tax collection from all business and professional firms. As a tax applicable to all stages of economic activity, its administration would involve many more firms than a tax confined to one level of activity (but not more than the income tax).

Senator BENNETT. Mr. Chairman, I have a question.

In your statement you bring up a point which I think many of us have overlooked. In the first full paragraph you make the point that while we think of individual taxes as income to individuals, actually of the 11 million businesses in the United States, 10 million are sole proprietorships or partnerships, so that what we call individual income taxes as far as those 10 million people are concerned are in fact direct taxes on business.

They are the people who would be most likely or are they not the people who would be most likely to invest whatever tax saving came to them directly in the business which they are operating?

Mr. MAGILL. I should think so. That is essentially why we made this statement. I think this is a fact which is commonly overlooked, that what you think of is high income people and you think that you are going to benefit wealthy individuals as distinguished from benefiting business.

Well, that isn't really so, because for the most part, as you see here, these taxes come out of the smaller businessman, and as you say, I think correctly, they would be the people who would be most likely to increase investment and thereby promote business growth.

Senator BENNETT. And many of them are in businesses—and I am speaking now from my own experience—that are always in need of capital.

Mr. MAGILL. Right.

Senator BENNETT. They being individuals, they don't have access to the security markets. They have either got to borrow this capital or save it out of their own earnings.

Mr. MAGILL. Very true.

Senator BENNETT. Borrow it from the banks or save it out of their own earnings, so the net effect is that this is a direct way in which the individual income tax rates in the brackets above the bottom one or two brackets might be stimulating to business investment.

Mr. MAGILL. I should think so, very.

Senator BENNETT. That is the only comment I wanted to make, Mr. Chairman.

The CHAIRMAN. Senator Gore.

Senator GORE. You come with a very thoughful statement, representing no one but your own good conscience, I take it?

Mr. MAGILL. That is right. To give the sinister side of my history, I am a member of a law firm of New York City called Cravath, Swaine & Moore.

Senator GORE. I wouldn't let you characterize that as sinister. I think it is a very distinguished law firm.

Mr. MAGILL. Thank you very much. I will be glad to withdraw the word "sinister."

I have been for a number of years chairman of the tax foundation. I am also chairman of the Committee on Federal Tax Policy. But I am appearing here as an individual.

Senator GORE. As one member of the committee, I want to thank you for your patriotism in coming. A good many people have come; like you and Dr. Smith this morning, Mr. Keyserling yesterday, and others.

It has been very helpful to this committee in trying to arrive at conclusions on this very difficult matter. I consider it the most important bill with which I have had to deal in my years in Congress.

It is not only a very large bill in terms of dollars, but it is precedential in many respects. Senator Byrd has pointed out that it is precedential in that it is the first time that we have had a planned deficit over a period of years in order to provide a tax reduction. What do you think of the advisability of that precedent?

Mr. MAGILL. I don't like it. I doubt if I like it any better than you do.

Senator GORE. What about Senator Byrd?

Mr. MAGILL. I will be glad to join with him, too, at any time. As you know, I am in a sense an alumnus of the Treasury. I like to think of myself as an alumnus of the Treasury. I think the position which I would have in mind as being the better one is essentially the position which Senator Byrd and yourself have been taking. There are plenty of places that the tax systems should be reformed. It would be wise to carry out those reforms without giving away the money in the form of revenue.

Senator GORE. Yes. I would join you in that. Yesterday afternoon Senator Douglas called attention to statistics which he had gotten from the Treasury Department citing a number of taxpayers with income of more than $1 million a year, and on which they paid no taxes at all. I placed in the record a table which the Department of the Treasury itself prepared showing that the composite taxpayers in various groups paid a relatively small percentage of their income, adjusted gross income, in taxes.

Were you here yesterday?

Mr. MAGILL. No, sir; I was not. I would like to see that.

Senator GORE. I would like to read some of the examples for you. It is a shocking table to me. Now please understand when I say "composite," I am not sure that is the correct word, but the Treasury in response to my request prepared this. Let me read you the caption on the table so that you will clearly understand it:

> Married couple with two dependents with typical dividends, capital gains, and other income and typical itemized deductions.

I am not sure we can say this would be the typical taxpayer at given income levels; that is why I used the word "composite." "Typical" might be a good word.

I wanted, though, to do justice to the chart and at the same time to give you a full understanding of what it was.

Now let me start with the top figure; $1 million adjusted gross income, tax payment is $261,929. This is under present law.

The average or typical taxpayer with an adjusted gross income of $1 million under present law is only paying taxes in the 26-percent bracket.

Mr. MAGILL. I think any of us, certainly a person in my position as a practicing lawyer, resents a case like that, because I know darn well I paid more than $250 taxes last year and so do we all. I don't know whether you can call that man a typical taxpayer or not. My return is more or less representative of the great mass of professional men's returns. The immediate thing you think of in the case of that man whose case you are giving is that he must have owned a lot of tax-exempt bonds.

Senator GORE. Let me give you a copy of this table.

I would think that this taxpayer would have a certain amount of income from municipal bonds, because this table shows typical dividends, typical gains, and other income, and also typical itemized deductions. However, interest from tax exempt bonds is not entered as a part of adjusted gross income.

Now let us come to a lower figure. Take the taxpayer with a $200,000 adjusted gross income. His payment is $63,318, which means that he is in the 31-percent bracket; I mean he pays a little over 31 percent of his income. This illustrates, I think, the rectitude of the position you have stated, that instead of providing a big tax reduction, a big reduction in governmental revenue when the needs of the Government are for more, not less revenue, we ought to be busying ourselves with trying to correct the inequities in our tax law.

But if you will notice this table prepared by the Treasury, if the pending bill is enacted, instead of the typical taxpayer with an adjusted gross income of $1 million paying 26 percent, he will pay 23 or 24 percent. So you see, the bill would make it worse.

Mr. MAGILL. I think the point you are making is a very good one, that what you need to do—as I see it, there are two questions before you. One is whether or not this is the time when you should reduce taxes at all.

Senator GORE. Yes.

Mr. MAGILL. And the other is whether or not this bill is the way to do it. I would be very doubtful myself, as perhaps you are, that the bill, that this bill is the way to do it.

Senator GORE. I agree with you.

I think there is serious question whether the level of governmental revenue should be reduced at all, when, as I say, with all of the debt and with the second largest deficit in peacetime history, you would think the Govrenment would be searching for additional revenue.

Mr. MAGILL. That is right, and you would suppose that you would look first to see whether expenditures can be brought down within the limits of the revenue-raising taxes which you now have, or whether you could get additional money from some source of revenue.

Senator GORE. And whether the condition of our economy is such, where the circumstances of our people are such, that some people need to pay less taxes and some people could justifiably pay more?

Mr. MAGILL. That is right.

Senator GORE. But, Mr. Magill, I think also that we can not sit here in this committee and consider this bill as an isolated piece of legislation. We must consider this as a part of the total economic program of the Government.

Mr. MAGILL. I think that is right.

Senator GORE. And when we do that, I find that this bill falls far short.

It is the wrong way to do it, and I think there are other things that we should be doing along with dealing equitably with tax dollars.

Mr. MAGILL. I am inclined to agree with you. To turn around what you are saying if I may, I think the real and basic question which is before you is whether this bill is so good that it is justifiable to pass it even though it reduces taxes below what your expenditures are going to be. Well, now, you need a very strong case, it seems to me, to justify legislative action under those circumstances. I don't believe you have it here.

Senator GORE. You need this doubt resolved beyond peradventure.

Mr. MAGILL. Quite so.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Chairman, the only thing I wish to state, that I appreciate Dr. Magill taking his time to appear before the committee. I have sat on committees before where he has testified.

His testimony has always been most valuable and I am delighted to have him here again today.

I think he has taken a very sound stand on this proposed tax legislation and I appreciate it greatly.

Mr. MAGILL. Thank you very much, Senator.

The CHAIRMAN. Senator Dirksen?

Senator DIRKSEN. Mr. Magill, I haven't seen you in a long time.

I remember my delightful visits with you when you were with the Treasury.

Mr. MAGILL. We ought to know each other well because I originated in your State.

Senator DIRKSEN. I know you did. This morning I asked Doctor Smith a question, and it is a trick question.

I said, "Suppose you were the chairman of the board of let's say, a moderate-sized corporation and you had some cash in your treasury for expansion. On your desk were a number of new products on which research and development had been completed, and you were ready to go and you wanted to go. Would you under the circumstances of this tax bill go ahead and invest that money and go for that expansion?"

Mr. MAGILL. I think you would be quite dubious about it.

Senator DIRKSEN. That is the purpose of this bill, isn't it?

Mr. MAGILL. That is right.

Senator DIRKSEN. To sponge up unemployment.

Mr. MAGILL. Of course the situation, it seems to me, has changed quite completely since the President originally proposed this bill. I think it was proposed last January, wasn't it? I believe so. At that time the President thought that the economy needed a forward shove and this bill would perform that service. The economic conditions have changed a good deal since last January. We now are going along pretty well, and I don't think this bill is calculated to give a forward shove which we may need now, but rather as I have said, the bill would be better designed if it were designed to enable all of us to save more out of our incomes than we have been able to in the past, so that we can invest and that would produce more business growth.

Senator DIRKSEN. Of course, the whole rationale of this bill is, No. 1, to put additional purchasing power in the hands of the consumer in the hope that the consumer will use it for that purpose, but if he can buy only a few additional packages of cigarettes a week or a couple of drinks of bad whiskey that is not going to excite the economy very much. But at the other end of that spectrum will it produce the incentive to expand and to provide new business that will sponge up the jobless?

Mr. MAGILL. What worries anybody in my position is that this bill will encourage consumer spending, but that is a short-term proposition. What you need for the long run, to promote more economic growth, one way to do it would be to enable further saving for investment but the bill is not geared that way.

Senator DIRKSEN. Let me ask you one other question:

I have asked Secretary Dillon to submit a memorandum, because one of the things that disturbs me is the financing of the deficit under this bill running into 1966, maybe 1967, and according to Arthur Burns, perhaps as far as into calendar year 1972.

Now, is it fair to assume that enterprise will require funds out of the private sector of the market in order to carry on this expansion program, but when we have these heavy deficits the Treasury may have to be financing the same sector, unless they depend on the Federal Reserve and the banking structure in order to carry out those deficits.

So you have got competition in the same market; and obviously it will have some impact on the interest rates, whatever they might be.

It could very well be inflationary. If it were, it would offset and sponge out certainly some of the benefits in the consumer sector to which this is directed.

Do you have any comment?

Mr. MAGILL. I don't believe I could add very much to what you have said. You brought it out very well with Professor Smith this morning, I thought.

I am fearful that this bill will not do what it is supposed to do. As I have already indicated, I am doubtful that this is the time to do it anyway.

Senator DIRKSEN. I thought Doctor Smith made one telling point this morning. If this were enacted into law and it fails, you are going to wait a good many years before you get another tax revision. The damage may have been done and it will be a continuing damage if this is not the right thing for the country at the right time.

That is all, Mr. Chairman.

Senator CARLSON. Mr. Chairman?

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Doctor Magill made a comment that I want to place in the record, an editorial that appeared in the Washington Post this morning entitled "A Bright Third Quarter."

I think Doctor Magill said the situation is a little different now than it was when the President proposed this tax cut. This editorial, in case you haven't read it, and I am not going to read it all but I want to read at least two sentences from it. The heading is, "A Bright Third Quarter":

> The clouds of uncertainty that have been darkening the short-term economic outlook are now dispelled by the news of an $8.9 billion rise in the value of goods and services produced during the July–September period, the largest gain in more than a year, and the substantial rise in the level of investment that accompanied the gain in the gross national product suggests the possibility of a gathering momentum which could carry the economy beyond the $600 billion level in the first quarter of 1964.

Now that is certainly, Doctor Magill, a different situation than prevailed at the end of last year and the beginning of this year.

Mr. MAGILL. Well, I had not actually seen that editorial, but what you have read is what I was referring to when I spoke a little earlier. I think that is a correct statement of what current economic conditions are.

Senator CARLSON. I want to quote one more sentence from this editorial.

Then we will place the entire editorial in the record, because the Washington Post has consistently urged the enactment of a tax program and the early enactment of a tax program. The sentence reads this way:

> This favorable turn in the wheel of economic fortune underscores the danger of invoking the fear of a recession in urging a prompt tax cut, a practice in which members of the administration have unfortunately indulged.

In other words, talking about a reduction in our economy when it is not factual, and the danger of leading some people to believe we may have a recession. I would like to place this in the record.

The CHAIRMAN. Without objection, it is so ordered.

(The document referred to follows:)

A BRIGHT THIRD QUARTER

The clouds of uncertainty that have been darkening the short-term economic outlook are now dispelled by the news of an $8.9 billion rise in the value of goods and services produced during the July–September period, the largest gain in more than a year. And the substantial rise in the level of investment that accompanied the gain in the gross national product suggests the possibility of a gathering momentum which could carry the economy beyond the $600 billion level in the first quarter of 1964.

What is encouraging about the rise of the GNP to the $588.5 billion rate in the third quarter is that it was accomplished by a strong expansion in the nongovernmental sectors. Of the $8.9 billion increase, only $2.2 billion—or less than 25 percent—was accounted for by increased Government expenditures, and that rise occurred largely on the State and local levels. Consumer expenditures rose by $3.9 billion and private domestic investment increased by $3.2 billion to a level which is nearly 8 percent above that of the first quarter.

Disposable personal income—or what is left after taxes are paid—rose to a record level of $404.4 billion in the third quarter, and the after-tax income per capita was $2,132.

But these gains must be viewed in the sober light of a persistently high level of unemployment. There are still more than 3.5 million Americans without jobs, and the rate of unemployment is not likely to fall below 5.5 percent unless economic growth is accelerated by the prompt reduction of income taxes.

This favorable turn in the wheel of economic fortune underscores the dangers of invoking the fear of a recession in urging a prompt tax cut, a practice in which members of the administration have unfortunately indulged. The rationale for tax reduction is that it will, over a period of years, help to close the gap between actual and potential output. Interjections of fear, based on forecasts which are subject to wide margins of error, can only detract from this compelling argument.

The CHAIRMAN. Doctor, we are very grateful to you for your appearance. You and I have been associated together for many years in regard to matters of taxation, and I have had an opportunity to come in contact with you, to know of your ability, your wisdom, and that you are working for the best interests of the country, so I appreciate your coming.

I would have some questions to ask but I understand that you have to catch a plane and I know they have been covered by others. I will also read carefully your statement.

Mr. MAGILL. Senator, I appreciate very much what you have said and I appreciate the opportunity of appearing before this committee, because if I had the wit that you have I could say the same things about the committee which you have attributed to me.

The CHAIRMAN. And you will also abbreviate to some extent the pamphlet you have?

Mr. MAGILL. I shall.

The CHAIRMAN. The Chair will ask permission to insert that in the record.

Mr. MAGILL. Thank you very much.

The CHAIRMAN. This completes the hearings for today.

We will adjourn until 10 o'clock tomorrow morning.

(Whereupon, at 3 p.m., the committee recessed, to reconvene Thursday, October 24, 1963, at 10 a.m.)

REVENUE ACT OF 1963

THURSDAY, OCTOBER 24, 1963

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, Long, Douglas, Gore, Talmadge, McCarthy, Hartke, Ribicoff, Williams, Carlson, Bennett, and Dirksen.

Also present: Nicholas Tomasulo, attorney, Joint Committee on Internal Revenue; Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

I have conferred with Mr. Biemiller and in view of the fact that Mr. Shuman has to take a plane, he has agreed that Mr. Shuman will give his testimony first.

Mr. Shuman, will you come forward, please, sir.

STATEMENT OF CHARLES B. SHUMAN, PRESIDENT, AMERICAN FARM BUREAU FEDERATION; ACCOMPANIED BY JOHN C. LYNN, LEGISLATIVE DIRECTOR; AND HERBERT HARRIS, ASSISTANT LEGISLATIVE DIRECTOR, AMERICAN FARM BUREAU FEDERATION

Mr. SHUMAN. I have with me Mr. Harris of our legislative staff and Mr. Lynn, director of our legislative department.

Mr. Chairman, we appreciate the opportunity to present Farm Bureau's views with respect to Federal tax policy. Farm Bureau has a membership of over 1,607,000 families in 49 States and Puerto Rico.

Through an extensive policy development process, our member farm families discuss problems and develop recommendations on many issues which affect them directly in the business of agriculture; also, those matters which have an important impact upon them as citizens of the United States. Rates of taxation and methods used in assessing taxes obviously are of vital importance to American farmers and ranchers.

The comments made in this statement are based upon policies adopted in December 1962 by the elected voting delegates of member State organizations.

Farm Bureau is opposed to the enactment of H.R. 8363.

We believe that a tax reduction in the amount proposed in the bill and without better assurance of reduced expenditures than has yet been provided would be fiscally irresponsible. Such action would—

Increase the deficit;

Further enlarge the national debt;

Threaten inflation; and

Retard, not expand, economic growth.

Farm Bureau's position with regard to Federal taxes is as follows:

I. It is necessary to reduce expenditures to make tax reduction economically feasible.

II. Congress should promptly institute effective expenditure controls because tax reduction is needed to improve the climate for economic growth.

III. Tax reduction should then be accomplished through rate reductions for individuals and corporations, scheduled in a series of steps and geared to responsible action with respect to the Federal budget.

IV. It is necessary to reduce expenditures to make tax reduction economically feasible: The fundamental purpose of taxes should be to raise needed government revenue in an equitable manner. Tax policy cannot be—or, at least, should not be—divorced from spending policy. Government spending must be paid for, either through taxes or inflation.

While taxes are undesirably high, our past record of fiscal management in the Federal Government has not earned us a tax cut. The fact is that, in recent years, we have consistently "borrowed from the future" through deficit financing. The Federal Government has spent more than its revenue in 26 of the past 32 years. The ever-mounting national debt which has resulted is a matter of grave concern to the American people.

Fiscal year	Budget surplus or deficit (millions)	Total public debt as of June 30 (billions)	Fiscal year	Budget surplus or deficit (millions)	Total public debt as of June 30 (billions)
1953	−$9,449	$266.1	1959	−$12,427	$284.7
1954	−3,117	271.3	1960	+1,224	286.3
1955	−4,180	274.4	1961	−3,856	289.0
1956	+1,626	272.8	1962	−6,378	298.2
1957	+1,596	270.5	1963	−6,238	305.9
1958	−2,819	276.3			

The debt has almost constantly gone upward and the budget surplus or deficit in that period of time has been mostly on the deficit side.

This failure to meet our Federal obligations through current revenue has meant that every year the Federal Government must budget increasing amounts for interest on the Federal debt. In 1964 the budget must include $10 billion for interest on the national debt. Such charges are now $3.4 billion higher than 10 years ago.

Legislation was enacted this session which increased the debt limit to $309 billion through November 30, 1963. This is the result of a deficit of $6.2 billion for fiscal year 1963.

Congress and this committee undoubtedly will be called upon again—before November has passed—to increase the debt limit still further. Deficit financing can be accommodated in no other way.

It is apparent that the request will be for a debt limit in excess of $315 billion.

Expenditures during fiscal year 1963 were $92.6 billion. The proposed budget for fiscal 1964 called for an increase of approximately $6.2 billion in expenditures to bring the total to $98.8 billion.

The 1963 deficit of $6.2 billion is the result of a budget which was initially estimated to involve a $400 million surplus. The $6.4 billion deficit in 1962 resulted from a budget which was expected to produce a $1.5 billion surplus. With this record in mind, a tax program based on an estimated deficit of $11.9 billion which was later revised to $9.2 billion could actually result in a deficit of substantially larger proportions and a fiscal situation that in our view would be irresponsible and dangerous.

Budget estimates: Receipts, new obligational authority, expenditures, and public debt

[In millions]

	1962 actual	1963 actual	1964 estimate
Budget receipts	$81,409	$86,400	$89,600
New obligational authority	92,862	101,500	107,927
Expenditures	87,787	92,600	98,802
Excess of new obligational authority over expenditures	5,075	8,900	9,125
Public debt end of year	298,200	305,900	315,600

This substantiates the figures which I have just presented.

Since over 80 percent of Federal revenue comes from individual and corporate income taxes, income tax reductions would have a significant effect upon the Federal Government's total revenue, particularly in the short run. If the Federal Government's expenditures are increased, a tax cut means more deficit financing, an increased national debt, the threat of inflation, and a loss of confidence in the soundness of the economy, which would discourage investment and prevent sound economic growth.

Farm Bureau rejects the theory that the United States can afford to take the risks involved in tax reduction without first earning it through reduced Government expenditures. We have rejected the contention that the biggest budget in the history of this country could not be substantially reduced. We have contended, instead, that such a budget should be cut and must be cut if we are to provide the sound basis for a tax reduction.

We have opposed any general reduction in taxes until effective action has been taken to reduce Federal Government expenditures. Actual expenditures in the current year, of course, cannot be completely controlled by Congress. However, new obligational authority can be controlled by Congress.

On March 20, 1963, Farm Bureau's position was presented to the Committee on Ways and Means of the House of Representatives as follows:

> If and when a reduction of at least $13.6 billion in new obligational authority has been achieved, we will support a tax cut * * * provided the tax reduction effected the first year is less than one-third of the amount by which new obligational authority for fiscal 1964 is reduced * * *.

During the current session Farm Bureau has presented specific recommendations to Congress to accomplish a $13.6 billion reduction in new obligational authority—including a reduction of over $1 billion in appropriations for agriculture.

The current situation is as follows:

1. The administration's budget requests called for new obligational authority of approximately $108 billion.

Approximately $12 billion of this reflects permanent authorizations for such things as interest on the national debt.

2. The House of Representatives has acted on eight major appropriation bills for fiscal 1964. These bills cover requests for new obligational authority of $85.2 billion.

3. House committee and floor action have reduced this amount to $80.5 billion.

4. The reduction of new obligational authority as a result of House action is $4.7 billion.

Since the House has taken action on approximately $85.2 billion of the President's budget requests, only about $11 billion remains to be acted on by the House. The $4.7 billion cut achieved thus far certainly is a meager reduction as compared to proposed new obligational authority of $108 billion.

Despite its plea for tax reduction, the administration has sought full restoration of these cuts in the Senate. In the appropriation bills considered so far this session by the Senate, House cuts totaling $530 million have been restored.

Therefore, with budget requests calling for a record new obligational authority of $108 billion, Congress has to date reduced these requests by only $2.4 billion in appropriation bills on which congressional action has been completed.

In view of the record, the fact is clear—a tax cut has not been earned through effective control of Federal expenditures.

II. Congress should promptly institute effective expenditure controls, because tax reduction is needed to improve the climate for economic growth: In our view, the U.S. economy has demonstrated considerable strength and is continuing to do so. We believe in the desirability of a higher rate of economic growth. But no one should deprecate the economic progress this country has made since the end of World War II.

We should not be misled by comparisons with foreign statistics which reflect the recovery of industrial economies from the destruction of war.

Economic growth is a complex thing. It does not take place at a uniform rate, and we should not expect it to do so. We should also recognize the danger that too much emphasis on growth might unbalance the economy and lead to future trouble.

While our present tax structure is by no means the only impediment to a higher rate of economic growth, it undoubtedly is an important one. Excessively high rates drain off the private investment capital that is needed to create new job opportunities through the development of new industries and expanded market for old industries. At the worst, high rates discourage risk taking, innovation, imaginative undertakings—the elements that generate progress.

Marginal tax rates that run as high as 91 percent are so punitive that they either kill incentive or lead to an erosion of the tax base by encouraging the enactment of numerous special rules and regulations for particular situations.

Given the power to tax away such a high percentage of the return, the Government directs the use of private capital. This often means that income is virtually confiscated unless it is directed into an activity prescribed by the Government through a process of political determination. In a very real sense, this substitutes the judgment of a relatively few Government officials for the judgment of millions of individuals in the day-to-day operation of our economic system.

Tax reductions are needed to release funds for private capital investment in a wide variety of projects and to encourage the use of such funds in sound investments.

Tax reduction, also, is important to the solution of our international balance-of-payments problem.

For more than a decade the United States has spent more abroad than foreign countries have spent in the United States (the only exception was the Suez crisis year of 1957). In recent years we have been relatively unsuccessful in correcting the imbalance despite the fact that we have maintained a sizable surplus in our balance of trade.

One of the critical factors in this problem is the persistent outflow of U.S. capital and the rather weak attraction the U.S. economy has had for foreign capital.

For example, U.S. long-term investments abroad exceeded foreign long-term investments in the United States by $2.1 billion both in 1960 and 1961. The net dollar loss from this factor in 1962 was $2.5 billion.

Our total international balance-of-payments deficit in 1962 amounted to $2.2 billion.

It is widely recognized that action should be taken to correct this dollar outflow. Yet the net dollar loss from this factor in the first half of 1963 is at the annual rate of $3.8 billion.

Government restrictions on investment abroad are not the answer, nor should tax penalties be applied to such investment. Rather, we must take those basic actions which will make investment in the United States more attractive to all investors and also strengthen our competitive position through reductions in U.S. production costs.

One of the most important actions we can take in this regard is to reduce the burden of excessive taxation and at the same time maintain confidence in the soundness of the economy. Obviously a tax cut based on deficit financing and a substantial increase in borrowing would not achieve this objective.

Agriculture can be an important element in the solution of our balance-of-payments problem—if our domestic programs are geared to the world market.

For example, U.S. cotton exports in 1962–63 declined 3.3 million bales below the 1960–61 level. This represented lost exports of approximately $400 million because of the mismanagement of the domestic and export cotton program. Instead of carrying out the true spirit of the Agricultural Act of 1958, which called for gradually lowering the price support level, the Secretary of Agriculture made two mistakes.

First, he increased the support price, and then he failed to offset the increased support price by raising the export subsidy sufficient to maintain U.S. cotton's competitive position in the foreign markets. These lost export earnings have aggravated further our serious balance-of-payments difficulty.

Current legislative proposals to make our cotton industry dependent on direct payments from the Government are not the answer.

On the other hand, there is every reason to believe that with the realistic administration of the provisions of the Agricultural Act of 1958 as applied to cotton, our exports could be built up again to the 1959 and 1960 figure of approximately 7 million bales. This would amount to increased dollar export earnings of approximately $500 million.

I would like to point out here that in light of this serious situation, it seems almost incredible that the House of Representatives would be seriously considering legislation that would increase the cost of the cotton program by almost $1 billion.

III. Tax reduction should then be accomplished through rate reduction for individuals and corporations, scheduled in a series of steps and geared to responsible action with respect to the Federal budget: We believe tax reduction should—

(1) Stimulate economic growth by giving primary emphasis to increased private capital investment;

(2) Reduce the excessive tax burden for individuals in all brackets of the income tax schedule and also for corporations;

(3) Be scheduled over several years in order to increase the incentive for investors to risk their capital in job-producing ventures by minimizing the threat of inflation;

(4) Be contingent upon a substantial reduction in new obligational authority in the first year of its effectiveness and upon a balanced budget in subsequent years.

We recognize that such a reduction does not fit into the "quick boost" or "shot in the arm" philosophy. Rather, it is predicated upon the principle of increasing net capital formation through private investment to solve the chronic and fundamental inability of the economy to realize its full potential and to move ahead at a satisfactory annual growth rate. It would stimulate investment, not inflation. It would emphasize opportunity and incentive to invest with expectation of proportionate return.

By reducing corporate tax rates and individual rates in the upper- and middle-income brackets, additional capital will be made available for private investment. By reducing the tax burden on all taxpayers, additional private purchasing power will be made available to stimulate the investment of such capital.

The promise of additional tax cuts in the years ahead would increase confidence in our economy and thus give added confidence to additional investment.

At the same time, by making tax reductions contingent upon sharp reductions in new obligational authority in the initial year and a balanced budget thereafter, we would be providing additional incentive for the sort of self-discipline that is necessary if we are to have successful self-government.

If deficits were the solution to economic problems and economic growth, our economy should be booming at the present time and there would be little need to extend foreign aid to many of the so-called underdeveloped countries.

The U.S. record for recent years has been as follows:

Fiscal 1961: Revenue, $77.6 billion; spending, $81.5 billion; deficit, $3.9 billion.

Fiscal 1962: Revenue, $81.4 billion; spending, $87.8 billion; deficit, $6.4 billion.

Fiscal 1963: Revenue, $86.4 billion; spending, $92.6 billion; deficit, $6.2 billion.

It is politically easy to spend; it is politically difficult to tax. Our private competitive enterprise system is placed in jeopardy by a siren song which seems to say, "We can spend without taxing; we can solve without effort."

The provisions of H.R. 8363 do not meet the criteria for tax reduction established by Farm Bureau policy. Tax reduction has not been geared to responsible action with respect to the Federal budget.

In addition, the rate schedule proposed in H.R. 8363 seriously distorts the graduation through the middle brackets and does not give primary emphasis, therefore, to the need for increased private capital investment.

For example, under the present rate structure, 36 out of 71 of the percentage points of graduation are reached at the $20,000 to $22,000 bracket in the case of a single taxpayer. Under the proposed schedule, 34 out of 56 percentage points of graduation are reached at the same bracket.

H.R. 8363 increases the intensity of graduation in brackets below $22,000 from one-half to two-thirds. Tax reduction should be accompanied by rate reform, not rate distortion.

UNDESIRABLE REFORM PROPOSALS PROVIDE ADDITIONAL REASONS FOR OPPOSITION TO THE PRESENT BILL

The so-called tax reform provisions of H.R. 8363 include some proposals that appear to have merit, some that we do not feel qualified to evaluate, and still others that are definitely undesirable.

In terms of Farm Bureau policy, the most objectionable of the "reform" provisions are those relating to—

(*a*) The minimum standard deduction;

(*b*) Adjustment of the basis of property on which an investment credit has been taken; and

(*c*) Elimination of the present dividend credit.

The House report indicates that the proposal to establish a per capita minimum standard deduction would remove 1.5 million taxpayers from the tax rolls. In our opinion, this would be highly undesirable. Every self-supporting person should make a direct contribution to the support of the Federal Government. The payment of even a small income tax will remind a taxpayer of the fact that government costs money.

A reduction in the number of people who are required to pay income taxes inevitably would increase the number of voters who are sure that someone else will bear the cost of proposed Federal programs. This cannot help but to encourage pressures for fiscal irresponsibility.

We would also like to point out that the idea of a per capita minimum standard deduction is completely illogical because it bears no relationship to the deductions individual taxpayers would be entitled to take on an itemized basis. In reality, this proposal is nothing more than an effort to increase personal exemptions for a part of the taxpaying public. It should not be enacted.

When the investment credit was originally before Congress, we took the position that it was "a selective form of tax relief" which would have discriminatory results and that—

it would be far better to liberalize the treatment of depreciation and to work toward a general reduction in income tax rates.

Among other things, we pointed out that the credit, as originally proposed, was in reality a subsidy because credit for new investment was to be allowed as a deduction from the amount due as taxes rather than as an adjustment in the amount of income subject to tax, and also because credit was to be allowed without reducing the basis for depreciation.

The Senate subsequently adopted an amendment which reduced the subsidy nature of the investment credit by providing that the basis for depreciation of capital items must be reduced by the amount of credit.

In our opinion, the Senate's action was fully justified, not only in terms of sound tax principles, but also by the fact that administrative action was taken to liberalize the treatment of depreciation while the investment credit was under consideration.

Repeal of the present requirement that the basis for depreciation must be reduced by the amount of the investment credit taken would be a backward step which would materially increase the subsidy aspects of these credits. We are opposed to such action.

As a matter of principle, we believe that all corporation earnings should be subject to a single Federal income tax, and that earnings distributed to stockholders should not be taxed in the hands of both the corporation and the stockholders.

We have supported the present $50 dividend exclusion and 4-percent credit as initial steps toward elimination of the double taxation of corporate dividends.

Under H.R. 8363, the $50 exclusion would be increased to $100 and the present 4-percent credit would be repealed. It is argued that this would completely eliminate the double taxation of dividends for a large number of stockholders, and that the number of taxpayers who would gain from the increase in the exclusion is greater than the number who lose by repeal of the 4-percent credit.

This may well be the case; however, the real issue is the equity of taxing distributed corporate earnings both in the hands of the corporation and in the hands of the stockholders.

If relief from the double taxation of distributed earnings is justified as a matter of principle, as we believe to be the case, the amount of relief to be granted should not be subjected to an absolute per capita ceiling even though the number of people that would be adversely affected may be rather small. Accordingly, we are opposed to the elimination of the 4-percent dividend credit.

In summary, Farm Bureau believes that Federal taxes are execessive and should be reduced. However, tax reduction should be based on reduced Federal expenditures—not on deficit financing.

We firmly believe that the task of first priority for Congress is effective control of Federal expenditures through the substantial reduction of new obligational authority.

Since that task has not as yet been accomplished, Farm Bureau opposes the enactment of H.R. 8363.

The CHAIRMAN. Thank you very much, Mr. Shuman.

Senator Long.

Senator LONG. I notice that President Eisenhower stated that he felt that we ought to bring all but one of those two divisions in Europe back home. If that were the case, it seems to me that that would just about solve our defense problem.

Is it not more or less unprecedented, in fact is it not almost completely without precedent in world history for one country to indefinitely maintain huge numbers of its people, particularly its military forces, on the soil of another nation long after a war is over, at that nation's own expense?

It has been done, I know; occupying forces have over a long period of time occupied someone's soil, making the occupant pay for it, but do you know of any previous case in history where someone has kept their troops on the soil of another nation over a decade at the expense of the country sending the troops?

Mr. SHUMAN. I am not that good a student of history. I do not recall any. There may have been, but I do not recall any, Senator.

Senator LONG. If we would change our policy as President Eisenhower is recommending, would not that one item tend to solve our whole balance-of-payments problem?

Mr. SHUMAN. I think there are several things that could be done to improve the balance-of-payments problem, one of which would be reducing military expenditures, of course.

Another would be reduction of foreign aid expenditures.

It seems to me that there comes a time when we must decide whether or not we can afford to continue foreign aid programs at the present rate. Of course, one of the real serious causes of our balance-of-payments problem is the difference, the unfavorable difference in inflationary policies in this country and other countries which have in effect caused capital to flee this country or avoid coming here.

Senator LONG. It seems to me that we have succeeded in proving how a nation could divest itself of its gold in three ways—three good possibilities.

One of them is by maintaining fantastic numbers of our nationals on somebody else's soil over a long period of time. I understand we now have 750,000 Americans in Europe alone. Not all of those are troops. Only a small percentage of them are actual combat troops, but that is the magnificent figure that we have succeeded in achieving, I believe, 750,000 even at this late date.

Then the second way that you can divest yourself of your gold is to give away fantastic amounts of money where a loan would have served the purpose just as well. If it ever occurred to anybody that that Marshall plan might actually be a success, that those nations might actually recover—in fact, if it had ever occurred to anybody that those nations recovered in the past and might have recovered without our help, rather than giving the $17 billion to Western Europe, we could have loaned the money and we now would not be in a position that those nations could empty Fort Knox, Ky.

Now a third way of divesting yourself of your gold is that in the event that you are going to give it when a loan would serve the purpose just as well, that you would then proceed to continue the aid long after there is no longer any real need for it.

I understand that the bill for Western Europe this year is about $400 million on commitments not authorized by Congress, simply made by administrators sitting around listening in the afterhours I suppose with their foreign friends, committing themselves to put up large amounts of money beyond any immediate need of it.

So we are now committed to aid rich countries, which, incidentally, hold the very dollars and credits that are necessary to empty Fort Knox.

The aid still goes on even though we are not able to pay off in gold what we owe already.

Now I take it that your association is against all those methods, and that would tend to prevent this country from being the master of its own monetary policy.

Mr. SHUMAN. We have a great deal of sympathy with the statement of problems that you have presented there. We believe that there can be reductions made in defense spending, in foreign aid, and we also believe that meeting our fiscal responsibilities and living within our income as a government would also help correct the balance-of-payments problem.

We are very much concerned along with the administration and many other people, with the continuing deficit in the U.S. balance of payments.

I think it is a question of whether our foreign aid policies of government to government assistance has accomplished its objective or whether they might not have recovered as well or more rapidly if other policies had been followed.

Senator LONG. The excuse for these high-interest rates that exist in this administration has been that we have an unfavorable balance of payments.

My impression would be that if this administration had done what our party platform stated, that is to drastically reduce interest rates, the carrying charges on the national debt would be about $5 billion less than they are today.

Do you or your organization have any views on that matter?

Mr. SHUMAN. Yes.

We believe that there is a money market just the same as there is a market for commodities, and that the price of money or credits is the interest rate and that it ought to be free to change. We do not believe in an artificial manipulation of interest rates.

I just want to say that dealing with the international balance of payments problems with interest is dealing with the symptoms, not the cause.

Senator LONG. My impression is that this Nation and this Government has been using its influence to manipulate those rates upward. Insofar as the influence of this administration has been used, it has been used to keep interest rates high and not to bring them down.

Mr. SHUMAN. I have not studied the effect of their actions on interest rates.

We are not in sympathy with government action to manipulate artificially interest rates either up or down, and we do not believe that this is an effective cure of the balance-of-payments problem.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. Mr. Shuman, I have no questions. I merely want to congratulate you on one of the best statements that has been presented to this committee in connection with this tax bill.

Mr. SHUMAN. Thank you, Senator.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Mr. Chairman, Mr. Shuman is a distinguished citizen of Illinois, highly respected by everyone. We are kindly in our personal relations. We do not always agree on economic policy, Mr. Chairman, but I want to say that I have a very real respect and an acute affection for him.

Mr. SHUMAN. Thank you, Senator.

Senator DOUGLAS. In spite of his deviations.

Mr. SHUMAN. Thank you.

Senator DOUGLAS. There is one thing that puzzles me, Mr. Shuman. You speak of the administration asking for new obligational authority of approximately $108 billion, and then you speak of the administration asking for expenditures of $98.8 billion, and you say the House has already acted on $85.2 billion, only about $11 billion remains to be acted on by the House. That comes to $96 billion.

Where do you get the extra $10 billion, the difference between $98 billion and——

Mr. SHUMAN. It is actually almost an extra $12 billion which is the amount that is permanent authorization for such things as interest on the national debt. It is explained——

Senator DOUGLAS. That is an annual charge, Mr. Shuman.

Mr. SHUMAN. Well, the Congress has no control of it. It is included in the $108 billion.

Under point numbered I, we say the budget request calls for new obligational authority of $108 billion and the next sentence says "of which approximately $12 billion reflects permanent authorizations." This leaves $96 billion that the Congress can act on.

Senator DOUGLAS. There is a question in my mind.

I thought $10 billion of interest was included in the $98 billion.

Mr. SHUMAN. The $98 billion is budget.

Senator DOUGLAS. Does that include $10 billion?

Mr. SHUMAN. Yes.

Senator DOUGLAS. Allowance for?

Mr. SHUMAN. Yes.

Senator DOUGLAS. Where do you get the extra $10 billion?

Mr. SHUMAN. The extra is the amount that the new obligational authority as proposed by the administration exceeds the spending.

Senator DOUGLAS. For what purpose would this be?

Mr. SHUMAN. It would include a number of items where new obligational authority exceeds the actual estimate of spending in the budget year. New obligational authority virtually never coincides with the spending.

Senator DOUGLAS. I wonder if you could itemize those, or if you would have your staff itemize them for the record.

Mr. SHUMAN. I think we can. We would be glad to do that.

Senator DOUGLAS. I have a feeling this is an inflated figure so far as current expenditures are concerned.

Mr. SHUMAN. We will be glad to itemize it.

(The following has been compiled from the official budget for fiscal year ending June 30, 1964:)

The budget for fiscal year 1964

[In millions]

	Estimated	
	New obligational authority	Expenditures
Total, national defense	$56,702	$55,433
Total, international affairs and finance	4,514	2,679
National Aeronautics and Space Administration	5,712	4,200
Total, agriculture and agricultural resources	7,289	5,696
Total, natural resources	2,628	2,503
Total, commerce and transportation	3,091	3,388
Total, housing and community development	509	276
Total, health, labor, and welfare	5,984	5,613
Total, education	2,983	1,537
Total, veterans benefits and services	5,594	5,484
Total, interest	10,103	10,103
Total, general government	2,277	2,195
Allowances, undistributed:		
Comparability pay adjustment	200	200
Contingencies	250	175
Interfund transactions (−)		−679
Total administrative budget	107,927	98,802

Senator DOUGLAS. Thank you.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Mr. Shuman, I am repetitive when I say this is an excellent statement. I think it has two very interesting meanings for me and maybe for the rest of the committee.

I had not realized until you read in your statement the figures which indicate if the administration just had patience enough to stand, hold its expenditures for 1 year, instead of creating deficits, would have approximately budget balance.

The revenue in fiscal 1962 was only one-tenth of a billion dollars off of the income for 1963. The expenditures of 1961 were only $100 million higher than the revenue for 1962.

Mr. SHUMAN. That is correct.

Senator BENNETT. And the expenditures for 1962 were only a little over $1 billion higher than the revenue for 1963.

It is like two men walking up the steps. If the man on the top step would just wait until his partner stepped up one step, then they would walk up the steps together, instead of one running ahead of the other.

I think that is a very interesting figure.

The other thing that you have given us which is interesting to me is that you have come in to defend the idea that we should be free from double taxation in corporate earnings.

There are not many corporate farmers, are there?

Mr. SHUMAN. Not very many. Only about 3 percent of the total units in agriculture are other than family operations, so there are very few corporate units.

Senator BENNETT. So this does not represent obviously a self-interest approach, but rather, a philosophical approach to this problem?

Mr. SHUMAN. That is correct.

However, we have many farmers who do own securities, stocks in various corporations, cooperatives and otherwise.

Senator BENNETT. We hope that number increases. We hope we spread out and broaden the base of corporate ownership.

Those two things plus the spirit of your whole testimony are very interesting and refreshing to me.

You make the point of the increased progressivity of this bill up to the $20,000–$22,000 bracket, and this was, interestingly enough, the same basic point made by the U.S. Junior Chamber of Commerce representative who came before us. So this is an interesting confirmation that you are in step with the young business executives of the country.

I have no other comments or questions, Mr. Chairman.

The CHAIRMAN. Senator Gore.

Senator GORE. Mr. Shuman, I find your statement most interesting. You have made a fine contribution.

Mr. SHUMAN. Thank you.

Senator GORE. I particularly find interesting a point of view you express, and I am glad to see you set this out in concrete terms. I have not seen anyone else do this. I would like to read from the second paragraph:

For example, under the present rate structure, 36 out of 71 of the percentage points of graduation are reached at the "$20,000 to $22,000" bracket in the case of a single taxpayer. Under the proposed schedule, 34 out of 56 percentage points of graduation are reached at the same bracket.

H.R. 8363 increases the intensity of graduation in brackets below $22,000 from one-half to two-thirds. Tax reductions should be accompanied by rate reform, not rate distortion.

Now, to add some figures in this context, I find from your statement, if it be correct, that under the present law 36 of the percentage points of graduation come before an income of $22,000, and 35 on income above $22,000.

Mr. SHUMAN. That is correct.

Senator GORE. But under the pending bill there would be 34 percentage points of graduation before the income level of $22,000, and only 22 thereafter.

Mr. SHUMAN. Yes.

Senator GORE. I find this striking.

Graduation tends to be steeper in the middle income brackets and tends to be much less steep beyond $22,000?

Mr. SHUMAN. That is correct.

Senator GORE. This is one of the reasons you oppose the bill?

Mr. SHUMAN. Yes, sir.

Senator DOUGLAS. If my good friend will let me interject.

Senator GORE. I yield.

Senaor DOUGLAS. In the case of joint returns, this is not $20,000 to $22,000, but $40,000 to $44,000.

Mr. SHUMAN. Yes.

Senator DOUGLAS. And since I assume most returns are joint returns, I do not think my good friend from Tennessee, with whom I am generally in accord, can say this is a middle income group.

Mr. SHUMAN. The point is still valid.

Senator DOUGLAS. Yes.

Senator GORE. The point is still valid, and I think this perhaps illustrates why the Treasury Department, which has been engaged in a selling operation on this bill, tends to limit all of its tables to a $50,000 income taxpayer, and it is beyond that point that you see the distortions.

Mr. SHUMAN. Yes.

Senator GORE. Which you say should not be written into law.

Mr. SHUMAN. That is right.

Senator DOUGLAS. That is correct.

Senator GORE. You agree with that?

Senator DOUGLAS. Yes; I agree. Except it is not quite as bad as the individual return would seem to indicate.

Senator GORE. I am glad, Mr. Shuman, not only to find myself in agreement with the distinguished senior Senator from Illinois, but also to find one of his distinguished constituents in agreement with him, too.

Mr. SHUMAN. Thank you.

Senator GORE. I notice your first objection to the bill is on the basis that you consider its enactment fiscal irresponsibility.

Mr. SHUMAN. Yes, sir.

Senator GORE. Since you have expressed views here with which many people disagree in some respects, I want to say that in all candor I endorse this particular point. It is the No. 1 point.

As you know, I am not generally regarded as being as conservative, as you sometimes are regarded. Be that as it may, I simply feel that it is dangerous to have an $11 billion reduction in governmental revenues when we already face a $9 billion deficit and a national debt of more than $300 billion on which the carrying charge alone is more than $10 billion per year.

I do think this is fiscal irresponsibility. I think it involves dangers.

Now, please understand that I am not one of these sticklers for a balanced budget every year. I think sometimes economic conditions may justify deficit financing.

Perhaps you would agree that that is sometimes the case.

Mr. SHUMAN. We certainly would, and we agree also that tax cuts do have some stimulating effect on the economy, but when you consider the amount of the deficit plus the proposed increased spending, it is inconceivable that the stimulative effect could do enough to offset it.

Senator GORE. So on two points you and I find ourselves in agreement?

Mr. SHUMAN. Yes.

Senator GORE. One, it is dangerous, and perhaps to the extent of fiscal irresponsibility—that may be a prejudicial term but to me and to you it has meaning.

Mr. SHUMAN. Yes.

Senator GORE. Then, second, you find that the bill, if enacted, would bring about rate distortions rather than rate equity and reform?

Mr. SHUMAN. Yes, sir.

Senator GORE. Beyond that, you and I might find ourselves in some points of disagreement?

Mr. SHUMAN. Yes, sir.

Senator GORE. But this is a very big subject.

I have expressed the view, and I wonder if you would concur in this, that this is perhaps the most important, and if enacted, the most far-reaching bill to be before Congress in many years?

Mr. SHUMAN. I would agree.

Senator GORE. Have you noticed that the records are in on the growth in gross national product in the third quarter of 1963 and that the GNP is now running at the annual rate of $588 billion?

Mr. SHUMAN. I think I saw that report; yes.

Senator GORE. Would this indicate that the country is in the bottom of a recession, justifying deficit financing for a couple of years?

Mr. SHUMAN. No, sir; I certainly do not think so.

I think that, by all the indicators that I follow, the health of the economy is such that we ought not to be engaged in deficit spending. I agree that there are times in the economic cycle when you can justify deficit spending, but certainly not with this kind of an economic situation.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator McCarthy.

Senator MCCARTHY. No questions.

The CHAIRMAN. Senator Hartke.

Senator HARTKE. Mr. Shuman, I read your statement. I was wondering, do you actually fear the Federal debt is going to bankrupt the United States at the present time, at the rate we are going?

Mr. SHUMAN. I do not think that "bankrupt" is the right terminology, and we have never used it.

I think, rather, that since the Federal Government has control over the "coining of money" and the fiscal and financial policies of the country, that the thing we have to fear is either completely turning over to other governments the management of our financial situation or wild inflation, or both.

Senator HARTKE. I did not understand, I am sorry.

Turning over to other countries—I did not follow.

Mr. SHUMAN. If we get into such a position that we continue to have a deficit in our balance of payments, you get to the position where we no longer have any reserve to speak of, then we will be subject to the dictation of governments which have followed a sounder fiscal policy, and they will be able to tell us what we have to do in order to continue to exist in the financial community. Either that or completely wild inflation which would destroy not the Government of the United States immediately, but would destroy many of our businesses and hurt the people.

Senator HARTKE. Let's take inflation for a moment.

Do you contend that we are continuing with spiraling inflation at the present moment or that we have in the past few years?

Mr. SHUMAN. No; I would not describe the situation as spiraling, but I would describe it as continued, persistent rate of inflation which could develop into a wilder type of inflation. It is just as dangerous a type of inflation as any, except that it has not reached the spot of wild——

Senator HARTKE. Do you question the present statistics which are put out by the Government under the cost-of-living index?

Mr. SHUMAN. No; I do not, but the cost-of-living index, if you take it year by year, has continued to increase.

Senator HARTKE. At what rate in the few years, to the period immediately after the war until say 1958?

Mr. SHUMAN. It is true that the rate is not as rapid as it was in the immediate postwar period, but part of this, of course, was related to the delayed spending that was released after the war. At the same time, I think the continued and persistent inflationary situation, at present, is probably just as dangerous, perhaps more dangerous than that in the postwar period.

Senator HARTKE. Do you feel then, in spite of the fact that the indexes indicate that there is a general overall stabilizing of the cost of living, which actually has been present for quite a length of time, that those facts do not justify the conclusion that we have a stable currency for all intents and purposes at the present time?

Mr. SHUMAN. That is correct.

I would recognize that for the last 3 or 4 years the rate of inflation has not been what you would call alarming, but it has been there.

Senator HARTKE. Now with regard to this question of the other governments dictating, do you feel that the deficits here are a major contributing factor to the so-called balance-of-payments problem?

Mr. SHUMAN. Yes. I think the lack of confidence on the part of investors, private investors abroad, and lack of confidence on the part of other governments that we meet our obligations and balance our budget and pay for our spending, I think there is a tremendous lack of confidence abroad, and that this has been a factor.

Senator HARTKE. Do you have any facts to indicate that?

Mr. SHUMAN. I do not have them with me, but I believe that there are some pretty well-established——

Senator HARTKE. I would be very interested.

I am concerned about the question of balance of payments too. I would be very interested if you have any concrete evidence or any factual information which would back up the conclusion.

Mr. SHUMAN. We would be glad to furnish that.

Senator HARTKE. I would be glad to have that.

(The following was later received for the record:)

The lack of confidence in the U.S. fiscal policy is illustrated by two elements of our balance-of-payments position:

(1) U.S. long-term investment abroad exceeded foreign long-term investments in the United States by $2.1 billion in 1960, $2.1 billion in 1961, $2.5 billion in 1962, and $3.8 billion in 1963 (first-half annual rate).

(2) Foreign governments have not been satisfied to hold their balances in dollars, but have converted them into gold at an alarming rate. The conversion of dollars to gold is an indication of a serious decrease in the confidence in the value of the U.S. dollar.

Senator HARTKE. Do you not really feel that the problem of the balance of payments in summary is due to other factors outside the budget?

For one thing, the stationing of our troops in Europe?

Mr. SHUMAN. I think that the balance-of-payments deficit is due to several things. I am not qualified to judge or pass an opinion as to the number of troops that are required. I think that the defense budget overall can be reduced.

Senator HARTKE. I am not asking you whether it can be reduced, but these are the factors. In other words, the number of troops overseas, our foreign aid, our U.S. travel overseas, these things are all factors, are they not?

Mr. SHUMAN. Yes, these are factors along with—I think that the the record of fiscal irresponsibility of this Government is perhaps more important than any of the others. It certainly ranks with the others.

I am not confining this fiscal irresponsibility to a short period, but I am looking at 26 out of 32 years.

Senator HARTKE. I understand that.

In other words, you mean the fact that there has been this amount of spending—do you feel the same concern for State and local governments?

Do you think that they are also acting irresponsibly in fiscal affairs?

Mr. SHUMAN. The State governments find that they cannot continue nearly as long as the Federal Government can, because they cannot manipulate the value of money. They cannot control the credit, or the situation in the banking system, and so they can go for a short time, but they are brought to a halt very rapidly, so it is not as critical with the State governments.

Senator HARTKE. But we have to recognize that the percentage of increase in expenditures by State and local governments is far in excess of that in the Federal Government; is that not true?

Mr. SHUMAN. Yes. They have increased spending very rapidly, but from the standpoint of deficit spending, State and local governments do not go very long on deficit spending, because they cannot manipulate the currency.

Senator HARTKE. They cannot increase taxes to compensate for it?

Mr. SHUMAN. Yes; their credit expires much more quickly than that of the Government of the United States.

Senator HARTKE. I gather that you feel that a general overall tax reduction is good, that high taxes have a stifling effect. Your only contention is that expenditures must be reduced first?

Mr. SHUMAN. Yes, sir; that is our position.

Senator HARTKE. And do you feel, for example, that they should be reduced in the agricultural segment of the economy with which you are vitally concerned?

Mr. SHUMAN. Yes.

Senator HARTKE. I notice you specifically point out the cotton situation.

Mr. SHUMAN. Yes.

Senator HARTKE. In that statement, just for my own clarification, as I understand it, you disagree with the Secretary of Agriculture in regard to how to interpret the law; is that right?

Mr. SHUMAN. Well, perhaps not the interpretation of the law, but we think he made a mistake.

Senator HARTKE. In the administration?

Mr. SHUMAN. Yes, sir.

Senator HARTKE. Do you think it is contrary to what was intended by Congress?

Mr. SHUMAN. Yes. We believe that the intent of Congress was to bring the level of price supports down and to reduce the export subsidies, and the action that the Secretary took, regardless of what his intent was, proved to be a mistake because it reversed this process.

Senator HARTKE. He raised the subsidy?

Mr. SHUMAN. He raised the price support.

Senator HARTKE. The price support?

Mr. SHUMAN. Which necessitated an increase in export subsidy.

Of course, we are also very much concerned that the legislation now being pushed over in the House of Representatives is directed at compounding the error instead of correcting the cause. It proposes subsidies to the bills to offset the subsidies being given to exporters.

Senator HARTKE. That is all I have, Mr. Chairman.

Senator BENNETT. The question of the amount of the increase in the Consumer Price Index has been raised. My information is that since the first of January 1961, the increase has been 2.8 percentage points on the scale.

Mr. SHUMAN. The Consumer Price Index for 1960 was an average of 103.1. In 1961 it was 104.2, in 1962 it was 105.4, which shows a rather persistent increase. But not as rapid as in some periods.

Senator BENNETT. That is right, but when you recognize that one full point on the scale represents more than $4 billion in lost purchasing power, you can see that it is creeping up steadily and persistently, which is the point you made in your testimony.

Mr. SHUMAN. Yes, sir.

The CHAIRMAN. Thank you very much, Mr. Shuman.

Mr. SHUMAN. Thank you.

The CHAIRMAN. The next witness is Mr. Andrew J. Biemiller, of the AFL-CIO. Take a seat, sir, and proceed. I must explain that Mr. Biemiller yielded to Mr. Shuman because Mr. Shuman has to catch a plane.

STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR OF THE DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS; ACCOMPANIED BY NATHANIEL GOLDFINGER, DIRECTOR OF RESEARCH DEPARTMENT, AFL-CIO

Mr. BIEMILLER. Mr. Chairman, my name is Andrew J. Biemiller. I am a director of the Department of Legislation of the AFL-CIO and I am appearing here today on behalf of that organization, and I am accompanied by Mr. Nathaniel Goldfinger, who is director of our department of research.

Let me begin by expressing our appreciation for this opportunity to comment on the proposed Revenue Act of 1963. In an effort not to impose upon your valuable time, I will confine my remarks to questions of fundamental importance to us and to the country and I will deal with these questions as briefly as possible.

At the outset I want to restate what is already well known: the AFL–CIO is for a tax cut and we urge its enactment now. Moreover, we supported H.R. 8363 when it was before the House of Representatives, for one major reason—because we believe that the funds it would release would significantly help create the additional jobs this country urgently needs.

Unemployment has been the No. 1 economic problem of the Nation for a very long time, and the time to take drastic action is long overdue. For 70 consecutive months, 5 percent or more of the American labor force has been officially counted as unemployed. In September, even 2½ years after the low point of the most recent recession, the jobless rate was 5.6 percent. This is the same ratio of unemployment that existed in September 1962, even though national production is about $30 billion higher than a year ago. Most of this production rise, however, has come through improved technological efficiency; the employment rise of the last 12 months has just not been enough to take care of last year's jobless plus the needs of the growing labor force.

While about 4 million people have been officially reported as unemployed in recent months, more than 2 million others are being compelled to work part time. In addition, hundreds of thousands of other people have given up job hunting because jobs are so scarce in their communities; their number exceeds 800,000 according to an estimate of the President's Council of Economic Advisers. These jobless do not appear in the official unemployment calculations.

A true measure of worktime loss in America today—the totally unemployed who are officially counted, those who are compelled to work part time, and the hidden unemployed—would be 8 percent or more.

To reduce this unemployment to a reasonable minimum, we need about 3 million new jobs right now. But the job need of the country does not end there.

Between 1963 and 1970, the labor force is expected to show a net increase of about 1.3 million each year. Jobs must be created to meet this need, too. In addition, the economy must grow fast enough to offset the job-displacement effect of rising productivity. With output per man-hour rapidly rising, the equivalent of about 2½ million additional job opportunities are needed each year just to keep this number of people from becoming technologically unemployed.

When we add up all these job requirements—to meet the needs of those now jobless, to provide jobs for the growing labor force, and to offset the impact on employment from rising productivity—the total is tremendous. The American economy must create about 4 million additional job opportunities each year between 1963 and 1970, or about 80,000 additional jobs every week, to achieve reasonably full employment.

The AFL–CIO supports a tax cut now for one single purpose—to help create badly needed jobs. We have no illusion that tax action alone will resolve the entire problem. Other private and public actions to spur the economy are also vitally important.

Indeed, the AFL–CIO has urged that the Federal Government undertake a number of construction programs which would have two primary benefits. First, they would have an immediate impact on employment, and, second, they would begin to relieve our critical shortages of classrooms, hospitals, and other public needs.

The effort made in the House of Representatives to make tax cuts conditional on reductions in Federal expenditures would heve been disastrous.

The purpose of the tax cut is to increase employment, reductions in Federal expenditures would reduce employment.

However, a substantial tax cut is one of the most hopeful steps we now can take to quickly boost sales and jobs. This is the reason why we supported the Revenue Act of 1963 when it was before the House and why we urge your support for an immediate and substantial tax cut now.

A substantial tax cut, concentrated among low- and moderate-income taxpayers, is essential to prevent an economic decline in 1964. Without such a tax cut, there will be a recession and rising unemployment next year.

When Secretary of the Treasury Douglas Dillon appeared before you last week, he urged favorable consideration for the House-approved bill, except for the elimination of provisions which would lower the tax on capital gains. We emphatically support the administration in this matter. But we also urge several other changes which we deem essential to improve the job-creating objective and the equity of the tax bill.

The AFL-CIO has consistently urged that a tax cut at this time should be concentrated among low- and moderate-income taxpayers. It is these families who will most surely spend their tax savings and, thereby, immediately stimulate production and the creation of more jobs. The tax cut for low- and moderate-income taxpayers will provide the greatest and quickest impact on the economy—in lifting sales, production, and employment.

The President himself has recognized this necessity. After pointing to the large tax reduction for business already granted in 1962, he said to the Economic Club of New York last winter:

> Now we need to increase consumer demand to make these measures fully effective—demand which will make more use of existing capacity and thus increase both profit and the incentive to invest. In fact profits after taxes would be at least 15 percent higher today if we were operating at full employment.

Only last week Secretary Dillon stressed the danger of the gap between our vast and growing capacity to produce and actual sales, when he told this committee: "Our persisting problem has been insufficient demand."

Clearly, if the tax measure is to produce the greatest possible rise in the demand for goods and manpower, concentration of the tax cut among moderate- and low-income families is now our priority need.

H.R. 8363 would provide a significant $5¼ billion individual income tax cut for taxpayers earnings under $10,000. However, this total is a third of a billion dollars less than the amount proposed for these families by the President. On the other hand, the net tax cut of over $3½ billion for taxpayers with incomes over $10,000, granted by the House, is a half billion dollars more than the amount proposed by the President. I must add that, in our judgment, even the President's proposal failed to concentrate enough of the tax reduction among the 43 million taxpayers with earnings of less than $10,000.

The wrong-direction tax cut redistribution of the House bill is the result of changes in the tax rate schedule—with too little cut at the bottom, and too much at the top—and the result of the failure to close loopholes significantly.

It is also our view that H.R. 8363 confers entirely too large a part of the total tax cut upon corporations. We heartily approve the proposal to cut the tax rate on the first $25,000 of profits from 30 to 22 percent; this particularly will aid small business. However, there is no justification for a reduction in the top corporate tax rate from 52 to 48 percent at this time.

If corporate profits were generally low and funds available for investment in needed new plant and equipment were inadequate, we might support the cut in corporate top rates proposed by the House; the cut might be justified as a spur to production and job growth. However, corporate profits after tax are now at an alltime high. Moreover, according to Secretary Dillon's testimony last week, the financial position of American corporations never has been stronger. At the end of the first quarter of 1963, he pointed out, they held over $57 billion in cash and U.S. Government securities. Besides, their net working capital of $155 billion was the highest total on record. Last year the retained cash flow of nonfinancial corporations—their undistributed profits after tax and their capital consumption allowances—exceeded $36 billion; this was more than their total outlay for new plant and equipment in 1962, a record capital investment year. What is more, in 1963 net corporate profits, dividend payouts and retained cash flow are all heading for new peaks.

It should be recalled that business tax liabilities were reduced by $2½ billion only last year through the revision of the Treasury's depreciation guidelines and enactment of the investment tax credit. Now, H.R. 8363 would reduce corporate taxes by an additional $2⅓ billion. Incidentally, two-thirds of this reduction would go to the 4,000 largest corporations, whose profits exceed $1 million a year, who need it least.

The question of the distribution of the tax cut, which I am raising, involves far more than a question of tax equity; most important, the large share of the tax cut proposed for corporations and for upper-income taxpayers is least likely to generate job growth. With part of our production capacity still idle and corporate cash reserves generally more than adeqaute to meet current investment outlays, the proposed top-rate tax cut for corporations is hardly needed to finance capital expansion. In fact, Secretary Dillon has already expressed the view that about $1 billion of the corporate tax saving may be quickly passed out in the form of higher dividends. What is more, the upper-income taxpayers who would receive most of this windfall are also the families least likely to fully spend their very substantial tax cut share.

Senator GORE. Mr. Chairman, could I interrupt at this point merely for an observation which I think my friend and former colleague in the House might recall and enjoy.

There is a famous story in the House of Representatives that upon one occasion a very stanch and loyal and eloquent spokesman for the Tammay organization, as a Member of Congress, was making a very eloquent speech against the bill. Just as he had concluded or was about to conclude the arguments about how awful this bill was and how it should not be passed, an aid rushed in with a telegram from the boss in New York instructing him to be for the bill. So with great aplomb he said, "Now Mr. Speaker, this is what I would have said were I against this bill."

You are making an eloquent statement against the bill. I am just waiting until you finally come to the point where you get the telegram, to see how you are going to support it.

Mr. BIEMILLER. May I observe, Mr. Chairman, that there is a difference in the story told by my good friend and former colleague, Senator Gore, and this sitaution. We are suggesting changes in the bill, and we very much hope this committee will make some fundamental changes.

Senator GORE. But you supported the bill, which you now condemn, when it passed the House without those changes.

Mr. BIEMILLER. We supported the bill in the House of Representatives because, as the Senator knows as well as every other member of this committee, in the House of Representatives tax bills are voted up or down, and we saw more good in the bill than we saw bad.

Senator DOUGLAS. Mr. Chairman, may I make a comment on this wonderful story. I have heard that story, but the version that I have heard was that it was a telegram from the National Association of Manufacturers to one of the leaders of the Republican Party.

Senator BENNETT. Mr. Chairman, under the circumstances, since that was obviously aimed at me, maybe I should make a comment. This sounds like Tammany to me, and I think I will join my forces with the Senator from Tennessee.

Mr. BIEMILLER. In our judgment, what American business now needs most of all is not another tax cut, but the assurance of high and rising sales. A greater concentration of tax relief among the 85 percent of all taxpayers who have incomes of less than $10,000 is the surest way to achieve that goal.

Subsequently I will propose several changes in the tax rate cut proposals for individuals and corporations—which would strengthen H.R. 8363 both with respect to job stimulus and tax equity. But first I want to briefly discuss other structural changes enacted by the House.

The President's original tax proposal contemplated a package including rate cuts for individuals and corporations on the one hand and structural changes—to relieve special hardships and to close loopholes—on the other. The House is to be commended for its action on many of the hardship-relieving proposals. However, significant loophole-closing reforms—with one exception—have been ignored.

The President asked the Congress to end the unjust dividend credit, and the House has concurred. The arguments in support of this action are so convincingly presented by Secretary Dillon in his exhibit No. 3 that no useful purpose would be served by repeating them again. I simply want to add this comment. The tax code is now so full of loopholes conferring special favors on unearned income as compared to earnings from wages and salaries that Senate rejection of this single significant loophole-closing proposal coming from the House would be the gravest misfortune.

For the same reason, the administration's plea that you reject any worsening of the existing capital-gains loophole should be honored. The AFL-CIO urged the House Ways and Means Committee to increase both the 25-percent maximum tax rate and the 6-month holding period on capital gains, which now provide the major tax-avoidance loophole enjoyed by the wealthy. Moreover, the President had urged the extension of this tax to all capital gains transferred at death or by gift, which we approve. In exchange he proposed to reduce the present tax rate on capital gains, which we do not under any circumstance approve.

The House has now cut the capital-gains tax by adopting a new 40-percent inclusion factor and a new top tax rate of 21 percent on so-called class A capital gains. At the same time it has rejected the President's request to tax capital gains transferred at death. Approval of this action, which confers a special tax cut for those who gain from stock market and real estate speculation—when their existing tax advantages should be curtailed—would be an intolerable miscarriage of justice. Rejection of this windfall will reduce the revenue loss contemplated by H.R. 8363 by $140 million by 1968, and make this sum available to serve a better purpose.

House rejection of the President's very modest proposal to raise $300 million by tightening the method of computing mineral depletion allowances—but not the rates—is also highly regrettable. Instead, H.R. 8363 makes a mockery of this effort to do something about one of our worst tax loopholes, by making a token reduction of $40 million. We now urge you to support the President's original request. It at least would modestly reduce the windfall now enjoyed by a favored few and build greater faith in the integrity of the Federal tax system. This action would increase revenue by $260 million, and make it available to serve a useful purpose.

H.R. 8363 slightly reduces the existing tax abuse under stock option plans, through real estate tax shelters and in a few other minor situations. But no effort is made to close other glaring loopholes such as the tax-free status of interest from State and local bonds, and rate reduction through income splitting, as well as inequities in the way family partnerships, gifts and estates are taxed.

Although H.R. 8363 does so little to close loopholes enjoyed by the wealthy—and would open the profitable capital-gains escape hatch still further—the House has accepted the major part of a so-called base-broadening proposal of the administration that particularly will hurt low- and moderate-income families. I refer to the proposal to end the exclusion from tax of sick pay up to $100 per week, except for pay received after 30 days of illness. By this action, H.R. 8363 would enrich the Treasury by $110 million, but 75 percent of the money would be taken from families with incomes under $10,000.

It is maintained that this proposal is equitable, but this is hardly so. Under most group insurance plans that compensate workers who are sick or injured, the employee receives only a portion of the wages and salaries he earns when working, usually only about 50 percent to 70 percent. If tax exclusion is now curtailed for such workers, the income loss from illness will be increased further, and at a time when medical costs generally impose an additional burden.

I would urge, therefore, that the House provisions apply only to wage continuation plans, under which the employee continues to receive the full amount of his wage or salary.

For those who receive reduced benefits under insurance programs or trust funds, existing provisions of the tax code should apply.

I cannot refrain from noting that, except for ending the dividend credit, almost all of the so-called base-broadening reforms proposed by the House fall heavily on families earning less than $10,000. This is true of the proposal to reduce casualty loss deductions, the limitation on State and local tax deductions, and is particularly true in the case of the reduced sick-pay exclusion.

The House is to be commended on the other hand for several desirable structural changes that are recommended to relieve special hardship situations.

Working people would be aided by the proposal to allow the deduction of moving expenses involved in taking a job in another community. They would also be helped by the approval of 5-year income averaging for tax purposes when unusually high earnings occur in 1 year.

Persons over 65 would be particularly aided by the elimination of the 1-percent floor on medical and drug expenditures, by the proposal to give special tax consideration to the gain from the sale of a personal residence, and by the proposed minimum standard deduction.

The AFL-CIO endorses all of these changes.

Another proposed structural change that would aid employed people who have children and other dependents in their care is also desirable, but it does not go far enough.

The President has recommended that the deduction for tax purposes for care costs for these dependents be increased from the existing $600 maximum to $1,000. He also proposed that the maximum amount that families with working wives can earn and remain eligible for tax relief should be raised from $4,500 to $7,000. Also he requested that the age limit of children who qualify be increased from 11 to 12 and that the deduction now be extended to certain other taxpayers—such as a married man whose wife is confined to an institution.

The House-passed bill accepts the last two proposals and increases the maximum deduction from $600 to $900. But married working women remain limited to a $600 maximum deduction. Moreover, all beneficiaries continue to be limited to the unrealistic $4,500 income maximum enacted in 1954.

The total revenue loss that would be incurred by adopting the President's reasonable proposal is only $20 million in contrast to the $5 million cost of the House proposal. We strongly urge that the President's original proposal be approved.

The most significant structural change to reduce hardship proposed by H.R. 8363 is the minimum standard deduction, but it too should be improved.

Under the House proposal a minimum standard deduction equal to $300 plus $100 for each dependent would be allowed. This would help about 13 million low-income taxpayers, and about 1½ million with the lowest incomes would become tax-exempt.

When we testified before the House Ways and Means Committee, we noted that the present $600 personal exemption buys even less in real goods and services than the $500 exemption allowed during wartime. Before the war, of course, a $1,000 personal exemption for every family member was allowed. We also noted that the present 20 percent first-bracket rate is 400 percent higher than the 4 percent prewar rate. Besides, the long-honored earning-income credit no longer is on the statute books.

These factors impose an indefensible tax burden on lower income families. Since the administration had not proposed an increase in the personal exemption, we urged two steps that would give meaningful tax relief to those who now need it most. We urged that the first-bracket tax rate be divided into two parts, with a 12-percent rate to be applied to the first of these and a 15-percent rate to the second. We also urged that a minimum standard deduction be established of $400 for an individual plus $200 for each dependent—a more liberal allowance than now proposed by the House.

The higher minimum standard deduction urged by the AFL–CIO would free a larger portion of the earnings of low-income taxpayers to meet essential family needs. Our proposal would raise the tax-free income of a single person to $1,000 from the present $667 level; for a married couple with no dependents to $1,800 from the present $1,333; for a couple with two dependents to $3,400 from the present $2,667; and for a couple with four dependents to $5,000 from the present $4,000.

These proposed income levels below which no tax would apply should require no defense in the richest country of the world. By enacting our minimum standard deduction proposal, we will at least achieve the equivalent of a modest increase in the personal exemption for families who most critically need it. Moreover, the increased cost in revenue would be slight in terms of the humane end achieved. Finally, no dollars saved by tax reduction would more quickly be spent and more promptly increased sales and stimulate job growth.

I have only two more observations to make about H.R. 8363. The House has inserted two proposals in its bill which were not originally requested by the administration and which we hope you will reject.

The first would undo the so-called Long amendment which is now a part of the Revenue Act of 1962. It prohibits depreciation set-asides against equipment outlays paid for by the investment tax credit the Congress generously enacted last year.

In 1962 the investment tax credit alone created a tax saving for business of $1 billion—a fairly substantial public contribution to meet private investment costs. In addition, the House now proposes to allow a yearly depreciation set-aside in order to ultimately replace the investment credit gift, as well as the original cost of the new equipment.

Under any circumstances, the tax credit itself will rise as total private investment goes up. If the Long amendment is now upset, however, an additional tax savings of $145 million will be gained by corporations next year and $185 million in 1965, according to Secretary Dillon. It is also conceded that this extra tax savings would rise rapidly through the years, because a constantly large depreciation set-aside would be claimed against the rising stock of equipment being financed by the investment credit. According to a conservative calculation, thus depreciation allowance proposal alone would create a tax loss for the Treasury—and tax reduction gain for business—of over $500 million in 1975.

This additional, and not too clearly visible, gift to business is completely unwarranted. It should be rejected, the revenue saved can also be used to serve a better purpose.

A second House-enacted proposal would also modify the Revenue Act of 1962. It would cause no tax loss, but it would cause a loss of hundreds of millions of dollars to American consumers.

The House has approved a proviso inserted in H.R. 8363 that it is "the intent of Congress" that Federal regulatory agencies shall not require a utility to count its tax saving from the investment credit as a cost reduction for the purpose of setting rates.

It should be recalled that the administration specifically urged the Congress not to grant the investment credit to utilities because, as Secretary Dillon pointed out 2 years ago—

> Investments by these regulated monopoly industries are largely governed by determined public policies and are subject to regulated consumer service charges designed to provide a prescribed aftertax rate of return on investment.

Over the administration's objections, the Congress nonetheless extended the investment credit to utilities and they enjoyed a tax savings of over $200 million because of the credit in 1962. In future years this tax savings will move substantially higher. The House-passed bill would now prevent this windfall from being considered a relevant factor in future rate determinations by Federal regulatory agencies. Without the utilities' express approval, none of it could be passed on to consumers in the form of lower rates.

The AFL–CIO cannot too strongly urge that this proposal also be rejected.

Changes in the House bill which the AFL–CIO urges, and which I will now summarize, follow naturally from observations I have already made. H.R. 8363, as it stands, would do much that is desirable. Most important, the tax cut it proposes would release funds that will considerably stimulate production and job growth. Its passage does credit to the Ways and Means Committee and to the House.

Nonetheless, the bill should be changed in several ways, in a manner that will increase its impact on reducing unemployment and will make the distribution of the overall tax burden more fair.

Important improvements can be achieved without any increase in revenue loss to the Treasury.

First, the unjustifiable top-bracket rate cut proposed for corporations should be reduced.

Second, proposals to open up costly and unjustifiable new tax loopholes should be firmly rejected.

Third, loophole closing ignored by H.R. 8363, particularly the modest proposals of the President with respect to mineral depletion allowances, stock options, and capital gains taxation on transfer at death, should be adopted.

The revenue gained by these actions will be substantial and should be allocated to increase the tax-cut share of moderate- and low-income families, where it will do the most good.

In the face of the nearly $2½ billion cut in business tax liabilities approved last year by legislative and administrative action, and the abundant funds already available for capital investment, we see little merit in a cut in the top corporate tax rate at this time. We strongly urge that any cut below 50 percent be rejected and that the $1 billion saved be applied elsewhere.

By accepting the administration request to reject the proposed cut in the capital gains tax rate, by adopting the President's proposal to modestly reduce the mineral depletion allowance and by rejecting the House proposal to delete the Long amendment from the Revenue Act of 1962, about three-quarters of a billion dollars in additional revenue will be saved annually by 1968, and more thereafter. Additional savings could be obtained by further loophole closings.

Revenue recouped by these actions should be used essentially to make tax reduction for the millions of moderate- and low-income taxpayers more meaningful. This would add to the job-creating impact of the tax cut and would more effectively reduce the near-wartime tax burden of these families. This can be achieved by:

(1) Raising the minimum standard deduction to $400 plus $200 for each dependent after the first.

(2) Rejecting the House proposal to reduce the sick-pay exclusion and by adopting the child-care deduction proposal of the President.

(3) Reducing the first-bracket individual income-tax rate further toward the 12-percent minimum originally proposed by the AFL-CIO.

The bill now before you can and should be improved in a way that will increase its usefulness as a stimulus to employment and will further its equity. Moreover, what you now achieve in advancing these objectives will do much to increase public confidence in the integrity of the American tax system.

In conclusion, let me express again our thanks for this opportunity to present our views on this vital matter.

(The tax table referred to follows:)

The effect of the AFL-CIO minimum standard deduction proposal [1]

Taxpayer using standard deduction	Income after which taxes start— Under present 10-percent standard deduction	Income after which taxes start— Under minimum standard deduction proposed by AFL-CIO	Equivalent increase in personal exemption per family member
Single person	$667	$1,000	$333
Married couple:			
No dependents	1,333	1,800	234
1 dependent	2,000	2,600	200
2 dependents	2,667	3,400	183
3 dependents	3,333	4,200	173
4 dependents	4,000	5,000	167

[1] Minimum standard deduction of $400 for an individual plus $200 for each dependent.

The CHAIRMAN. Thank you very much, Mr. Biemiller.

Senator Long?

Senator LONG. You have made a very fine statement here, Mr. Biemiller. Of course, we are not considering monetary policies on this matter, but speaking for the need of jobs and more purchasing power in the hands of consumers. I would like to ask what is your view with regard to the existing level of interest rates in this country?

Mr. BIEMILLER. We think they are too high. We have expressed ourselves volubly on this question on more than one occasion.

Senator LONG. I have about worn out my welcome in a number of quarters expressing the same view. I would hope that in addition to the views that you have expressed here, that your people will be more vocal and more active in expressing that view that it would also put more people to work and generally help to improve the economy, if this Government, instead of using its efforts to keep interest rates high, will use its efforts to keep them low.

Mr. BIEMILLER. We quite concur in that view.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Mr. Biemiller, I have just one question. Does your organization have any statistics, and can you supply them to the committee, which would show the number of your members who are stockholders in the companies in which they have employment, stock which probably has been gained by pension plan programs and other stock purchase plans?

Mr. BIEMILLER. Mr. Goldfinger informs me there are no such figures available.

Senator BENNETT. I think they would be interesting to the committee, because you have taken such a strong position against any tax relief at this present time for corporations or their stockholders. I am sure a very substantial number of your members have become stockholders. But you say those figures are not available?

Mr. BIEMILLER. No. There is no breakdown that we are aware of that would give you that data. I know that some of our members are stockholders. There are many firms that have a regular stock-buying program, et cetera, as you know as well as I. But I do not believe that anyone has ever systematically collected such data company by company or union by union as the case may be.

Senator BENNETT. I hope someday the AFL–CIO will develop enough interest in this interesting relationship to gather that data for us. I think you could get it more easily.

Mr. BIEMILLER. We could make a stab at it. But I also want to make it perfectly clear, which I am sure, Senator Bennett, you are well aware of, that the great bulk of the income of the members of the AFL–CIO comes from wages and salaries.

Senator BENNETT. There is no question about that. But as the years go on, our industry becomes more and more employee owned, and more and more people find themselves on both sides of this problem of management, or ownership rather than labor.

Mr. BIEMILLER. That is true.

Senator BENNETT. No other questions, Mr. Chairman.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Mr. Biemiller, I notice that you recommend an increase in the minimum standard deduction of $100 for each person.

Mr. BIEMILLER. That is correct.

Senator DOUGLAS. $300 to $400 for the taxpayer; $100 to $200. Wouldn't it be simpler to increase the exemption figure from $600 to $700? That would give the same results, wouldn't it?

Mr. BIEMILLER. I refer that to Mr. Goldfinger, on this problem.

Mr. GOLDFINGER. For the bulk of taxpayers you would get the same result, or it would be generally similar. However, the minimum standard deduction would apply only to the lower income taxpayers whereas the increase in the exemption would apply across the board.

Senator DOUGLAS. You would not oppose, however, an increase of $100 in the exemption limit, would you, from $600 to $700?

Mr. BIEMILLER. No; we wouldn't oppose it.

Senator DOUGLAS. This would cost about $3 billion.

Mr. BIEMILLER. That is right.

Senator DOUGLAS. And we would recoup this by eliminating the reduction in the corporate income tax, plus the plugging of three-fourths of a billion in other loopholes, so that the net tax reduction would be approximately the same as in the administration's bill, but distributed primarily in favor of the lower rather than the upper income groups.

Mr. BIEMILLER. Correct. But we would still point out that we think we get the emphasis in the lower brackets better by the $400–$200 proposal than you do by the straight $100 increase.

Senator DOUGLAS. It is a little more complicated for the public to understand.

Mr. BIEMILLER. With this I would agree, that it has that effect, and it also costs less. It only costs about $70 million to up the $300 to $400, and the $100 to $200.

Senator DOUGLAS. Now I was very pleased to see that you are still advocating tax reform as well as tax reduction. There is an unfortunate tendency on the part of many to forget tax reform and concentrate almost exclusively on tax reduction. I wondered if you would mention for the sake of the record, some of the tax reforms which you regard as most important.

Mr. BIEMILLER. Mr. Goldfinger has been working on that.

Mr. GOLDFINGER. Senator Douglas, we have indicated——

The CHAIRMAN. Will the witness identify himself?

Mr. GOLDFINGER. My name is Nathaniel Goldfinger. I am director of research of the AFL–CIO.

Senator Douglas, we have indicated these in the text that Mr. Biemiller presented. Among them are the mineral depletion allowances.

Senator DOUGLAS. I am glad you start off with that. Now the administration has a very complicated series of flaw proposals which it is very difficult to understand. Wouldn't it be much simpler to adopt the reduction in depletion allowance now, which I have advocated for some years, retaining the 27½-percent rate for oil and gas firms with a gross income of less than $1 million a year, cutting it to 21 percent for firms with a gross income between $1 and $5 million, and to 15 percent for those with a gross income over $5 million.

Now, according to the figures from some years back, this would have netted around $400 million a year, which is excess to the proposal of the administration, and probably now would net a larger sum.

Mr. GOLDFINGER. Yes. We are on record in support in the reduction of the rates. However, as we indicated in the text of Mr. Biemiller's presentation, we would view adoption of the President's proposal as a minimum. We would much prefer the kind of thing that you are talking about, Senator.

Senator DOUGLAS. Thank you. What are some of the other tax reforms?

Mr. GOLDFINGER. Well, another one mentioned in Mr. Biemiller's presentation is the tax-exempt status of income from State and local bonds.

Senator DOUGLAS. You may be theoretically correct, but politically this is impossible.

Mr. GOLDFINGER. Well, income splitting is another.

Senator DOUGLAS. Again I think you are probably theoretically correct, but again I think this is politically impossible.

Mr. GOLDFINGER. Yes; and the capital gains issue, of course, is the major one that we devoted most of our time to in the statement that was just presented to you.

Senator DOUGLAS. That is, make capital gains at death taxable.

Mr. GOLDFINGER. Yes.

Senator DOUGLAS. It presently escapes taxation completely.

Mr. GOLDFINGER. Yes. Our view is that the Congress, we would hope, should adopt the kind of proposal you just referred to, and that is taxation of capital gains after death, or if Congress fails to do so, then at a minimum it should return to the current procedure of the 50-percent inclusion rather than cutting it down to a 40-percent inclusion factor.

Senator DOUGLAS. What about liquidation of personal holding companies?

Mr. GOLDFINGER. Yes. I believe that we mentioned this in the text as well.

Senator DOUGLAS. Did you notice the colloquy which I had with Secretary Dillon last Wednesday, when I quoted from an internal memorandum of the Treasury Department which they had furnished help on at my request, and which he stated was accurate; namely, that in the year 1959 there were five men with gross incomes, adjusted gross incomes, of over $5 million who did not pay a single cent in taxes?

Mr. GOLDFINGER. Yes.

Senator DOUGLAS. That there were 10 men with adjusted gross incomes between $1 million and $5 million who did not pay a single cent, or over 15 therefore with adjusted gross incomes of over $1 million, who did not pay a single cent.

Mr. GOLDFINGER. Yes.

Senator GORE. Will the Senator yield?

Senator DOUGLAS. Yes.

Senator GORE. And income from tax-exempt State and local bonds is not reported as a part of adjusted gross income.

Senator DOUGLAS. That is right and neither writeoffs for drilling and developmental costs in the oil and gas industry, nor are included half of the capital gains, so that the real income of these gentlemen is probably grossly in excess of the figures quoted.

But even with the figures quoted, it indicates that these gentlemen paid no taxes whatsoever, although a person, a workman with an income of $5,200 a year, $100 a week, would pay taxes of about $460. Doesn't this to your mind indicate gross injustice in the tax system?

Mr. BIEMILLER. There certainly is no question about that, Senator. We quite concur that the loopholes that have been consistently used not only in the very glaring cases that you give but in many others, as were brought out in the tables that Senator Long inserted in the record, in our opinion, certainly ought to get full attention by the Congress. We want to see reforms in the bill as well as reductions.

Senator DOUGLAS. Now if we try to trace the devices by which the taxes were avoided by these gentlemen, I think we will find that there is first a capital gains loophole; second, the depletion allowance loophole; third, the corporate shield thrown up around personal income; fourth, stock options; and a number of others. Doesn't it seem to you strange that there seems to be very little public information about this subject?

Mr. GOLDFINGER. Yes. Unfortunately, the public seems to be misinformed on the kinds of issues that you are raising and on the facts that you just presented, Senator.

For example, in our examination of the returns of people earning $1 million and more, it is rather clear that the effective tax rate is well under 30 percent, and yet there are a lot of people who speak of the 80 and 90 top tax rates which are really not effective because of all of the various loopholes.

Senator DOUGLAS. I take it, therefore, that the AFL-CIO would actively support methods of reducing what are called loopholes, what I call truckholes.

Mr. BIEMILLER. Quite.

Senator DOUGLAS. And you would not regard this as endangering tax reduction.

You see, this is now the excuse which some people put up. Yes: they say we should have tax reforms, but tax reduction is so important that we should not take up time discussing or trying to get tax reforms. Let's do that in some later year.

I would like to ask if we do not act now when we have a tax bill before us, and when it is always very painful to get tax reform, when tax reform is not soothed by a tax reduction, when will we ever get tax reform?

Mr. BIEMILLER. I do want to make it perfectly clear, which is inherent in the question you have just asked, Senator Douglas, that we think there is real reason for moving with rapidity, but in our opinion, this does not mean that you cannot move with rapidity in both directions at the same time.

We are fearful of the economic situation and what could happen in this country in 1964. We are anxious to get purchasing power into the stream of things. But I would think that with the background this committee has, with the accumulated knowledge and wisdom which exists in this committee, that both matters could be done if the committee were of a will to so do.

Senator DOUGLAS. You pay a compliment to the committee and I would say it is deserved for the other members, perhaps not in my case but deserved for the others. But a committee cannot move or a Congress cannot move more rapidly than public opinion, and has not public opinion been so concentrated on the question of tax reduction that the necessity for tax reform has been pushed into the background?

I regard this as unfortunate, and I hope we can enlist you among the militant advocates of tax reform.

Mr. BIEMILLER. Insofar as we can control the educational process, we have done everything we can inside the labor movement to bring these facts home through our publications and various other media.

Senator DOUGLAS. There is one feature—by the way, have you looked at the personal holding company section of this bill?

Mr. BIEMILLER. Not in any detail.

Mr. GOLDFINGER. No, we have not.

Senator DOUGLAS. I wonder if you would pay some close attention to that—that is a very puzzling section to me at least—and perhaps you would later make a statement as to whether you see any weakness in the treatment as it came over from the House.

Mr. BIEMILLER. We would be very happy to send up a supplemental statement.

(The following was later received for the record:)

SOME OBSERVATIONS ON THE HOUSE PROPOSAL AFFECTING PERSONAL HOLDING COMPANIES

The House proposal on personal holding companies is a significant forward step, but still more should be done to eliminate this tax shelter entirely.

Since 1934 the revenue laws have recognized the need to impose special taxes on undistributed income held by a personal holding company in order to discourage their use as a tax shelter by high-income taxpayers. This sheltering device involves directing income from so-called passive investments—from dividends, interest, certain rents and royalties, etc.—into a personal holding company where it is subject to the lower corporate tax rate. (In the case of dividend income, the tax is only 7.8 percent under present law. After the 85 percent exclusion allowed for dividends received by corporations, the 52 percent top rate applies only to the remaining 15 percent.) In due course, if the personal holding companay is sold, its accumulated earnings are taxed to the individual beneficiaries at only the low capital-gains rate. More often liquidation occurs at death, and no tax is levied on these earnings at all.

In 1934 the revenue laws were changed in an effort to tighten up on this loophole. Accordingly, a company set up to serve as a tax shelter was to be subjected to a special additional corporate tax, the personal holding company tax. The purpose of the tax was not to collect revenue but essentially to discourage the use of this loophole by the wealthy to avoid payment of statutory tax rates on dividends, rents, interest, etc., under the Federal individual income tax.

To implement the new tax it became necessary to specifically define a personal holding company subject to the additional tax. Several definitions were established to meet varying situations, but the major criteria has been the extent to which the company involved actually received "active" income—income derived from the actual conduct of a business, as distinguished from the mere receipt of "passive" income from enterprises run by others.

Under the formula devised and in use today, if more than 20 percent of the gross income of a company comes from a so-called active source, it does not have personal holding company status and it escapes the special tax.

Various methods are now being used to produce slightly more than 20 percent of gross income from so-called active enterprises and by this means escape the tax. Therefore, the administration has proposed to increase to 40 percent the income that must be produced by an active business, and the House has concurred. This and other definitional changes regarding the determination of personal holding company status would produce about $15 million in additional revenue.

We have been advised by Treasury experts and by others that a change from the prevailing 20–80 formula to a 40–60 formula is a significant step toward closing this loophole. We are further advised, however, that if at least 60 percent of income were required to be obtained from an active business rather than the proposed 40 percent, this tax shelter would be more effectively closed and no legitimate business enterprise would be jeopardized.

Senator DOUGLAS. There is another feature which I believe is mentioned in one of the exhibits submitted by the Secretary of the Treasury, and that is the provision which we passed some years ago permitting virtually unlimited deductions for charitable contributions. It mentions the case of one taxpayer who got a tax credit of I believe $21 million by conveying property which had an original cost of less than $500,000.

Now, the full tax implications of this are not fully understood by me, I must admit, nor am I quite certain as to the tax treatment in the present bill which is given to such as donation. But the illustration I believe, which is given by the Treasury, seemed to be very striking.

Did you look at that case, Mr. Goldfinger?

Mr. GOLDFINGER. We did look at it. We have not examined that one in detail either because we were concentrating on the major aspects.

Senator DOUGLAS. As a matter of fact, I remember when this was raised in the Finance Committee some years back, and I must admit that I did not realize the full importance of what this provision might do. But it is certainly an extraordinary occurrence and if this occurred in one case, it might well have occurred in others.

I wonder if the staff, Mr. Stam, has analyzed this question of unlimited donations as a tax deduction.

Mr. Chairman, I wonder if we might have a statement from a member of the staff as to what the provisions in the present law are and the degree to which this would be altered by the bill before us. Could we have that for the sake of the public record now?

Mr. TOMASULO. Under present law the full fair market value of a contribution to charity may be deducted without regard as to how much it costs. This is not changed by the bill.

The fact of making a large gift which costs the donor a great deal of money is to avoid the gain which would have been realized on the sale of that property while, at the same time, the ordinary income is reduced by its full value. Thus an example given by Senator Douglas, if a person had property which cost him $500,000, but was worth $21 million at the time he gave it away, the deduction would be $21 million against ordinary income, although he never would have paid the capital gain from $500,000 to $21 million. The reduction would be limited to 20 or 30 percent of the income, however, except in the case of those taxpayers who were permitted an unlimited charitable contribution deduction.

Senator DOUGLAS. Now I would like to ask this question:

Under these circumstances, would the donor actually make money by making the contribution?

Mr. TOMASULO. Of course he would be poorer by $21 million in the sense that there was $21 million of property no longer owned, he would be incredibly better off, a great deal better off than if he had sold the property. He may be far better off than if he had sold the property.

Senator GORE. So some of our very charitable citizens may not be in fact as charitable as it might appear?

Senator LONG. If I might give an illustration, if a person is in the real estate business, he cannot take capital gains on the sale of real estate. If he has a piece of real estate and it costs him $100,000, it might be worth $5 million now. Let's say he would avoid the 91-percent tax rate on $5 million of other income by giving away that $5 million. If he sold it after taxes, he would have 9 percent of the 91, he would have $45,000 left of it after taxes. But against other income, that deduction would be worth to him—he would have $450,000 left if he sold this $5 million piece of property, but if he had $5 million of income against which to deduct it, he would have saved roughly——

Mr. TOMASULO. He would have up to 91 percent of the full fair market value of the property.

Senator LONG. He would have saved about $4.5 million. So if the gift is worth $4.5 million to him, if he takes his income it is worth $4.5 million to give it rather than to sell it.

Senator GORE. Would the Senator yield for one further question?

Senator DOUGLAS. Yes.

Senator GORE. I would like to ask the staff expert if it is not possible also for a corporation executive enjoying a very high salary, and having been the beneficiary of restricted stock options on which the accretion in value has been very great, to make a so-called charitable contribution of this stock obtained under special circumstances and on which he paid no tax, and thereby reduce the tax that he would otherwise have to pay on the salary he draws from the corporation.

Mr. TOMASULO. Yes, that is possible.

Senator DOUGLAS. Mr. Biemiller, do you think that we should try to plug this truckhole?

Mr. BIEMILLER. I think any loophole——

Senator DOUGLAS. I would call this a truckhole.

Mr. BIEMILLER. I think any loophole, Senator, that you can get this committee and the Senate to close should be closed, and I certainly think that the one you are talking about is a very flagrant one. It is one that I know is also used on a comparatively smaller scale as well as a bigger scale, but to the same effect.

Senator DOUGLAS. Mr. Chairman, I want to congratulate the member of the staff who gave this explanation as an indication of the high standard of technical competence of the staff.

I have no more questions.

The CHAIRMAN. Senator Gore.

Senator GORE. Mr. Biemiller, you have given the most detailed analysis of the changes which in your opinion are needed in the interests of tax equity of any witness before this committee. You have asked the committee, as I understand it, to give consideration to these recommendations of the great organization of American labor which you represent.

Mr. BIEMILLER. That is correct, sir.

Senator GORE. Plus other glaring inequities such as those that have just been brought to light.

Mr. BIEMILLER. Quite so.

Senator GORE. I shall be glad to—do you have a legal staff who can draft amendments which you recommend?

Mr. BIEMILLER. Yes.

Senator GORE. Then if you will be so kind as to supply them to me, I shall see to it that the committee gives them consideration.

Mr. BIEMILLER. We shall be happy to.

Senator GORE. Thank you.

Did the chairman of this committee request you to testify or did you in writing request the opportunity to testify?

Mr. BIEMILLER. We requested the opportunity to testify by phone, I believe, rather than by writing, if we want to be technical about it.

But I want to say that the chairman of this committee and his staff have always been most gracious in according us time at our convenience and we have appreciated the fine cooperation we have always had from the chairman and his staff.

The CHAIRMAN. The committee is glad to have you, sir.

Senator GORE. I would think the committee would be remiss in its duty if it failed to afford the president of the American Farm Bureau Federation who testified preceding you, at his own request, or refused to allow the American Federation of Labor and the Congress of Industrial Organizations the opportunity to present its view on this important issue.

Mr. BIEMILLER. There has never been any such problem with this committee.

Senator GORE. And you do not think such a problem should arise?

Mr. BIEMILLER. Oh, of course not.

The CHAIRMAN. It will not arise as long as I am chairman.

Mr. BIEMILLER. I am sure of that.

Senator GORE. But I ask you these questions because this committee has been severely criticized for undertaking to hear public witnesses on this bill. In fact, is this not the first opportunity you have had to testify on this bill as it is now drafted?

Mr. BIEMILLER. In its present form, yes, certainly.

Senator GORE. When you testified before the House committee there was no bill?

Mr. BIEMILLER. That is correct.

Senator GORE. You testified in the abstract?

Mr. BIEMILLER. No. There was a bill before the House. I beg your pardon, there was a message before the House.

Senator GORE. Well, that is hardly in the abstract, but almost.

Mr. BIEMILLER. There were some fairly concrete suggestions that had been made to which we addressed ourselves.

Senator GORE. But insofar as the message resembles the bill now before us, it was almost in the abstract.

I find your statement so well phrased, I wonder if you would mind if I had it reproduced for limited distribution?

Mr. BIEMILLER. We would be flattered.

Senator GORE. I think members of some of the locals of your organization might be interested in your analysis of the bill. I am not sure they would agree with your conclusions that support it.

Mr. BIEMILLER. It is already in the mail to our State and local city central bodies.

Senator GORE. That may be the reason I have this letter:

DEAR SENATOR GORE: After careful study and discussion of the pending tax reduction bill, we are pleased to inform you that Local Union 2113 of the IBEW has officially voted to endorse your position on this bill. Our local union represents over 400 employees. Although we would certainly like to have our taxes decreased for personal and national economic reasons, we feel that your opposition to this particular bill is valid and sound. It is our belief that the majority of all Tennesseans support you in this matter.

Now I would like to take this issue to the country and I would like to bring about more understanding of it, something you and Senator Douglas agreed was needed. So if you will select any locals of your choice in the East, the middle part of the country and the West, I will pay my own expenses and appear before those locals and discuss this bill with the membership and then have a show of hands.

Mr. BIEMILLER. I am not sure I quite follow.

Senator GORE. I think I would for the most part read your statement.

Mr. BIEMILLER. The time element involved here, however, is one that I think deserves some consideration.

Senator GORE. We can travel by jet to the west coast.

Mr. BIEMILLER. Actually, as I have said, we are distributing this document very widely. It will also in news form go to the entire labor press of the country. We are not hiding any documents. We get them out. All of our documents get out.

But the thing that is——

Senator GORE. An appearance by you and me might enlist some more interest that a mimeographed statement.

So you contemplate this and if you would really like to bring about an educational campaign among the locals in the American Federation of Labor and the CIO, we can not only start with these three, but perhaps we could expand.

Senator DOUGLAS. Mr. Chairman, may I say I always marvel at the subtlety of my friend from Tennessee. It reminds me of the characterization which was once given to Martin Van Buren when it was said that he rowed to his destination with muffled oars. But I hope we can get a tax reduction bill that the Senator from Tennessee will support.

I think the clarification of the record this morning may help. I hope we can get a tax bill with emphasis on cuts for the lower brackets which the warm heart of the Senator from Tennessee will find pleasing.

Senator GORE. I must say, in the spirit of the remarks of my distinguished friend and colleague from Illinois, that if we have many more such eloquent endorsements as Mr. Biemiller has given the bill this morning, sentiment is apt to go in the other direction.

Senator LONG. Mr. Chairman, I just might comment on that statement. As one who has on occasion been engaged with the Senator from Tennessee in debating a piece of legislation to which he was opposed, I must state that anyone seeking to pass a piece of legislation to which the Senator from Tennessee is adamantly opposed has a long, tedious and arduous road ahead of him.

Senator GORE. Mr. Chairman, I am most grateful for the very generous comments of my colleagues and friends. They do compliment me in a way.

Senator LONG. It was intended as a compliment.

Senator GORE. Thank you, and I appreciate it.

This is in my view one of the most important bills to come before the U.S. Congress since I have been a Member, and the worst.

I feel so deeply about it that there is an arduous fight ahead, and I would like to go to the country with it. I would like to go to the working men and women with this issue.

Mr. BIEMILLER. Mr. Chairman, I think it has been perfectly obvious in the previous statements of the AFL–CIO and also it is in my opinion quite implicit in the statement rendered today that we do regard the enactment as quickly as possible of a tax reduction bill, plus all of the reform that the Congress of the United States is willing to vote, as of great importance to the economic welfare of our great Nation. This is the reason that we are, at the same time, urging that you consider all of these matters, but we are urging that you move with the greatest possible rapidity.

I do not see a conflict in these two concepts.

Senator GORE. Mr. Biemiller, I thank you for giving me permission to reproduce your statement.

I hope you will not mind if your membership in Tennessee reads it twice.

Mr. BEIMILLER. I hope that our membership everywhere would read it two or three times. I would be very happy if they did.

Senator GORE. Now I would like to ask you some specific questions, if I may.

What, in your opinion, will the gross national product be in calendar 1964 without the enactment of the pending bill?

Mr. BIEMILLER. Mr. Goldfinger.

Mr. GOLDFINGER. I am not prepared, Senator, to give you a precise figure, but I can tell you, as Mr. Biemiller's statement declared, that we fear very seriously the onset of a recession in 1964, in the absence of a substantial tax reduction, because we think that the current trend of economic developments point toward the onset of a general economic decline next year.

Senator GORE. Mr. Goldfinger, we have had lots of generalities before this committee. You just stated another one.

Now, if you are for this bill, if Mr. Biemiller is for it, you ought to know why, and I am going to ask you some specifics. Generalities are a dime a dozen.

Do you have any idea what the gross national product will be in calendar 1964, with or without the bill?

Mr. GOLDFINGER. I have already stated what the outlook is as we see it, and that is that the gross national product would not rise sufficiently next year to reduce the level of unemployment, and at some time during the course of the year, there is a likelihood that the gross national product will begin to decline, with a rapid rise in unemployment.

Senator GORE. Mr. Biemiller, since your aid has no estimate, do you have an estimate of gross national product with and without the bill in 1964.

Mr. BIEMILLER. I rely on our research department in this area.

Senator GORE. Then let's go to this.

You said you are for this bill because it was going to increase jobs.

Do you have an estimate of how many additional jobs will be created by this bill?

Mr. GOLDFINGER. Yes.

Senator GORE. Over and above what would be created without the bill?

Mr. GOLDFINGER. Yes, we do.

Senator GORE. Will you give us the figure?

Mr. GOLDFINGER. Yes.

We believe that the full effect of the tax cut, of an $11 billion tax cut along the lines that we have been talking about, would, after its full effect is in, have an impact——

Senator GORE. I said 1964.

Mr. GOLDFINGER. I will come back to that. Let me give you the full impact first.

Senator GORE. I do not want to buy any share of outer space right now.

Let's begin with 1964, and then we will move up.

Mr. GOLDFINGER. In 1964 I would think that the impact of this bill, with approximately two-thirds of the tax cut going into effect, would mean something like about a $10 billion increase in the gross national product, $10 or $12 billion increase in the gross national product above where it would have been normally.

Senator GORE. How many jobs do you think—well, first, what part of this will go into investment, into savings, and into consumer spending?

Mr. GOLDFINGER. I do not have a model worked out in front of me to give you, but I would say that it would depend upon the specific type of tax cut that is proposed.

Senator GORE. I am talking about the bill that is before the committee. This is the bill you have endorsed, and this is what I am asking you about.

Mr. GOLDFINGER. Yes.

Mr. BIEMILLER. Assuming there are no changes made in it?

Mr. GOLDFINGER. Assuming that there is no change in the bill; two-thirds of it, roughly close to $9 billion for individuals, would go into effect in 1964, that would be roughly about $6 billion. Overwhelmingly this would be spent.

I believe that probably about 90 percent or close to 90 percent of that $6 billion figure would be spent.

Senator GORE. You know that economists do not agree with you on this?

The estimate on which I believe most economists are in general agreement is that income in the portion of our society which overwhelmingly spends what it makes on something to eat, wear, drive in, and live under is about 92 percent, but if you distribute this in the upper income brackets, then you do not have, in my view—and I believe in the view of the economists—90 percent expenditure.

Mr. GOLDFINGER. I would agree with you, sir, that a smaller percentage than the general average percentage of spending and saving would be involved in this bill.

We said so in the statement. Mr. Biemiller made that very clear in his statement.

It is for that reason that we very strongly urge amendments to the bill to improve the economic impact of the tax cut.

Senator GORE. I agree with many of the amendments you suggested.

Now another thing Mr. Biemiller said quite eloquently was that there is a surplus of investment capital, a surplus of savings, that corporate profits are the highest in history, that the liquidity position of corporations is in a most advantageous position and cash flows are higher than ever before.

Mr. GOLDFINGER. Yes.

Senator GORE. Why then would you endorse a bill that would increase availability of investment capital and expect that this would have any material effect on jobs?

Mr. GOLDFINGER. Senator, Mr. Biemiller's statement very strongly urged no reduction, or a smaller reduction, in the corporate tax rate. This is very specifically written into the statement that Mr. Biemiller just presented to the committee.

Senator GORE. Let's go on with the jobs.

How many jobs do you think are going to be created in 1964 by the bill if enacted unamended? Then I would like to know how they will be distributed among services, government, manufacturing, mining, construction, transportation, public utilities, and wholesale, and retail trade.

If you are for this bill, then there must be some specific reason why you are for it.

You say jobs?

Mr. GOLDFINGER. Yes.

Senator GORE. So let's analyze this bill and see what results are likely to flow from it.

Mr. GOLDFINGER. I gave you a rough approximate estimate, Senator, of the increase in the gross national product that we think would be involved, and that increase in the gross national product would involve an increase in employment. That is why we are for the tax reduction.

Now in terms of how many extra jobs would be created in the year 1964, in terms of a rough approximate estimate, I would say it is somewhere between a half million and three-quarters of a million additional jobs, in addition to any normal increase in employment as a result of the regular force of business conditions, would be involved next year in terms of this kind of tax reduction.

Now, where those jobs would be I cannot precisely tell you.

Senator GORE. I do not ask you precisely.

I wonder if you have made any estimate?

Mr. GOLDFINGER. We have an overall general estimate along the lines that I indicated. We do not have an estimate of how much employment would be involved in manufacturing, in the services, in government, et cetera. It would depend upon where the purchases are made, the kinds of increased purchases that are made, where the spending, and the kind of spending would be developed.

Senator GORE. I will not press you for the moment because obviously you do not have statistics which you wish to submit at this time.

Mr. GOLDFINGER. Senator, economics is not that kind of precise science.

Senator GORE. I understand it is not, and I wonder how we have come by this theory that the way to balance the budget is to reduce taxes.

Would you call that a product of an exact science?

Mr. GOLDFINGER. What we are saying is that the primary problem before us is not the condition of the Federal budget but is the condition of employment and unemployment and unutilized resources in the American economy.

Now, this is what we are talking to.

Senator GORE. I think I would almost agree with you there, but what I want to know from either of you is how this bill is going to reach the great bulk of our unemployed, and you have not shown me that. Indeed, no one has.

Mr. GOLDFINGER. Let me try to restate it, if I may.

I do not know that I would add anything to what hase been said many times probably before this committee and others. But the tax savings involved in a tax reduction, most of the tax savings will be spent. The tax savings that are concentrated among low and moderate income taxpayers will almost all be spent or all of it will be spent. It is for that reason, Senator, that we very strongly urge the committee and the Congress to concentrate as much of the tax reduction as possible among low and moderate income taxpayers, because, as you yourself indicated, it is among those groups that you will get the fullest economic impact.

Now, as the money goes through the spending stream, it is spent and respent. The money is spent by the consumer. The money is then respent on inventories and orders to the manufacturer and the wholesaler from the retailer, and the money goes through the economy.

As this process operates, there is a multiplier effect, so that whatever amount is involved in the tax reduction, such as $11 billion, after a period of time becomes more than $11 billion as the money is spent and respent for various kinds of purposes.

Now, all of this spending of money, the spending of additional money involves the creation of additional employment opportunities, and it is employment opportunities with which we are primarily concerned.

Senator GORE. I think I would agree with what you say, but really if it is correct that the way to balance the budget is to reduce taxes, it seems to me that the tax cut of 1954 would have already brought about a balance.

Mr. BIEMILLER. I just want to inject here, so there can be no misunderstanding, that we have never at any time advocated the tax cut on the sole theory that it would balance the budget. This is not our position.

Senator GORE. I understand. I am trying to find out what your position is.

Mr. BIEMILLER. Our position is that we want jobs for the unemployed.

As Mr. Goldfinger has just explained, with the multiplying effect of a tax cut you can make progress. But you will also recall, Senator, that I repeated, I think in at least two places in my formal testimony, that we do not regard a tax cut as the only answer to this problem. It is one of the answers, and we are just as strongly advocating other proposals as we are this one.

Senator GORE. I understand.

What I was about to suggest a few moments ago, since you are not prepared to furnish specifics, is that I submit a few questions to you to which you can respond later.

Would you be willing for me to submit a few questions along this line so you can give some estimates?

Mr. GOLDFINGER. I can give that to you now, Senator.

We are on record as estimating the increase in the gross national product and the increase in employment that we believe would be involved in the adoption of a tax reduction bill along the lines of the bill before you. The $11 billion tax cut would go into effect spread over 2 years, partly on January 1, 1964, the second phase of it on January 1, 1965.

Our estimate is that this $11 billion tax cut by 1966, after the tax cut is in full effect, that in 1966 this tax cut would have an impact on the gross national product of adding approximately something like $20 to $30 billion. This is in terms of the additional multiplier effect and the additional investment effect of these funds circulating through the economy.

Furthermore, we are on record also as saying that the additional $20 to $30 billion of gross national product that would emanate from this tax cut by 1966 would create as many as 2 million additional jobs. Now these, of course, are approximate estimates, but these are our best estimates.

Senator GORE. I understood you in that regard, but I would like some further breakdown if you would be willing to give us your estimate on it.

I would like to know, for instance, how many of these new jobs will go to members of your own unions who are unemployed, how many of the unskilled unemployed would be put to work as a result of this bill, how many of those who have lost out because of technological changes and who are in their forties or fifties are likely to find jobs as a result of this bill.

These are some of the things that I had intended to ask you. If you would be willing to give it some thought, I will submit a few questions and you can answer as your judgment indicates.

Mr. GOLDFINGER. Yes; I will be glad to, Senator.

(The answers to the questions subsequently submitted to Mr. Biemiller by Senator Gore were not completed in time for inclusion in this record.)

Senator GORE. Thank you, and thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Biemiller. I want you to feel you are always welcome before this committee. All you have got to do is to give Mrs. Springer a ring on the telephone.

Mr. BIEMILLER. I know of no more courteous person in charge of a committee on the entire Hill than Mrs. Springer. She is always cooperative.

Thank you very much.

The CHAIRMAN. We will recess until 2:30.

Senator GORE. Mr. Chairman, I must apologize for being unable to be here at 2:30. As you know, the Senate is having a memorial service for my late colleague, Senator Kefauver, this afternoon, and I will of necessity be absent from the committee.

(Whereupon, at 12:40 p.m., the committee recessed, to reconvene at 2:30 p.m. the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order. The first witness is Mr. Johnson McRee, Jr., of Manassas, Va. Mr. McRee, I am very glad to welcome you, sir.

STATEMENT OF JOHNSON McREE, JR., MANASSAS, VA.

Mr. MCREE. Thank you, Senator.

My name is Johnson McRee, Jr. I am a partner in the firm of Brydon, McRee & Smith, certified public accountants, of Richmond and Manassas, Va.

My purpose in appearing before you today is to discuss H.R. 8363 with particular reference to its rate provisions. It has been my privilege to follow closely this bill since its introduction into the House and to testify before the House Ways and Means Committee in March of this year. Though the House has made some minor improvements in the bill as originally introduced, it appears that the character of tax revision is still primarily based on the consumer spending approach—an approach completely out of step with the American system of free enterprise that has made this Nation the greatest in the world today.

We are oppressed by a staggering graduation of the income tax based on the socialistic theories of academicians. These stargazers embrace deficit finance, pump priming, and government expenditures as a method designed to produce more for all regardless of individual effort expended. Thus, we have had 30 years of almost rampant inflation and deficit financing trying to insure economic equality for all men. Such equality can never be obtained because there is never and has never been equal effort expended by each man. We do try in our system of free enterprise insofar as is practicable to provide equal opportunity for all men. We do not claim that the American capitalistic system is perfect or has ever been perfect—we do claim that it is the best system ever devised in the history of mankind.

Congratulations are certainly due the Treasury Department and this administration for having brought a recognition of the need for tax rate reduction this far through the Congress. We deplore, however, the lack of adequate recognition in the bill before you of the importance of new capital formation. Growth of capital has been retarded drastically by our present tax system. I fear this retardation is not sufficiently curtailed from a permanent standpoint under the present bill. The real culprit is the high degree of graduation in the tax structure. We must relieve the middle brackets, that is, the brackets from $10,000 to $50,000 in income from oppressive taxation which removes incentives and confiscates capital from our free society.

We hear much these days about tax reduction at a time when Government expenditures are already too high. It is true that such expenditures are too high and that something must be done to correct this problem. It is my belief, however, that the problems which beset us because of oppressively high tax rates are separate and distinct from the problems brought on by excessive Government spending. I am primarily concerned lest the Congress enact the wrong kind of tax rate reduction regardless of what is done in the area of expenditure reduction. Let us be certain that tax reduction and rate reform really are designed to release the drags of heavily graduated taxation so that the economy is simply given a healthy and free competitive atmosphere within which to function. We could not do a greater disservice to this Nation than to lead the people to believe we will have more employment, more prosperity, and a healthy business community simply by providing a small stimulus for immediate consumption by persons already employed. What we must do is release incentives and capital, as I have said, through the middle and higher income groups so as to create new business, new production, and new employment. The lack of consideration in this bill for the potential capital formation inherent from our middle-income citizens is its most glaring deficiency.

We have said that the need for relief from oppressive tax rates is a problem separate from the need for Government expenditure reduction. This does not imply, however, that the latter need is not severe in our economy today. If properly devised tax rates are capable, as we think they are, of allowing operation of the natural upward thrust inherent in the American economy, we certainly have the obligation to reduce Government expenditures so the economy can be given a truly free atmosphere in which to so expand. If there were no other reason, this is sufficient reason for the reduction of Federal expenditures to the absolute minimum.

There are many other reasons for such reduction, however. There is much waste in this bureaucracy which we have allowed to grow to strangling proportions. We have reached the point where we have people on the Federal payroll simply to somehow create more work for more people without providing anything new. There is admitted waste in practically every form of Federal expenditure. Further, it has become a foregone conclusion in many minds that reduction should only be effected in the nondefense sectors of the Federal budget. I do not subscribe to this premise. I believe there are many millions of dollars unnecessarily expended yearly in the name of national defense. This is a matter with which I realize you gentlemen are faced constantly, but it seems inconceivable that we show no more concern in this Nation for the constantly rising Federal deficit. This deficit has risen so quickly as to require the raising of the Federal debt limit as often as twice a year.

We have many State and local governments in this Nation where expenditures are admittedly too high, but I am sure those local governments of which I have any knowledge would find raising the legal debt limit twice a year incredible. Perhaps these deficits have become so usual that their full significance is lost upon the average Member of Congress. I for one would strongly suggest that each Member examine this problem thoroughly and in the light of its startling ultimate consequences. No resources can constantly flow out without being depleted. This has to be true of governments—even strong ones—with regard to the use of credit.

As for the reforms embodied in H.R. 8363, I shall not attempt to discuss each of them. I would point out, however, that it is seldom possible to close one so-called inequity or loophole without simultaneously creating another. What appears to be privileges and inequities in a complicated tax structure are only accentuations of an oppressively high rate structure. Flattening the curve of graduation within the tax structure would obviate the necessity for further complicating an already too complex income tax law.

It has been only a year since we enacted the investment credit as a part of our tax law. This was a gimmick fostered by academicians from the nonbusiness community who strangely felt themselves competent to instruct businessmen on the kind of tax reduction needed in the business world. We in the accounting field discovered very promptly the difficulties and extremely unnecessary complications even for the smallest taxpayer which this feature has added to the tax administration. I would strongly recommend that the investment credit be stricken from the code and that a further reduction in the corporate rate be substituted so as to create approximately the same effect. Failing in this, I would favor the provision changing the investment credit as embodied in the House bill.

Several years ago, we embarked upon an effort to eliminate the double taxation in corporate dividends by the institution of a small dividend credit against the tax. Yet we now find a movement to repeal this small step in the right direction even though the double taxation of corporate dividends is freely understood and admitted by almost all citizens. This proposal I find preposterous. Please let us not go backward.

In conclusion I should like to summarize two basic points regarding tax rate reduction as represented in the bill before this committee.

1. I implore you not to let the tremendous problem of excessive Federal expenditures obscure the very real necessity for the right kind of tax rate reduction; that is, a rate schedule which will release the pent-up energies inherent in a free enterprise economy, as opposed to one which attempts to prime the pump by encouraging the average consumer to spend pennies more each day within the framework of our current economic climate.

2. Although the problems of tax rate reduction and Federal expenditure reduction seem to be entwined, we must recognize each as a separate problem and we must not minimize either for the sake of the other. This Government has too long spent more money than it has, and the attack on this problem must be a frontal one—reduction of expenditures in all areas which are unnecessary or excessive regardless of taxes and revenues.

Gentlemen, I deem it a privilege to have been able to appear before you today. Like all Virginians, I have a particular friend in your chairman. Our only regret in sending so conscientious a statesman as Senator Harry F. Byrd to the Senate is that we lose too much of his counsel in the affairs of our Commonwealth. Thank you.

The CHAIRMAN. Mr. McRee, I certainly appreciate your personal reference to me. I am grateful.

Senator Bennett?

Senator BENNETT. I have just one question, Mr. McRee. I was not here when you began to read your statement or when you were introduced. Are you a tax accountant?

Mr. MCREE. Yes, sir.

Senator BENNETT. Would you say that if this bill is passed, your problems of serving your clients will be increased or diminished?

Mr. MCREE. I would say that taking the bill intotal, the problems would probably be increased, but that is primarily because of certain other reform sections in the bill.

Tax reduction is something that we need, that we have long needed: but as I say, we need it in the middle brackets, the brackets which can release capital into our economy, so as to create new production and new employment.

Senator BENNETT. Yes. I am thinking of the technical changes in the bill. Are they going to present new problems which will in turn involve more effort on your part to serve your clients?

Mr. MCREE. I am sure they will.

Senator BENNETT. That is all, Mr. Chairman. Thank you.

The CHAIRMAN. Senator Dirksen.

Senator DIRKSEN. Mr. McRee, do you have industrial clients?

Mr. MCREE. Yes, sir.

Senator DIRKSEN. Very many?

Mr. MCREE. Well, I think the question is relative. I suppose the number relative to the size of our firm would be considered substantial.

Senator DIRKSEN. Do you have industrial clients who have cash resources and could possibly expand their businesses if proper incentives were there?

Mr. MCREE. Incentives—the cash resources I think would be greatly increased if they did not have to expend them in payment of taxes; that is, particularly those in the surtax bracket.

Senator DIRKSEN. What I mean particularly is this: Whether you have clients who possibly could expand their operations, and in so doing create jobs in their particular industry if there was an incentive to do so.

Mr. MCREE. Absolutely.

Senator DIRKSEN. Now in that same class, of course, would be industries who might put new products on the market if they felt the incentive was there, and they felt reasonably secure and confident about the future.

Mr. MCREE. That is true.

Senator DIRKSEN. If the chairman or the president of such an industry were to ask you and get your advice as to whether it would be advisable to go ahead and expand, provided this tax bill were being put on the books, what would you advise your clients to do?

You see what I am trying to get at is simply this. It is represented that this tax bill will bring about economic growth and economic expansion, and in so doing it will have a tremendous impact upon the unemployment factor that we are faced with today.

Now, obviously you do not achieve that result unless people are willing to expand, and they set about to make this appear that this is an incentive for expansion. Now I am sure that some of your clients have probably asked you that question or will, before we get through.

Mr. MCREE. They have, and I am sure that more will. Of course, it is hard to get any man in business to say that he is against tax reduction. However, I would have to advise on the basis of the bill as presently constituted that the amount of tax reduction for the average small business on the way up is so small as to make the incentive not really sufficient to justify expending great amounts of money and capital with which to expand.

Senator DIRKSEN. In other words, that objective would not be achieved, and you would so advise any of your industrial clients.

Mr. MCREE. That is on the basis of the current tax structure. I do believe that this bill, however, provides a framework within which this committee could change the rates so that those incentives could be present.

Senator DIRKSEN. Insofar as you know the temper of others who are associated in the same field, namely tax accountants, what do you think they would say to their clients?

Mr. MCREE. Of course, I would say I would think they would say the same thing. I don't propose to speak for all of them, but those that I have discussed this problem with in the past several months feel as I do.

Senator DIRKSEN. I see you mentioned the investment credit, and suggest that perhaps it might best be repealed and the corporate rates refined accordingly to achieve that result. What has been your personal experience as an accountant with that investment credit?

Mr. MCREE. It has been nothing but one of frustration—particularly where you are dealing with small taxpayers. We have had investment credits of 82 cents and amounts of money which certainly don't justify the filling out of such a form.

Of course, as I am sure you know, the primary problem created was the requirement that the asset value be reduced by the amount of credit for depreciation purposes. This created a tremendous problem in the field of accounting insofar as statement presentation is concerned.

The American Institute of CPA's came out, after much disagreement among their members and among the members of their committee as to how to handle this with a decision. I personally think their ultimate decision was wrong, but it certainly is true that the only real way to eliminate the problem is to simply eliminate the investment credit and go back to simple rate reduction.

That is what this purports to do. Why do we have to do it in such a complicated fashion?

Senator DIRKSEN. Do you have some specific example in mind within your own experience to make the point clear that you are trying to make in this statement on investment credit?

Mr. MCREE. Well, yes. I don't have the specific figures with me, but I know of several cases where, on the one hand we reduced the value of the assets for depreciation purposes, and on the other did not. Just on the depreciation schedule itself, it makes a rather complicated document to try to show exactly what you have done; particularly when you are dealing with first year depreciation and different kinds of depreciation.

This return I have in mind did not even embrace the new guidelines. It used the same rates they had been using, so that the actual 7-percent reduction achieved in the case that I am thinking about was something less than $100, and yet it must have cost them that much in time of their own people and accounting fees, in order to get it computed.

So that in itself would indicate to me that, if business is to be given an incentive, just reduce their tax rates. Why create some new gimmick just to do something that can be done very simply?

Senator DIRKSEN. Was this a reasonably substantial enterprise which you are talking about?

Mr. MCREE. Within the framework of small business, yes; but it is a small business.

Senator DIRKSEN. And you say the reduction worked out to only $100 in the course of a year?

Mr. MCREE. That is right, the reduction in taxes. It was less than that.

Senator DIRKSEN. They couldn't hire you for that, could they?

Mr. MCREE. Well, hardly.

Senator DIRKSEN. In a depreciation matter.

Mr. MCREE. I would hope that my services were a little bit more involved than actually computing that credit, but the fact of the matter is that it did take considerable time, considering the fact that you had to set up a depreciation schedule and try to tie figures from about four different directions into your balance sheet, not to mention the statement, so I would say it would be hard to measure.

But I think it would be almost irrefutable to say that it cost them more to compute that credit than it was worth when they got it.

Senator DIRKSEN. If you were to set up a rate schedule, how would you do it?

Mr. MCREE. A corporate rate schedule?

Senator DIRKSEN. Yes.

Mr. MCREE. I think I would approach first the surtax bracket and try to reduce the surtax bracket to as low a rate as we can conceive of within the framework of needed revenue.

Of course, you have got to consider that. But we jump after $25,000 from 30 to 52 percent under the present law, which seems just a little bit unreasonable to me—I mean to say that a business ceases being small and becomes large after it makes $25,000. That is an arbitrary sum to start with.

I would think actually, as far as corporate taxation is concerned, that the rate probably should be scaled down considerably in the surtax bracket in order to really create incentive to make more money—and also I might add to stop all this business that we seem to be trying to stop—of setting up multiple corporations within small business enterprise.

Senator DIRKSEN. Now, going from that point on, you say the real culprit is the high degree of graduation in the tax structure. What are the recommendations which you make?

Mr. MCREE. I would flatten the degree of the graduation curve insofar as we can do so—again in the framework of revenue loss—so that what real relief is afforded can produce—can be released into the economy to produce new business, whether it be from the same framework or new frameworks. That is the way that it seems to me new employment would be created.

I have a table which was prepared, I think, by your staff, which indicates that the most average annual tax reduction per taxpayer for those under $10,000 is $90. That is in the $5 to $10,000 class.

I just don't believe that you are going to get enough additional savings and additional investment from that kind of money to produce a marked effect on the economy. I believe $90 amounts to something like 25 cents a day.

Senator DIRKSEN. Why do you limit your estimate of capital formation in those brackets from $10,000 to $50,000? Isn't there capital formation below $10,000?

Mr. MCREE. Yes; there is, but the formation it seems to me is not sufficient to produce as much new economic impetus as it does after you get over that figure because it is going to be taken up in living expenses, and an increased living standard.

Senator DIRKSEN. Yes, but look at the millions of additional taxpayers that you have in the brackets under $10,000.

Mr. MCREE. I understand.

Senator DIRKSEN. They are frugal people who have contributed very materially to capital formation.

Mr. MCREE. Some of them are.

Senator DIRKSEN. I think if you just take the building and loan associations all over the country, and there are thousands of them where they add a little bit of money every month and they save systematically, of course they become a part of the capital formation structure. So I would not underrate that group under $10,000.

Mr. MCREE. It is not my idea to underrate that group, but what I was trying to refer to in the bill before you is the group which has not been affected. I think that there is tax reduction for that lower income group in this bill, but the middle-income group has not been properly considered.

The points of graduation—I believe one of your witnesses earlier today pointed this out—the points of graduation under this bill in the middle-income group are more severe than they are under present law. So that is my point.

I am not trying to focus attention on the middle-income group as opposed to others, but in this bill I believe that they have been neglected more than the others.

Senator DIRKSEN. I think that is all, Mr. Chairman.

Senator BENNETT. May I make just one more comment. Money that goes into the savings and loan associations ends in one particular area only, and that is mortgages. I think by law the savings and loan associations are not allowed to use that money for common stocks or in the development of productive enterprises.

Now this in an area that has to be kept going, and all the money that is available for mortgages is pretty well used and needed.

Senator DIRKSEN. But I think I should point out to my distinguished friend from Utah that when you build a house, it embodies nails that come from the wire area, and timber that comes from the timber area of the country, and cement that comes out of the portland cement factories that dot the whole wide country.

So it goes right back to these industries where people find employment, and even the Government shares in it because the reserves have to be invested in something that is good, and that means usually U.S. bonds, so even the Government gets an outlet there.

Senator BENNETT. This is the process of consuming the goods produced by the lumber and other industries. It doesn't provide money to buy stock.

Senator DIRKSEN. Oh, no.

Senator BENNETT. In lumber companies, and that is what I thought you meant.

Senator DIRKSEN. It buys the commodities.

Senator BENNETT. It buys the commodities. This is a part of the process of consumption rather than the other business. That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. McRee. I appreciate your coming down.

Our next witness is Lester V. Chandler, professor of economics, Department of Economics, Princeton University. Mr. Chandler, will you proceed?

STATEMENT OF LESTER V. CHANDLER, PROFESSOR OF ECONOMICS, DEPARTMENT OF ECONOMICS, PRINCETON UNIVERSITY

Mr. CHANDLER. My name is Lester V. Chandler and my position is professor of economics, Department of Economics, Princeton University. I should like to present a statement approved by 313 economists affiliated with 14 colleges and universities located in the various parts of the country. A list of the signers and their affiliations is appended to the statement. The statement is as follows:

As professional economists, we welcome the administration's clear recognition of the role which Federal fiscal policy can and should play in maintaining and expanding the level of economic activity. While some of us disagree with one or another specific feature of the tax program now before the Congress, we all, without exception, subscribe to the following propositions:

1. There is now a substantial deficiency of aggregate demand in the American economy, with the result that the level of unemployment is

significantly higher than it need be—and, in our opinion, higher than it should be.

2. While there are significant "structural" problems which make it difficult to find jobs for the more disadvantaged of the unemployed, the first need is to achieve a higher overall level of economic activity. If this is done, efforts to retrain and relocate displaced workers will be more effective.

3. We subscribe to the belief, as recently expressed by Walter Heller, that an—

increase in aggregate demand is most appropriately brought about in a predominantly private enterprise economy such as ours by means of monetary or fiscal measures.

4. It is generally agreed that, in the present situation, monetary policy by itself cannot bring about the necessary expansion of economic activity—in part, because of the restraint imposed by the present balance-of-payments situation. Hence the primary reliance must be on fiscal policy.

5. While we welcome the improvement in economic conditions which has occurred in the last few months, we believe that "natural forces" alone will not eliminate excess unemployment this year or even next year.

6. It therefore follows that, in the months ahead, substantial use should be made of fiscal policy as a means of stimulating aggregate demand and raising the level of employment. This can be done by reducing tax revenues, by increasing Government expenditures, or by some combination of the two.

7. We believe that the increase in the Federal deficit proposed by the administration is not too large, given the objective being sought. We are confident that both the short-run and long-run effects of the tax reduction will be beneficial. Indeed, insofar as there is a difference of opinion among us, it is that some of us believe that a larger tax cut should have been proposed.

8. On the whole, we believe that the administration's program, as originally submitted to the Congress, represents a reasonable compromise. It provides tax reductions for both individuals and corporations. It should provide a significant stimulus to consumers' spending, and it should have a beneficial effect on private investment. Virtually all of us believe that substantial tax reform is badly needed, but we also believe that arguments as to the details and timing of tax reform should not delay the prompt approval of a substantial across-the-board reduction in Federal income tax rates.

9. We should like to assure the American people that a Federal deficit of the magnitude proposed, given the extent to which capital and labor are not now being fully utilized, carries no danger of accelerated inflation. Nor does such a deficit in any manner or degree threaten the solvency of the Federal Government. This country's outstanding record of economic growth during the last century and a half or more has been associated with increases in debt representing mobilization of the people's savings by business and Government. It should be noted, also, that the size of the deficit will automatically decline as rising incomes generate increased tax revenues at the lower rates.

10. We should also like to affirm—and we do so with complete confidence—that there is nothing to fear from the present size of the Fed-

eral debt. Nor is there anything to fear from the moderate increase in the debt that will result from the deficits envisaged in the next few years. Indeed, measured as a fraction of the gross national product, the Federal debt today is much smaller relatively than it was 15 years ago. And interest payments on the debt absorb a significantly smaller fraction of the national income than they did at the end of World War II.

In the realm of economic policy—as in all social and political action—there are as many versions of what is best as there are people who are likely to be affected by any proposed line of action. To insist on a perfect tax program is to insure that nothing will be done. The administration's program is a significant step in the right direction.

Thank you, Mr. Chairman.

(The list referred to follows:)

We subscribe to the propositions included in the statement on "The Tax Program of the Kennedy Administration." Each of us signs as an individual economist and not as a representative of an institution.

Amherst College:
- Ralph E. Beres
- Arnold Collery
- Irwin Kleinberg
- Heinz Kohler
- Willard L. Thorp
- Colston E. Warne
- James R. Wilson

Bowdoin College:
- Albert Abrahamson
- Paul G. Darling
- Giulio Pontecorvo
- William D. Shipman
- James A. Storer

Brandeis University:
- Richard I Weckstein
- P. J. D. Wiles

Brookings Institution:
- Barbara R. Berman
- Edward F. Denison
- Gary Fromm
- Bert G. Hickman
- Joseph A. Pechman
- Merton J. Peck
- Alice M. Rivlin
- Walter S. Salant

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- George T. Break
- Eugene W. Burgess
- Norman R. Collins
- J. M. Culbertson
- Malcolm M. Davisson
- Kenneth B. Farrel
- Hugh Folk
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- R. A. Gordon
- E. T. Grether
- Gregory Grossman
- Saul H. Hymans
- Sydney Hoos
- Van D. Kennedy
- Ivan M. Lee

California, U. of—Berkeley—Continued
- John M. Letiche
- Choh Ming Li
- Sherman J. Maisil
- Julius Margolis
- Hyman P. Minsky
- David Olbe
- Andreas G. Papandreou
- Ray Radner
- Earl R. Ralph
- David A. Revzan
- Henry Rosovsky
- Arthur M. Ross
- Bernard Saffran
- Tibor Scitovsky
- Lloyd Ulman
- Dow Votaw
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- Sidney G. Winter, Jr.

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- Frank C. Child
- Bruce Glassburner
- Warren S. Gramm
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- Martin P. Oettinger
- J. Herbert Snyder
- Stephen H. Sosnick
- J. M. Tinley

California, University of—Santa Barbara:
- Mortimer Andrew
- J. F. Halterman
- Jerry F. Karer
- William J. Kennedy
- Walter J. Mead

California, University of—Los Angeles:
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- E. F. Brighen
- C. J. Huizinga
- R. J. Jessen
- Erwin L. Kelley, Jr.

California, U. of—Los Angeles—Con.
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H. Lawrence Miller, Jr.
Harold P. Moody
George E. S. Murphy
Frank E. Norton
J. Fred Weston
Robert M. Williams
Carnegie Institute of Technology: G. L. Bach
Chicago, University of:
B. M. Fleisher
Harry G. Johnson
Dale W. Jorgenson
Arnold Harberger
Marshall D. Ketchum
Lloyd A. Metzler
Merton H. Miller
Albert Rees
T. W. Schultz
Columbia University:
Harold Barger
Arthur R. Burns
Alexander Erlich
Carter Goodrich
Albert O. Hirschman
Robert Lekachman
David E. Novack
Julius Rubin
Connecticut, University of:
David G. Edens
Dorothy C. Goodwin
James C. Loughlin
Morris Singer
William P. Snavely
Paul N. Taylor
Philip E. Taylor
H. John Thorkelson
Paul Weiner
Imanuel Wexler
Cornell University:
William D. Carmichael
Douglas F. Dowd
John A. Henning
George H. Hildebrand
Alfred E. Kahn
Chandler Morse
George J. Staller
Dartmouth College:
William A. Carter
M. O. Clement
James F. Cusick
Clyde E. Dankert
Thomas J. Finn, Jr.
Herbert Goertz
Martin L. Lindahl
Kenneth J. Rothwell
Martin Segal
Ian A. Stewart
Duke University: William Porfohe
Harvard University:
Abram Bergson
Richard E. Caves
Robert Dorfman
John T. Dunlop
James Duesenberry
Otto Eckstein
Harvard University—Continued
Alexander Gerschenkron
Seymour Harris
R. B. Heflebower
Richard O. Mallon
Edward S. Mason
Rhod J. Ohyme
Gustave F. Papanel
T. Schelling
Wolfgang F. Stolper
Illinois, University of:
V. Lewis Bassie
Ruth A. Birdzell
John D. Bowman
Sanford Cohen
Milton Derbe
John F. Due
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Marvin Frankel
Donald W. Paden
Indiana, University of:
Robert W. Campbell
Troy J. Conley
Irvin Grossack
Taubman A. Miller
Henry M. Oliver
Lloyd D. Orr
Ross M. Robertson
Nicolas Spulber
Ted Witney
E.R. Wicker
Iowa, University of:
Raymond R. Beruke
Eugene A. Brady
Harold W. Dewey
Hirschel Harper
Earl O. Heady
Bob R. Holden
Sydney James
Lee Kolmer
Francis A. Kutish
Stanley S. Long
Dudley G. Luckett
Charles Meyer
John W. Rowe, Jr.
J. T. Scott
Erik Thorbreke
Karl A. Totz
John F. Truemont
Don Winkelmann
Johns Hopkins University:
Z. Adel
G. Heberton Evans, Jr.
James K. Kindahl
Kelvin J. Lancaster
Edwin S. Mills
R. T. Sparrow
Maryland, University of:
John H. Cumberland
Dudley Dillard
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Lyle E. Gramley
Robert E. L. Knight
Philip C. Packard
Melville J. Ulmer
Paul Wonnacott

Massachusetts Institute of Technology:
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Francis Bator
E. Cary Brown
Paul H. Cootner
Rischard S. Eckaus
Everett E. Hagen
Daniel M. Holland
Edwin Kuh
Louis Lefeber
Max F. Millikan
Paul A. Samuelson
Robert M. Solow
Charles P. Kindleberger
Michigan State University:
Abba P. Lerner
Minnesota. University of:
John Buttick
E. Coen
Edward Foster
Lowell Gallany
Ralph H. Hofmeister
Leonid Hurwicz
A. O. Krueger
Jim Schwinden
Harlan M. Smith
John G. Trumbull
New York University:
Clifford D. Clark
Lawrence S. Ritter
Arnold W. Sarnet
Harvey H. Sezal
North Carolina, University of:
Paul N. Guthrie
Leopold B. Koriebroski
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R. S. Winslow
Marice Whee
Pennsylvania, University of:
Irving B. Kravis
Wilfred Malrubaum
Robert Summers
C. R. Whittlesey
Willis J. Winn
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Pittsburgh, University of:
Benjamin Chuntz
A. T. Eapen
R. D. Entenberg
Alan E. Fechter
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Charles L. Levin
Daniel McFadden
William C. Pendleton
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Merrill J. Roberts
Edward Sussia
C. Edward Weber
Princeton University:
William Baumol
Arthur Benavie
William G. Bowen
Ansley J. Coale
Warren W. Eason
F. Aldrich Finegan
Peggy Heim
Edward J. Kane
Klaus Knorr
Richard A. Lester
David McFarland
R. A. Musgrave
Gardner Patterson
Richard E. Quandt
Frederic C. Shorter
John Williamson
Burton A. Weisbrod
Lester V. Chandler
Rice University:
S. N. Afriat
John H. Auten
Dwight S. Brothers
Edgar O. Edwards
Hans Jurgen Jalesch
Gaston V. Remlinger
Rochester, University of:
Marcus Alexis
William E. Dunkman
Robert R. France
Myron J. Gordon
Ronald W. Jones
Lionel McKenzie
Rudolph G. Penner
Richard T. Rostoff
Edward Zabel
Southern Methodist University:
Leo T. Bakomy
Paul T. Hornan
Attiat A. Farag
Richard B. Johnson
W. J. Lovejoy
Daniel J. Ott
J. H. Pratt
Stanford University:
Kenneth Arrow
Richard Attrych
Paul David
Emile Despres
John G. Gurley
Bernard F. Haley
Paul Hartman
James Howell
Theodore J. Kreps
Alan S. Manne
Ronald McKinnon
Mel Reder
Louie Tarshis
Dale Yoder
Tufts University:
V. E. Andric
John Cornwall
Franklyn D. Holzman
Utah, University of: Sigmund Krauthauser

Vanderbilt University:
- Rudolph C. Blitz
- John A. Brittain
- Reynold E. Carlson
- Reulias Fels
- E. J. Eberling
- Leo J. Raskind
- Ewing P. Shabor
- George W. Stocking
- Fred U. Wertfield
- Jeffrey G. Williamson
- James S. Worley

Virginia, University of:
- George R. Hall
- Almarin Phillips
- James R. Schlesinger
- Rutledge Vining

Washington, University of:
- Henry T. Buechel
- J. A. Crutchfield
- Barney Dowdle
- J. P. Gillingham
- William S. Hopkins
- W. D. Morris
- Vernon A. Mund
- Judith Thornton
- Charles M. Tribout
- D. A. Worcester, Jr.

Wesleyan University:
- Clyde Olin Fisher
- Burton C. Hallowell
- Lawrence C. Jones
- Stanley Lebergott
- Melvin Lurie
- Gerald M. Meler
- Richard A. Miller
- Edward J. Nell
- Vladimir L. Stoikov

Williams College:
- Henry J. Bruton
- Paul G. Clark
- Robinson G. Hollister, Jr.
- Joseph A. Kershaw
- Robert Miki
- Frederick S. O'Brien
- William G. Rhoads
- Norman Schneider
- John Sheehan

Wisconsin, University of:
- Benjamin Bridges, Jr.
- Martin H. Daid
- James S. Earley
- Arthur S. Goldberger
- Edward Greenbey

Wisconsin, University of—Continued
- Farsham Hall
- Kathleen Haygood
- Edward B. Jakubauskas
- David B. Johnson
- John Korbel
- Roger F. Miller
- Guy H. Orcutt
- Robert Ozanne
- Gerald G. Somers
- James Stern
- G. E. Swingay
- William Russell
- Hans O. Schmitt
- Ernst W. Stromsdorfer
- Leonard W. Weiss

Yale University:
- John Arena
- Bela Balassu
- Sylvester E. Berki
- Ronald G. Bodkin
- William Brandio
- William T. Bruns, Jr.
- Duncan R. Campbell
- Mariam Chamberlain
- Neil W. Chamberlain
- John Davis
- F. Trenery Dolbear, Jr.
- Eeme Draudabej
- Stanley Engerman
- John Fei
- James W. Frieda
- Reginald H. Green
- Joseph Grunewald
- Donald A. Hester
- John W. Hoofer
- Shane J. Hunt
- Zoran Horfert
- Lawrence B. Krause
- Michael C. Lowell
- Peter Mieszkowski
- Harry A. Miskimin
- Arthur M. Oken
- Hugh D. Patrick
- Richard C. Porter
- Raymond Powell
- Gustave Ranis
- Lloyd C. Reynolds
- Leonard Schifrin
- Peter Schran
- Adolph Strumthel
- James Tobin
- Harold W. Watts
- Menuhin Yaari

The CHAIRMAN. Thank you. These economists, are they employed teaching in these various universities?

Mr. CHANDLER. Yes. These are all professional economists teaching at the colleges and universities indicated.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. No questions.

The CHAIRMAN. Senator Dirksen.

Senator DIRKSEN. Did these economists come together in a group? Was this the consensus of a meeting of some kind that you held?

Mr. CHANDLER. The procedure, sir, was that some of us drew up a statement and sent it to the departments at the institutions indicated, and asked how many people would approve of the statements.

Senator DIRKSEN. So, Dr. Chandler, this statement was circulated to the schools and colleges, and they were asked whether they approved this kind of statement.

Mr. CHANDLER. That is true.

Senator DIRKSEN. Did you get negative answers also?

Mr. CHANDLER. I am sorry, I can't answer that question because the people did not write directly to me. The statement was sent to a representative at each college. Then the people who wished to sign signed and presumably those who did not approve just didn't sign. I have no indication of negative votes.

Senator DIRKSEN. You say this represents some 436 economists?

Mr. CHANDLER. 413, I believe.

Senator DIRKSEN. How many teaching economists are there in the country?

Mr. CHANDLER. I suppose 3,000 or 4,000. The statement was not sent to all institutions. We did not have large funds at our disposal, so we had to economize.

Senator DIRKSEN. Yes. The reason I am interested is because yesterday we had Dan Throop Smith, of Harvard, whose position in the field of economics, I believe, is pretty well recognized. I think you would agree, wouldn't you?

Mr. CHANDLER. Yes; he is a very competent man.

Senator DIRKSEN. And in addition, of course, he has a rather long Treasury experience under the prior administration.

Mr. CHANDLER. Yes.

Senator DIRKSEN. Now he took a pretty stout position against this tax bill yesterday.

Mr. CHANDLER. There are certainly quite a number of economists who would take that position.

Senator DIRKSEN. So you think there are as many as 4,000 teaching economists at the college level?

Mr. CHANDLER. This is a guess, but it is probably of that order of magnitude.

Senator DIRKSEN. It would represent then let us say about 10 percent.

Mr. CHANDLER. Yes, sir. If I had to guess, however, as to the percentage of them who would have signed, had they seen the document, my guess is it would have been well over 50 percent.

Senator DIRKSEN. Well, were they all circularized?

Mr. CHANDLER. No; they were not. The statement went to approximately 75 colleges and universities.

Senator DIRKSEN. That would be how many people?

Mr. CHANDLER. Probably 700 or 800 would have been the potential.

Senator DIRKSEN. So you only circularized roughly 20 percent of the total number of teaching economists?

Mr. CHANDLER. That is true.

Senator DIRKSEN. And there is no indication of the negative answers that might have been returned?

Mr. CHANDLER. No. These would not have come to me. I am sure that there were some who did refuse to sign, but I have no way of knowing their names or number.

Senator DIRKSEN. I notice you say in paragraph 10:

Nor is there anything to fear from the moderate increase in the debt that will result from the deficits envisaged in the next few years.

Have you every speculated on how much debt this country can take and still go forward, adding economic growth and momentum at an acceleration that we would like to see?

Mr. CHANDLER. I do not have the statistics closely in mind, but I think one could compute rather well the percentage rate of increase in the debt that would be required to give us something like full employment without getting into an inflationary state.

Of course, in the period since the war the Federal debt has grown very slowly, State and local debts very rapidly, and most rapidly of all is the business and private debt.

Now the growth of the business debt reflecting a sort of stagnation of business investment has slowed down in the last few years, and if the growth of business debt were at the rate of the early postwar years, then it would certainly be a dangerous matter to have a growth in the Federal debt. It is only because of the lag in the private expenditures that one can safely engage in this kind of Government spending and this kind of tax change.

Senator DIRKSEN. Would you say that municipal debt has reached rather alarming levels in the country?

Mr. CHANDLER. I am not competent to speak on that. I have heard of no cases of defaults or complaints about the quality of municipal debt, but this is not my field of specialty.

Senator DIRKSEN. But it begins to appear as if it becomes a more and more difficult load to carry on with time.

I am thinking in terms of the age of cities for one thing, the fact that they are confined, and that there are certain limitations on their growth and their expansion. There are areas where the boundaries of the localities cannot under State law be expanded.

You don't take in new property, therefore, you don't gain new taxpayers, and as a result you have a static condition on which a monumental debt is being assessed. That is why I say I think it is assuming rather alarming proportions.

Mr. CHANDLER. Mr. Senator, I think you have put your finger on at least two of the most important items in the municipal debt picture. The problem is not so much that the income of the citizens of the cities are too low. The problem is, in the first place, that boundary lines are becoming more and more unrealistic as the population spills over the traditional political boundary lines, and, in the second place, that there have not been innovations in municipal tax systems that would enable them to meet the problem they still rely so very, very heavily upon the property tax, and now much of the property is beyond the municipal limits where the expenditure is needed.

Senator DIRKSEN. Would you subscribe to the definition that debt is a speculation on the future?

Mr. CHANDLER. Yes, sir; every kind of purchase where the return will come in the future is certainly a speculation on the future.

Senator DIRKSEN. Well, I have in mind a modest metropolitan center which is ringed by satellite villages and communities which, under State law, cannot be annexed because the law requires that there must be approval by both the annexer and the annexee.

The result is that you have got a community of a given static size that can't grow. Yet the demand for all sorts of improvements is there. The result is that it has got to bound itself upon a fixed package, and I would say that that becomes a little alarming for communities of that kind, because ultimately they will get to the point of no return.

Now what happens? Well, people move out. They move out among the satellite towns, because they discover the tax rate is so much lower, that the fiscal burdens are so much easier that they can afford to do that and still be pretty close to all the advantages of metropolitan life. Would you say that is a general situation over the country?

Mr. CHANDLER. It is a general situation around those metropolitan areas that are getting the great suburban and exurban areas, and there seems to be good reason to fear that unless important changes are made in the political arrangements, that what were formerly central city areas will now be abandoned and allowed to rot, because they simply will not have the people; they will not have the resources for the urban renewal kinds of programs required to make them viable. So that some sort of political invention in terms of new groupings within States, new tax arrangements, and various other things will be essential if this kind of result is to be avoided.

Senator DIRKSEN. But, of course, you are dealing with State and local taxes, which is a rather static pattern, to say the least, so that in considering the size of the Federal debt you can never sustain the debt of the localities, the counties, the sewer debts, the paving, the water districts, and we have got them by the thousands over the country, because the impact is on the individual when you come to taxes, and that is true here in talking about the impact on the individual.

Yet the debt goes up, and you have got to express the interest, because you can't pay it in any other way except in terms of money.

Mr. CHANDLER. That is true. The point that we were making here is not that it is impossible to have excessive debt in any sense of the term, but rather that the debt has to be looked upon as a relative matter, the amount of debt relative to wealth or the amount of debt service relative to the funds available for servicing, and this kind of thing.

I think one needs to remember that our gross national income is now at $588 billion annual rate as compared with only a little over $200 billion in the early postwar years, and it seems only a short time ago that it was between $400 and $450 billion. There certainly has not been what any of us would consider to be a frightening rise of the debt relative to our capacity to service it, and to do so without resorting to inflationary devices.

Senator DIRKSEN. Now you know, of course, that this bill, along with other factors, is designed to generate a deficit of, let us say, $9 billion in fiscal 1964–65, and an unnamed deficit in terms of total dollars in 1966.

Now in addition to that, Dr. Burns, who was head of the Council of Economic Advisers of the prior administration, does not believe we will get that deficit gap closed until 1972. Now you indicated in your statement that you do not regard this deficit as particularly dangerous or alarming.

How much more of a deficit do you think we could take in connection with the tax bill? I think you say in here somewhere that you thought perhaps there ought to be even a greater reduction in taxes than is articulated in this bill.

Mr. CHANDLER. May I first make a comment on Professor Burns' position, because I think it is crucial in this?

Senator DIRKSEN. Yes.

Mr. CHANDLER. There probably are several reasons for a difference of judgment between him and others on this, but one is a difference in judgment as to the behavior of Federal Government expenditures over the intervening period.

I believe Professor Burns expects the rise of Federal expenditure to be somewhat greater than many others have thought, so that is one of the sources of disagreement or lack of agreement.

I would say, sir, that a deficit of $9, $10, $12 billion at present levels of gross national product would not frighten me in the slightest.

The point that I want to make here, which I am sure is thoroughly familiar to you already, is that there is a great difference between the impact effect of this tax cut and the effect after there has been generated some rise of economic activity, because tax revenues are so tremendously sensitive to the level of national income.

I would suppose that every dollar rise of gross national product would increase Federal revenues under the present system by at least 25 cents, and possibly by more than that, so that the very rise of income which we believe would be generated by the tax cut would restore a considerable part of the revenue.

Senator DIRKSEN. Has that equation always worked in our economic history?

Mr. CHANDLER. Since we have had this kind of tax system, and I think it should be emphasized that if one goes back 20 or 30 years when the tax rates were extremely low, we did not have this kind of response, but certainly since we have had the high tax rates, the fairly high degree of graduation, we have seen automatic responsiveness of tax revenues to changes in GNP.

There would be no other way of explaining, for example, the extremely large budget deficit during the 1958 recession and a few of the others, and the subsequent rise of revenues as the recovery came in 1959. There is just no question about the responsiveness of the revenues to movements of national income, the money value of national income.

Senator DIRKSEN. Dr. Chandler, you have put a lot of emphasis on stimulation of consumer spending. I presume you have looked at the economic tables where it is indicated that savings are rising constantly, that people are chipping away a little bit at income and putting it in a bank or in a savings and loan association or some other thrift institution for a rainy day. That would indicate that if they got $90 or $100 by way of a tax saving, it does not necessarily mean they are going to spend it?

Mr. CHANDLER. May I comment on two aspects of that?

During recent years personal consumption expenditures have been remarkably stable at about 92 to 94 percent of personal income after taxes.

Of course, this does not give us proof positive that consumers would use dollars saved from taxes in exactly the same way, but is strongly suggestive in that direction, indicating that in those years they have been saving between 6 and 8 percent of their incomes.

Senator DIRKSEN. Can we nail that down at that point and get one item, that it is, after all, speculative?

Mr. CHANDLER. Forecasting always is, that is true.

I think we have reason to believe that it is highly probable though perhaps not certain, that if people save some money in taxes that a major part of it would go for consumption, although certainly one would expect some to go to increase the rate of saving. But I should like to emphasize that I at least would emphasize the improvement of investment as much as the improvement of consumption demand, and I think that at this stage of affairs perhaps one of the very important ways of getting an increase in actual investment is to get an increase in demands for the products of industry.

It has been brought out here several times—I believe Senator Bennett brought it out at one stage—that the cash flow to business firms has been fairly large in recent years. There have even been some times when it has been larger than actual business expenditures for plant and equipment. Probably an increase in demand for the output of industry would be as strong an incentive to spend for capital investment as anything we could do.

So I would not want to have it appear that I am interested only in increasing the output of consumer goods. It seems to me that this is an important way of increasing our output of capital goods as well.

Senator DIRKSEN. In your statement you speak of the strain of the balance-of-payments problem. I wonder if you could amplify that.

Mr. CHANDLER. I should be glad to do that. I think it is well known that one of the methods in this country that is considered acceptable to stimulate the economy is to make credit more easily available and to lower interest rates.

Well, we are just not in a position, or at least the officials in charge of these functions think we are not in a position, to lower our interest rates because if we did lower our interest rates relative to those abroad, and more specifically in the principal financial centers abroad, we would stimulate an outflow of capital—especially short-term funds, although the long-term funds are proving to be a little more sensitive in recent months—which would worsen our balance of payments. So that officials believe that there is a limit to the extent to which we can increase the supply of credit, and lower interest rates, because of the very unfavorable impact upon our balance of payments.

I know there are rather widespread differences of opinion as to just how sensitive these capital flows are to interest rate differentials between New York and the other financial centers, but I think experience in the last few years has suggested that at least potentially it is a danger to the balance-of-payments position.

Senator DIRKSEN. At a level of $600 billion GNP, what kind of a debt do you think this country could sustain, the Federal level?

Mr. CHANDLER. That would be about $12 billion above the present level.

First, Mr. Senator, may I raise a question about methods of measurement of the size of the Federal debt? I do not have the figures in front of me.

I believe the figures show something like $307 billion at the present time, of which nearly $80 billion are held in the Treasury itself and in the Federal Reserve System, so that the amount outstanding in the hands of nonofficial holders is far below that. So it is hard to know what are the relevant figures here.

But I would say with $600 billion GNP we could certainly handle without difficulty a national debt $50 or $100 billion above the present level.

I rush to say that I am not advocating any such increase in the debt. That is not my point at all. My only point is that if we had it, we could certainly service it.

Senator DIRKSEN. Of course you are not forgetting that you have to express the interest rate or the aggregate interest in an appropriation bill every year, and it has to show up in the budget.

Mr. CHANDLER. That is right, sir, and it is running now I believe something around $12 billion a year.

Senator DIRKSEN. Yes.

Mr. CHANDLER. Which is just a little over 2 percent of our gross national product.

Senator BENNETT. Mr. Chairman, may I question the doctor a minute or two?

The CHAIRMAN. Senator Bennett.

Senator BENNETT. I passed you before because I was fascinated to see that you got one man from the faculty of the University of Utah which is my alma mater, and I wanted to have a minute or two to get my figures straight.

I do not want to embarrass you, but was this request for signed support of your statement circulated to individuals or to departments?

Mr. CHANDLER. The procedure was that I simply mailed it to someone whom I know, or whose name I knew, in a department, together with a form letter saying, "Would you show this to your colleagues?"

Senator BENNETT. You selected 41 institutions?

Mr. CHANDLER. It was actually sent to somewhat more than that. Forty-three responded, I believe.

Senator BENNETT. I though I counted 41, but I could have missed a couple.

Mr. CHANDLER. My count was 43. I would not swear to that.

Senator BENNETT. I wondered whether you addressed this to people whose point of view you knew in advance, you could be reasonably sure that you would get the answer you expected from the people you addressed?

Mr. CHANDLER. No; I did not, and it was not addressed to individuals as such. It was addressed to someone with the request that he bring it to the attention of his colleagues.

Senator BENNETT. I am interested. The University of Utah is not a big school. There are eight full professors, six assistant professors, one instructor, one special lecturer in the economics department of the University of Utah. I know most of them, but you get 1 whose name I have never heard and you get only 1 out of 16. He sounds to me as though he may be a very newcomer to the staff, which means that he may have come from outside the State.

I am fascinated also by this other fact. I was looking down here at the State universities. You have got from the University of Iowa 18 signers. You have got from the University of Minnesota one signer. This puzzles me as to how much of a smoothly spread application——

Mr. CHANDLER. May I explain the Minnesota one, sir?

I sent it to a person whom I knew at the University of Minnesota about the end of May. He left about that time on an economic mission to India, and the statement was forwarded to him in India, and it was only by luck that one man at Minnesota heard about it and wrote in saying, "I would like to sign it."

Senator BENNETT. You had the same bad luck at Michigan. You got one man from the University of Michigan.

You do not ask the committee to believe that this is a consensus? This is the response of a group of people who had taken the motion in advance more or less. The people who opposed that position just did not reply to you. You did not send them a choice, one paper representing say, Dr. Dan Smith's position and one representing yours and saying, "Which would you support?" You sent them a predetermined position saying, "If you support it, sign your name so we can add it to the list"?

Mr. CHANDLER. That is right.

I do not present this with pretense that it is a consensus of all American economists, nor could I say that I had sampled all shades of opinion and knew what the distribution was.

I think that if we had time to analyze these you would find some of the most distingusihed economists in America on the list, and I also admit that there are some whose names are not on the list. It is not meant to be a scientific sample or to indicate anything about the percentages.

May I say that one thing on which a great number of people would have differed, I am sure, would be on the relative importance attached to tax reform and to the tax cut. A number who might have signed had they had the opportunity might have refused to do so on the assumption that there should not be a tax cut unless we got a really first-rate tax reform. Others would have felt, if I may say so, that reform of really important magnitude seems to be unachievable in the foreseeable future, and therefore would say that there is no point in holding off the tax reduction because the tax reform of appropriate times and in significant amount will not be forthcoming anyway.

I am sure that in the profession there is a great deal of disagreement on things of this sort.

Senator BENNETT. Would you not have had disagreement on your statement on item 7?

Well, maybe I have got the wrong paragraph, but where you suggest here that we would be better off if we had increased spending as well as a tax cut.

Mr. CHANDLER. This was not meant to be suggested by the paper. I believe it is item 6, which says that you could increase demand for output in these three different ways.

Senator BENNETT. That is right; item 6.

Mr. CHANDLER. But this does not advocate an increase in Government expenditures. There is nothing in there to advocate an increase. It merely points out the possibilities, and then goes ahead to approve the tax-reduction route.

Senator BENNETT. Turning to another thing that has always intrigued me, we had a tax reduction in 1954, which represented a combination of changes in the pattern, and also a rate reduction. It was an across-the-board 10 percent, and yet between 1954 and 1963 we have had continuing deficits and the deficits get larger.

Does history demonstrate that whenever you reduce taxes you can look forward inevitably to a balanced budget because of the increased activity of the economy?

Mr. CHANDLER. There are two points on that.

First, I think the history of events after the tax cut at the beginning of 1954 would suggest that it was probably very useful in helping to make short and shallow the recession of 1954. I would not want to say that was the only factor involved in it.

Secondly, we do not say in here that the way to balance the budget is to cut taxes. There is nothing in here that says that a tax cut at this time will, in fact, increase revenues beyond what they would have been next year or the year after that.

Senator BENNETT. Yes, but the inference is that over the long run it will release enough activity so that it will have that ultimate effect, or have I misunderstood you?

Mr. CHANDLER. I think all of us believe that the budget will be balanced. I cannot say whether in 1965 or 1966, but will be balanced by the growth of income that would come both from this and from the rise in the labor force, improvements in technology, and so on.

Senator BENNETT. We had all of this, we had the same prospects for this after the tax cut in 1954, and we have had $26 billion in increased deficit since 1954.

Mr. CHANDLER. We had very good years: 1955, 1956, 1957.

There is no tax cut, no increase in Government expenditures, or no other one thing that I know of that can make the American economy recession proof. There may be things we can do to shorten the recession, but there is nothing in our history that would indicate there is any one measure or gadget or anything of the sort that would prevent recessions from occurring. We can only hope to deal with them after they do occur and to make them short and shallow.

Senator BENNETT. We have gone now for 31 years and had six balanced budgets. Now we are embarking on another program on the theory that Government spending or Government deficits will stimulate the economy and move us—and we hope we can have a balanced budget—the Secretary says in 1967 or 1968.

Is there anything in this tax cut that will make it different from the other situations where we have had Government deficits?

Mr. CHANDLER. I would like to point out one difference from the other situations that I think ought never to be forgotten in this present situation, and that is that at the present time we have no reason to believe that we will have available to us easy monetary policies to help bring us out of recessions or to prevent them, unless something happens abroad to make their interest rates go down significantly, and very significantly.

We will probably, if we try to use monetary policies in a really aggressive way, bring on a first-rate balance-of-payments crisis, so that we do not have the alternatives we had earlier.

Senator BENNETT. In other words, is it not fair to say that there is a limit to the amount by which you can reduce the cost of money? We have been operating really on an easy money policy since the Kennedy administration came in.

Mr. CHANDLER. I would not so characterize it, not when you have got long-term Government interest rates above 4 percent and as short a term as 90-day rates around $3\frac{1}{2}$ percent, I would not characterize this as easy money by quite a lot, especially not when we have 4 million people unemployed and when private investment in plant and equipment in real terms is probably not even up to the 1957 level, and this is 6 years later.

I would not characterize that as easy money at all.

Senator BENNETT. Then your idea of easy money is 2-percent money?

Mr. CHANDLER. Under present conditions, in the absence of the balance-of-payments problem, the bill rate ought not to be above 2 percent and the long-term Government security rate probably not more than $3\frac{1}{2}$, if that high.

The test of the whole thing, however, would be, How is the economy behaving? And it has behaved with sluggish business investment, with sluggish employment growth, with excessively high unemployment, which is in itself a test. It shows that fiscal monetary policies together are too tight.

I know of no other test that one could apply except the behavioral test, How is the economy behaving?

Senator BENNETT. Do you think that our balance-of-payments problem is being affected by the continued deficit policy of the Government to the extent that our European friends are beginning to lose their faith in the dollar.

Mr. CHANDLER. The amusing fact about this sir, is that our friends abroad, if one refers to our friends as the central bankers, find themselves in the strange position of saying we ought to use more expansionary fiscal policies here so that we can have higher interest rates, which is a somewhat unusual position for a central banker to find himself in. Yet this apparently is the attitude among the central bankers who have control of the very large official short-term claims against dollars.

Senator BENNETT. Yet they are constantly lecturing us about our unwillingness to put our fiscal house in order in terms of our regular annual balance of the budget.

Mr. CHANDLER. Their emphasis seems to have shifted toward the monetary side and away from the fiscal orthodox.

I understand that there is a split of opinion between the central bankers and the private bankers on this issue.

Senator BENNETT. I had the privilege of visiting with two British private bankers just yesterday, who say that the faith in the American dollar abroad in commercial circles is being reduced at an alarming rate, and people are beginning to turn away from the dollar in the direction of some other European currencies, and this is not good.

Now, it is one thing to have the professionals in the field with one point of view, but the boys that are doing the buying and the selling, if they have this point of view of a diminishing faith in our situation, then we had better look at this philosophy that we can solve our problems by increasing our deficits.

Mr. CHANDLER. Of one thing I am sure, and that is that we cannot allow our fiscal policy or our monetary policy either, for that matter, to be determined by private financiers abroad. If we are going to solve this problem by cooperation, we are going to have to get the cooperation of the central bankers and governments, and, both individually through the Bank for International Settlements, through the Office of Economic Cooperation and Development they have all indicated that the Americans should push up their growth rate and should try to do it through fiscal policy rather than monetary policy.

May I just add to this that there are some of them already seeing possible handwriting on the wall in terms of decreased American demand for the products of European industry. They do not want us to have a stagnant growth rate here. Some of them whose balance of payments have already turned from being extremely favorable to being less favorable or even unfavorable are beginning to be really concerned about this.

Senator BENNETT. I think I have consumed too much of the committee's time this afternoon, but will you agree that there is a point of view which is opposite to your own, held even by men in your general field, and that this is not an open and shut case?

I think it is interesting that you do not have even more names than you were able to get on this kind of a request for a statement of position.

Mr. CHANDLER. Perhaps I should have spent more money on postage and typing, but since it was at my own expense, I decided to limit my expenditures on it.

I will certainly admit there are others with different points of view on this. I think they are wrong. They think I am wrong. And I submit, however, that the answer to this is not to be found on whether there is 60 percent on one side and 40 percent on the other side, but for every person to use his own analysis on this.

It seems to me if one does this, looks beyond simply the financial markets and at the performance of the economy, that he must agree that this position is right.

In other words, we talked about deficits in the Government budget. There is a deficit in the American economy in the tens of billions of dollars. Before the end of 1963, and certainly in 1964 in terms of the fact that people are not turning out things because the are not given an opportunity to work.

I mean, what we are suggesting is not something for nothing. We know that you do not get something for nothing. You have to produce it. But people are not going to produce it if they cannot sell it on favorable terms. That is the point.

Senator BENNETT. I have been in business for 30 years before I came to the Senate. You talk about a difference of opinion among economists. There is a difference of opinion among the members of this committee.

The difference between your position and ours is that one day we will have to stand up and say "Yes" or "No" to each of the propositions in this tax bill.

This has been a very interesting experience for me, and I appreciate the privilege.

Senator DIRKSEN. Dr. Chandler, in paragraph 7 you say:

> Indeed, insofar as there is a difference of opinion among us, it is that some of us believe that a larger tax cut should have been proposed.

Now I read into that you are one of those who thought perhaps there should be even a larger tax cut.

Mr. CHANDLER. Yes, I am.

Senator DIRKSEN. How much larger?

Mr. CHANDLER. Perhaps 3 or 4 billion, not more than that, the point being that not only do we have the excess unemployment at the present time, but we are going into a period when the labor force is going to rise at an accelerating rate, and that when one takes the amount of the tax cut and applies any sort of a reasonable multiple to it, it just does not seem likely that this tax cut would do very much to decrease the present rate of unemployment.

It would probably be adequate to keep that rate from rising, but not cut into the backlog of unemployment very much.

Senator DIRKSEN. Do you think it could have been $4 billion more?

Mr. CHANDLER. This is probably getting toward the upper limit, if not beyond.

Senator DIRKSEN. How would you distribute that as between corporate and individual and between higher and lower brackets?

Mr. CHANDLER. No economist can pretend to have the experitise or right to answer that question with certainty. One gets immediately into the question of one's concept of equity in the distribution of income, and I do not think an economist has any right to say his concept of equity is any better than that of anyone else.

And, also, on the question of the form as to whether it is personal income tax or corporate income tax, he comes to the question of whether he would like to stimulate consumption primarily or investment primarily, which again is to some extent a question of taste.

With all those provisos, I would say that I do think that if one takes this proposed cut in conjunction with the actions that were taken last year in terms of the investment credit and the liberalization of the depreciation rules, this strikes me as being a fairly good balance, that you had both last year and under this proposed act a decrease in the corporate rates, and you got a considerable increase in consumption here, so that as I see it it is a sort of a balanced expansion.

I would not claim it is perfectly balanced by any means, but a rise in the demand for output at the same time making more funds available for investment.

Senator DIRKSEN. Doctor, your statement is rather strangely silent on the whole question of industrial incentives. Was that purposely omitted from the statement?

Your emphasis seems to be almost entirely on stimulation of consumer goods.

Mr. CHANDLER. We wanted to have a short statement so we can concentrate on this aspect of it. I am quite sure this does not mean that the people who signed this statement are uninterested in industrial incentives.

On think I think we all would emphasize is that one of the very best incentives is to have a good market for your product.

Senator DIRKSEN. Are these matters discussed in your classes?

Mr. CHANDLER. Yes, sir.

Senator DIRKSEN. Actively?

Mr. CHANDLER. Yes, sir.

Senator DIRKSEN. Have you ever been a Government economist?

Mr. CHANDLER. Twice. Once during World War II, and once in the 1949–50 period when I was an economist for the Joint Economic Committee of the Congress.

Senator DIRKSEN. I thought you had been.

This is only an observation, but I have an idea that somewhere along the line, if and when we ever get a tax bill, that somebody will get up in the course of the execution and wave this and say, "Now you see, Dr. Chandler has gotten 413 economists who say this is the thing to do, and 50 million Frenchmen cannot be wrong."

You see how the logic works.

Well, thank you, sir.

Mr. CHANDLER. Thank you.

The CHAIRMAN. Mr. Chandler, I would like to ask several questions. Was this manifest sent around for signatures?

Mr. CHANDLER. Yes, sir.

The CHAIRMAN. And each one signed it?

Mr. CHANDLER. The first part of the statement, the first two pages, were sent with a very short form letter saying;

> Here is a statement that is being circulated by three of us, Prof. Robert A. Gordon, of California; Prof. James Dusenberry, of Harvard; and myself. Would you please bring it to the attention of your colleagues, and if you approve of it would you sign the atached sheet and send it back?

And that is what happened.

The CHAIRMAN. Did all of the economists sign it in person?

Mr. CHANDLER. I have every reason to believe so; yes, sir.

The CHAIRMAN. Did they come back to you?

Mr. CHANDLER. The statements came back to me. They went first to the person to whom I sent the statement at the institution and then he mailed it back to me.

The CHAIRMAN. With signatures? How many are there?

Mr. CHANDLER. 413.

The CHAIRMAN. How did they sign?

Mr. CHANDLER. It was in ink or pencil, as the case may be.

The CHAIRMAN. They came back to you?

Mr. CHANDLER. Yes, sir.

The CHAIRMAN. And you have them?

Mr. CHANDLER. I assume I still have them.

The CHAIRMAN. I was wondering about what it says under section 8:

> On the whole we believe the administration program as originally submitted to the Congress represents a reasonable compromise.

Were they endorsing the original recommendations of the administration or endorsing the bill passed by the House?

Mr. CHANDLER. This was circulated in late May before action was taken by the House.

The CHAIRMAN. So they are not endorsing necessarily the legislation that is now pending before this committee?

Mr. CHANDLER. Only in the sense of a tax cut of something like this magnitude, not the particular reform measures in it.

The CHAIRMAN. Did I understand you to say that the Federal debt had been slowly increasing?

What did you say with regard to that?

Mr. CHANDLER. That it has increased more slowly than any other major category of debt in the postwar period.

The CHAIRMAN. When I came to the Senate 30 years ago on the 4th of last March, the debt was $16 billion. Now it is $306 billion. And you regard that as a slow increase in the debt?

Mr. CHANDLER. I said in the postwar period, sir.

At the end of World War II, the Federal debt was well over $200 billion. I have forgotten how much more. It must have been about $225 billion at that time. That was the gross debt. Now the gross debt is $306 billion.

In the meantime, the very significant parts of that debt have been absorbed into Treasury accounts and into the Federal Reserve holdings and so on, so that I think you would find if you took the debt held outside the Government itself, that it is very little larger now than it was at the end of World War II.

I am sorry, I do not have those figures precisely in mind.

The CHAIRMAN. You mentioned individuals who put money in savings accounts?

Mr. CHANDLER. Sir?

The CHAIRMAN. I did not understand you. What do you mean by savings accounts?

Mr. CHANDLER. That the Government securities were absorbed into the Government trust funds of various kinds. The Government itself bought up its own debt and put into the trust fund.

The CHAIRMAN. That is social security?

Mr. CHANDLER. The various social security accounts primarily.

The CHAIRMAN. Suppose the debt increased in the same ratio in the next 30 years? It increased 20 times since I came to the Senate. Suppose it increases 20 times what it is now, what would happen then?

Mr. CHANDLER. I sincerely hope it does not do that, sir, because that would either indicate we had lost our minds or that we had gone through two great catastrophes again.

If one breaks down the increase of the debt, he will find that the major part of the increase since 1929 came from two things: First, the great depression; and, second, World War II.

If one cuts out those great calamities, the increase is nowhere near as frightening. Certainly to have this done as a deliberate policy in peacetime would be highly undesirable.

The CHAIRMAN. Is it not true that we paid off practically all the costs of World War I?

In 1932 we owed only $16 billion, and it was the policy of the Presidents going back to Andrew Jackson, who said he was more proud of paying off in toto the public debt than anything he did in his administration.

Mr. CHANDLER. As I remember, the debt at the end of World War I was $25 billion, and it was gradually reduced to about $10 billion in 1929. And then proceeded to rise from that point on.

The CHAIRMAN. The practice then was to start paying them off. We paid a good part of the cost of the war from current taxes.

Mr. CHANDLER. It is also true, sir, that after every major war in the past we had major recessions, major depressions I should say; and it may not be unrelated that taxes were kept so high to repay the debt rapidly, and simply did not leave with industry, and with the people, enough funds to keep the economy going.

The CHAIRMAN. You are not disturbed about the fact that it has only been once that we have had deficits consecutively in 3 years, in peacetime years since World War II. That is 1963, 1962 and 1961?

Now we propose to have deficits continue continuously for 7 years. Is that not disturbing?

I can understand having a deficit for a year or so and then having a surplus, but this is the first peacetime period since the war that we propose to have deficits for 7 consecutive years with no certainty of balancing the budget at the end of the 7 years.

Mr. CHANDLER. May I make my position completely clear on that? I do not like inflation. Every time we have been in an inflationary situation I have spoken out in favor of restrictive measures. But one cannot measure inflationary pressures by the presence or absence of a deficit.

Some of the greatest peacetime deficits this country ever saw were those of Mr. Herbert Hoover, and those of Mr. Eisenhower and so on, and those were certainly not periods of inflation.

I would be terribly worried if I saw us, even with a balanced budget, with revenues equaling expenditures, if we were in or close to a period of rising prices. But given the kind of deficient demand we have at the present time, I am not worried in the slightest about relatively modest deficits here because these things are self-limiting.

The CHAIRMAN. Mr. Bernard Baruch testified before this committee a few years ago that the thing that caused inflation more than anything else was deficit spending. But leave the inflation out of it. Suppose we never balance the budget. Is that possible?

Mr. CHANDLER. I hope not.

The CHAIRMAN. If we have a deficit for 7 years, we could have it for 10 years, we could have it for 15 years, especially if they follow the doctrine that you are preaching now, that we must reduce taxes and add it to the public debt. That is what disturbs me.

I think if we have deficits for 7 years, and I have heard economists who think it will probably be 1972 before there is a balance.

Mr. CHANDLER. Mr. Senator, if this tax cut as now scheduled goes through, if the Congress looks at expenditures in the economical way that I am sure we all hope they look at them, authorizing them only if they are justified on their merits, then it seems to me that there is every safeguard built into this, because, if inflation did tend to start, it could not start until we got to a full employment kind of situation, the revenue would certainly be great enough to cover expenditures, and probably more than that, so it would be a self-limiting experience.

The CHAIRMAN. Would it not be safer policy to reduce expenditures first and then reduce the taxes?

Mr. CHANDLER. Not from a point of view of providing employment.

The CHAIRMAN. In other words, you want to increase the expenditures?

Mr. CHANDLER. No, sir.

The CHAIRMAN. And reduce taxes at the same time?

Mr. CHANDLER. No, sir.

My choice is not to increase expenditures for employment-increasing purposes, because it seems to me history indicates that temporary increases of expenditures largely for employment purposes turn out to be nonreversible, and so I am not in favor of it.

The CHAIRMAN. Which is the more effective way to relieve unemployment? Is it to reduce taxes or increase expenditures?

Mr. CHANDLER. Either method can be used to increase employment, but there are very important differences beyond that.

One is the question of who chooses what additional goods and services will be bought, and the tax reduction will leave this to the private sectors, whereas the increase in expenditures would leave it in the hands of the Government.

The other is that a rise of expenditures for employment-creating purposes may not turn out to be reversible at all.

The CHAIRMAN. Do you think the next budget is going to be less than the present budget?

Mr. CHANDLER. I am sorry, I do not know about that.

I would certainly hope that it would be scrutinized very carefully to make sure that everything in it was justified on its own merits.

The CHAIRMAN. Do you think the present expenditures were scrutinized and justified?

Mr. CHANDLER. My own impression is that the Government is spending far, far too much for some purposes, and not enough for other purposes that are important, but some of them are just tremendously wasteful, and that they need not only be scrutinized but squeezed very sharply.

The CHAIRMAN. By what means do you think that situation should be corrected?

Mr. CHANDLER. Sometimes I get pessimistic about it, sir, but this is a question that the Congressmen themselves must answer.

The CHAIRMAN. In other words, you are living on hopes?

Mr. CHANDLER. I suppose we all have to.

The CHAIRMAN. And not performance.

I think the time has come for this Government, if a tax reduction is desired, to reduce expenditures and do it first, so that instead of having promises which are not kept we would have performance.

Do you agree with that or not?

Mr. CHANDLER. You make a much better political strategist than I could ever be.

The query is, "What will work?" and I am just a little bit afraid, sir, that if they waited for the Congress to introduce economy into the various expenditures that the tax reduction might be very long delayed indeed.

The CHAIRMAN. How do you account for this spurt in the profits of these companies?

I saw a piece by Sylvia Porter, a writer, the other day, that profits are going up. Du Pont went up five points the other day on increased profits. Others, too, have gone up. Inventories are going down. Where is this recession? How is it going to come and when is it going to come?

Mr. CHANDLER. I should like to make it clear that in signing this statement I did not do so on the assumption that it rested upon the probability of a recession. This is justified on the basis of the potential economic growth of the economy and the failure of the economy to rise that fast.

Now, if a recession comes, that would be a further reason for a tax cut, but I have no way of saying when such a recession will come.

The CHAIRMAN. Has not the President said time and time again that if we do not reduce taxes there is going to be a recession? Did he not say it when he first presented this plan to the Congress in January?

Mr. CHANDLER. I thought that was a mistake.

The CHAIRMAN. He said it and he has continued to say it.

Mr. CHANDLER. It seemed to me to be giving the wrong reason for what I considered a right policy, and if the reason disappeared the justification for the policy would seem to have disappeared.

I think it was a tactical error on his part, and I think it was also on the part of the Secretary when he made somewhat the same point last week.

The CHAIRMAN. Notwithstanding these prophets of doom, we are now having a considerable prosperity. We are in it now.

Mr. CHANDLER. We are at the highest level of production of all time. The thing that concerns most of us is this: that we are at the highest level of automobile production we have ever been. You can point to all sorts of things that have grown the same way, but that unemployment rate simply does not fall. We are just not growing enough to keep the unemployment rate from being excessive and, with the rise in the labor force and the productive capacity of the economy, the rise in the rate of increase of the labor force——

The CHAIRMAN. Do you not think automation has had a great deal to do with the unemployment?

Mr. CHANDLER. It certainly has, but this does not necessarily mean that a rise of aggregate demand will not help reemploy people.

The CHAIRMAN. And was not automation increased by the development credit tax provision where they got 7-percent credit for putting in new machinery and so forth?

Mr. CHANDLER. Presumably this increased investment of all sorts I would assume includes automation, but when one considers automation in the short run, it is probably employment-generating rather than employment-decreasing.

The next step is the employment-decreasing step. Somebody has to build these machines.

The CHAIRMAN. Take the coal mines. Virginia is quite a coal State. Employment has been reduced there terrifically by automation, simply because they put in machinery to do work that human hands did before. I think that is something that ought to be considered as far as unemployment is concerned.

Mr. CHANDLER. That is true, sir, but it gets one into a discussion of the so-called structural unemployment which is one of those wonderful terms that a lot of people do not stop to analyze. It seems to mean something concerning the failure of the supply of labor to be adopted to the demands for it. But this is not at all independent of the behavior of the demand for output.

For example, a typical way of bringing the unskilled and the inexperienced into the labor force is to have those with experience, and perhaps with more ability in some cases, drawn into the higher echelon positions, making way for these people.

My guess is that if a full study were made, we would find that a number of the people who are looked upon as victims of structural unemployment are really victims of the lack of adequate job opportunities up above for people whose jobs these people might have gotten.

The CHAIRMAN. There is one thing we have agreed upon, that the President made a mistake in predicting a recession in order to pass this bill to reduce taxes. We will agree on that?

Mr. CHANDLER. The recession may come, but I have no evidence of it.

The CHAIRMAN. But you said a few minutes ago——

Mr. CHANDLER. I think it was a tactical mistake, yes.

The CHAIRMAN (continuing). That it was a mistake.

Such statements as that could promote a recession.

Thank you very much, Mr. Chandler.

Senator DIRKSEN. Dr. Chandler, could one evaluate your attitude toward the present tax structure in terms of a whimsical statement I saw the other day where a fellow said, "Never did we have it so good and never did they take it away so fast"?

The CHAIRMAN. Thank you very much, Mr. Chandler. You have made a good witness.

The next witness is Mr. William S. Wasserman. Take a seat, sir. Will you proceed, sir?

STATEMENT OF WILLIAM S. WASSERMAN, NEW YORK, N.Y.

Mr. WASSERMAN. My name is William Stix Wasserman. For the past 40 years, I have been actively engaged in business—first as a manufacturer and then as an investment banker. During this period, I represented the United States as the American delegate to the World Economic Conference held in Berlin in 1932, as an employer's delegate to the ILO in Geneva, and as chief of the first U.S. lend-lease mission to Australia during the Second World War.

I believe in the free enterprise system as the best approach mankind has yet devised for solving his economic and social problems. At the same time, I must point out that economic systems must evolve with the times, and that attempts to prevent necessary and essential changes often court decay. This tax bill is in tune with today's necessities. It presents an enlightened new approach to the problem of the business cycle. It is the first attempt our Government has ever made to forestall a cyclical downturn before it occurs. In essence, the central problem of our times is to maintain a high rate of employment and full usage of our plant and material resources so that we can successfully compete with the growing economies of the free world. At the risk of oversimplifying, let me point out that this tax bill will cause a chain reaction which will result in both increased employment and a solution of our balance-of-international-payments problem. By putting increased purchasing power into the hands of the public, our lagging capital goods industries should be revitalized. This will produce a period of full employment and prosperity which, in turn, will attract foreign capital and bring about a decrease in the export of American capital as new investment opportunities developed at home.

Those who object to the passage of this bill on the grounds that it will create a budgetary deficit so inflationary as to cause a further run on our gold supply are laboring under a misconception as to the true nature of our present economy.

An unbalanced budget, in and of itself, is not inflationary so long as there is an overabundant labor supply and unused plant capacity. With the exception of the inflation of the first Truman administration, when there were actual shortages, such inflationary price rises as we have had have been the result of a wage-price spiral created by a tacit agreement between big labor and big business to pass along to the public, in the form of higher prices, the cost of increased wages and profits. As a result of these agreements, the normal forces of supply and demand became inoperative and even in times of severe unemployment and great overcapacity, prices rose. It is high time we realized that the budget of our Government has nothing in common with that of a housewife. It is much more realistic to compare it with that of a large corporation that is expanding its plant in relation to the population growth and increasing demand for its product. Such corporations always have two budgets: a capital budget and an operating budget. It is essential that the operating budget be balanced at all times by operating income, including the debt service of any moneys borrowed for capital expansion. But corporations rarely attempt to pay for their capital goods expansion out of a single year's profits. Similarly, we as a nation should divide our budget into a capital budget, where moneys spent on actual capital goods should be allocated, and an operating budget, where moneys spent on Government operation should be allocated and paid for.

This is the policy of practically every major European country whose governments have not been frightened by the periodic cries that we hear from the distressed and ignorant public that we are living beyond our means. So long as our money is being spent for the useful enrichment of the Nation, so that for each dollar of debt there is a tangible asset, we need not worry about our budgetary deficits in times of abnormal unemployment provided we cover our operating costs by current taxation. This does not mean for one moment that I am advocating a program of foolish public expenditures or boondoggling or public spending solely for the purpose of spending money. I am merely stating that after giving private industry strong incentives to expand—and this bill gives industry these incentives—the Nation could profitably put to work the remaining resources, both human and material, in such public works as we as a nation require, provided that in so doing we do not stretch our capacity to the point of inflationary stresses that a program of overspending might induce. As a practical yardstick of restraint, we might well put a limit on the growth of the public debt by restricting its expansion to the rate of population growth or the rate of increase in our national income.

Finally, one more word about debt. Our debt becomes burdensome only when its servicing requires too large a proportion of the national income. In the old days, we cured the excess of debt by letting the economy "go through the wringer," but then almost everybody was self-employed or on a farm. Employees made up at that time only about 10 or 15 percent of the population. Today, about 85 percent of our people are dependent on weekly paychecks, and if they are laid off, they have no farms to return to; as for their savings, they are to a large extent in the form of durable goods which could not readily be sold under such circumstances.

Under these conditions, it has become essential to our own survival to see to it that the economy be kept going at a sufficient momentum to keep employment at a high level. We have learned the imperative of governmental interference if we are to preserve our free-enterprise system against the hazard of a massive depression which would surely destroy it. It is for this reason that the more sophisticated European economists and bankers heartily endorse the administration's tax bill—because they realize that prosperity in this country is essential not only to the stability of the dollar but also to their own industrial well-being. Therefore, those people who oppose the tax bill on the ground that it would weaken the dollar clearly demonstrate that they do not understand what governs the value of our money or the true facts of our international balance of payments. Money today throughout the free world consists primarily of credit, namely, bank deposit money. Between 90 to 95 percent of the business of this country is done by check, and the money that we use in these transactions is bank money, or bank credit. This credit is under the strict surveillance and control of the Federal Reserve Board. It is within their power to increase or decrease its volume in relation to needs arising out of our business, the growth of the country, and the necessities of keeping our money stable in value. Gold has long ceased to be a major component in our money system. In fact, the world should have learned this lesson prior to the Second World War, when, despite predictions by economists that Germany could never wage war because she had no gold, Hitler restored Germany to prosperity and built the greatest war machine in the history of mankind. Dr. Schact had convinced him that production alone was the real source of wealth and that as long as the volume of credit was intelligently controlled, gold was superfluous. Conversely, in the depression of the 1930's, we experienced the greatest period of unemployment and industrial stagnation in our history at a time when our central banks and treasury were bulging with gold.

And yet in spite of this, the old economic myths still hold sway over the minds of a great many of our businessmen and the public in general. They fail to realize just how strong our dollar is, or that our loss of gold reserves has in fact strengthened our economy rather than weakened it. The gold we have lost was used in part to purchase and develop a large part of the oil resources of the free world: we have built refining plants, distribution stations, and pipelines throughout the free world, all of which are returning to us a substantial profit on our investment. We have invested in the automobile factories of the free world, so that today we own approximately one–third of them. We own a major share of the communications facilities and manufacturing plants in those lines of the free world, we have built refining plants, distribution stations, and pipeproductively. In fact, for my part, I would be very happy to see the balance of our gold reserves traded for similar profitable investments in the full knowledge that the value of our currency was much more soundly based on the ownership of productive assets and the productivity of our people than in the sterile hoarding of an idle metal. As a matter of fact, to be hamstrung in the expansion of our economy and in our taxation and trade policies because of the whims of an Arab shiek, since most of the newly mined gold is now going to the shiekdoms of Kuwait and Saudia Arabia in the sale of oil, or in the sale of Russian hoards, or the production of South African semislave labor is the strange situation in which we, supposedly the most civilized nation in the world, now find ourselves. This, however, is the subject of another discussion.

In the long run, the dollar is worth what it can buy, and what it will buy is the result of the relation between production on one hand and the amount of money outstanding on the other. That amount, as I have said before, is subject to the control of the Federal Reserve Board, which has it in its power to regulate the volume of credit through the control of bank reserves. As long as this Nation sells more than it buys abroad, which it now does, and is the world's greatest creditor nation, and as long as the dollar will buy what it does currently, the value of our money in the long run would not, in my opinion, be affected if we did not have a single ounce of gold with which to back it up. In fact, the shoe is on the other foot—the thing that makes gold valuable is the fact that it is exchangeable for usable currency. Today the dollar will buy more per unit of currency than any other currency in the world. It will buy more oil, more coal, more food at a cheaper rate than you can find anywhere else. In spite of the fact that our labor rates are double and triple those of our foreign competitors, most of our great mass-produced goods are still obtainable at competitive prices. This is because we have been able to substitute, to a greater degree than any other nation, horsepower slaves for manpower hours. If we are to maintain this competitive advantage, we dare not permit our large resources in manpower and plant capacities to remain unused. I say again and again, the tax bill is the key to that usage.

As we create more employment and fuller usage of our productive capacity, we will automatically increase our volume of production, which will tend to reduce our costs to the point where we become more competitive with the world at large. By reducing taxes in the higher brackets, we will dramatically increase the incentives for risk investment which is essential to our free-enterprise system. And finally, by creating greater prosperity in the United States, we will, in a sense, massage the economies of the whole free world. Thank you.

The CHAIRMAN. Thank you very much. Any questions?

Senator BENNETT. No questions.

The CHAIRMAN. Thank you very much.

Mr. WASSERMAN. Thank you.

The CHAIRMAN. The committee will adjourn until 10 o'clock tomorrow morning.

(Whereupon, at 4:20 p.m., the committee adjourned, to reconvene at 10 a.m., Friday, October 25, 1963.)

REVENUE ACT OF 1963

FRIDAY, OCTOBER 25, 1963

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 (presiding), Long, Douglas, Bennett, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The Chair is very sorry to announce that of the 17 members of the committee, 10 are out of town, as the Senate is not in session. We have very important witnesses, and I am sorry this has occurred. It could not be anticipated.

The first witness this morning is Dr. Charls E. Walker, executive vice president of the American Bankers Association.

Will you take a seat, sir, and proceed.

STATEMENT OF CHARLS E. WALKER, EXECUTIVE VICE PRESIDENT, ACCOMPANIED BY LESLIE C. PEACOCK, DIRECTOR OF RESEARCH, AND CHARLES R. McNEILL, DIRECTOR, WASHINGTON OFFICE, THE AMERICAN BANKERS ASSOCIATION

Mr. WALKER. Thank you very much, Mr. Chairman.

If I might, I would like to introduce my associates and present a brief statement for the record.

The CHAIRMAN. Without objection.

Mr. WALKER. My name is Charls E. Walker, and I am executive vice president of the American Bankers Association in New York City. I am accompanied today on my right by Mr. Charles R. McNeill, who is director of the ABA Washington office, and on my left by Dr. Leslie C. Peacock, who is director of our department of economics and research and secretary of our economic policy committee.

We appreciate very much the opportunity to present our views, the views of the ABA here today.

Since the question of a tax cut first became a major issue of national debate, the American Bankers Association—working through its appropriate committees—has given extensive thought to the need for general tax reduction; to the structure of tax reduction which would best serve the Nation's needs; and to the safeguards which might be erected to minimize the risks involved in substantial tax reduction during a period of sizable deficits in both the Federal budget and in the Nation's international accounts. On the basis of what we consider to be a thorough examination of these issues, we have reached the following conclusions:

1. The need for general tax reduction is immediate, and may even be characterized as being pressing.

2. The bill now pending before the Congress contains a reasonable distribution of the benefits of tax reduction, and its overall design reflects adequate recognition of the objectives which a program of tax reduction should be tailored to meet.

3. The Nation's ability to improve its economic position through sound tax reduction depends heavily on its willingness and ability to exercise discipline in Federal expenditures. Consequently, we believe that tax rates should be reduced only if, at the same time, effective steps are taken to prevent further increases in Federal spending during the 2-year period in which the major revenue impact of rate reduction occurs.

THE NEED FOR TAX REDUCTION

The variety of national problems to which an across-the-board reduction in taxes could contribute partial solutions is not often exaggerated, although the extent to which a tax cut actually can solve these problems often is. Principal among these problems are the unsatisfactory rate of utilization of the Nation's resources (including manpower); the deficit in the Nation's international accounts; sustained and protracted weakness in the budget position of the Federal Government; and the challenge of achieving a growth rate which will provide jobs for large prospective additions to the labor force. Each of these problems has social and political ramifications which extend far beyond the boundaries of economic analysis. Each, in and of itself, will require the careful application of public policy.

We do not deceive ourselves that a simple answer to these and related problems can be found in a tax cut. We do believe, however, that tax reduction—more than any single action that could be undertaken by the Government—has the potential for making a major contribution to the ultimate solution of each of these problems. We believe, in fact, that permanent and satisfactory solutions to these problems cannot be found within the framework of our existing tax structure.

The persistence of unused resources in the economy in recent years is partially attributable, in our judgment, to the dampening effects of a tax structure designed during a period of recession and modified to meet the needs of wartime financing. Existing rates discourage investment, innovation, risk taking, and other expression of economic incentive. They therefore exert a drag on the Nation's economic growth and obstruct the achievement of satisfactory employment of the Nation's resources. Until this handicap to more vigorous and sustained economic expansion can be removed, greater progress in achieving sustained high-level utilization of resources is not likely to be forthcoming.

The international financial difficulties now being experienced by this country also call for immediate relief, and we believe that the enactment of the pending tax bill could provide some, even if not all that is needed. By improving the climate for domestic investment, a tax cut could make a significant contribution to curbing the outflow of investment funds from the United States. Moreover, the stimulus to domestic investment provided by a cut in taxes also could be expected to promote improved efficiency and lower production costs in this country thereby strengthening our international competitiveness as producers of goods for world markets. In our judgment, these sources of improvement in our international payments position would be partially counterbalanced, but not wholly so, by the probable rise in imports normally associated with domestic economic expansion.

We believe, also, that tax reduction—if properly handled—can lead to improvement in the Government's budgetary position. At existing rate levels, economic expansion produces a sharp transfer of funds from the private sector of the economy to government, and the evidence suggests that this heavy siphoning off of private purchasing power tends to thwart the full development of expansive movements. Under existing rates, moreover, the surpluses which would be produced at full-employment levels of income would be large—assuming no change in spending—and possibly too large to permit the sustained operation of a high-level economy. For these reasons it is not surprising that existing rates, by serving to thwart economic growth, also can deprive the government of needed revenues. Thus, over time, as has been demonstrated in the past, tax reduction can serve to strengthen the government's budget receipts.

THE STRUCTURE OF TAX REDUCTION

We realize that a broad program of tax reduction must reflect the need for sustaining or improving consumption demand, while at the same time releasing the forces of incentive for greater business investment. The rate of economic growth and the maintenance of cost-price stability are heavily dependent on this type of investment.

The bill now under consideration appears reasonably well balanced in its attention to these objectives. Our own view is that results beneficial to the economy as a whole can and should be achieved through somewhat greater emphasis on investment incentives. In particular, we believe that the reduction in corporate tax rates should be larger than the cuts now proposed. This could be accomplished without straining the Government's budget position by adding a third-stage reduction in the rates applicable to corporate income. We also believe that 4 percent dividend credit should be retained because of its contribution to investment incentive.

MAINTAINING FISCAL PRUDENCE

We view discipline in Federal spending as the essential requirement for reaping the benefits which tax reduction is capable of providing. Unless increases in spending can be avoided during the period of adjustment to lower tax rates, in fact, we would not favor enactment at this time of legislation calling for tax reduction.

The problem of maintaining effective control over Federal spending is, indeed, a difficult one. In part, it reflects the absence of procedures for congressional review and action on overall spending—both in total amounts and in relation to prospective revenues. Despite these shortcomings of the appropriations and spending process, we do not doubt that the Congress can prevent further increases in spending if it is dedicated to achieving this end. Therefore, while stressing our conviction that the pending tax bill should promptly be enacted, we reemphasize our final conclusion that Congress should enact the proposed legislation only if, at the same time, effective steps are taken to prevent advances in Federal spending over the next 2 years.

That concludes our statement.

The CHAIRMAN. Thank you very much, Dr. Walker.

I would like to ask how you would effectuate what you propose to do in your last paragraph, that we emphasize the final conclusion that Congress should enact the proposed legislation only if at the same time effective steps are taken to prevent advances in Federal spending over the next 2 years.

There is no new budget before Congress as you know, and it will not be until January. Is it your though that we should defer this action until we ascertain what the next spending budget will be in January or not?

Mr. WALKER. No, sir; we are not making that recommendation. We are saying in effect that only a relatively few of the appropriation bills, although one large bill, the defense bill, have cleared the Congress at this time. We believe that the appropriate orthodox approach to containing expenditures lies with the group that appropriates the funds, namely, the Congress, and there is sufficient time for taking a look at these overall appropriations during this current session of the Congress.

Other methods could be considered which are less orthodox, but we believe that effective action could be achieved with respect to the remaining appropriations.

The CHAIRMAN. Some of the reductions have been in obligation authority as you know, and you are no doubt aware of the fact that there are unexpended balances amounting to $87 billion which are expendable at the pleasure of the President. How would you suggest handling that?

Mr. WALKER. I think if this is going to be truly effective, that there has to be a strong joint effort on the part of the Congress and on the part of the Executive.

I would hope very much that the Executive would submit a budget for the coming fiscal year, which would reflect no rise in spending in that year over the present fiscal year.

I mentioned less orthodox steps. In our testimony before the House Ways and Means Committee on this subject last March, we recommended that the Congress enact or establish a lid or ceiling on Federal spending during the transition period to lower tax rates. This is an unorthodox approach, but nevertheless, under the circumstances, we suggest it should be considered.

The CHAIRMAN. Would you suggest doing that by refusing to increase the debt limit?

Mr. WALKER. No, sir; I would not. The debt limit as a device of expenditure control, viewed from my standpoint personally as a former official in the Treasury Department, is not an efficient tool of expenditure control. While it can be effective, it can also be pernicious in its effect.

It seems to me that its primary weakness is that it does not place restraint upon those agencies which are responsible for the spending of these obligated funds which have not yet been spent, but rather forces the Treasury to scrape up the money to meet the bills and meet the spending of these other agencies.

This can lead to unsound debt management practices, as has been the case at times in the past, and to borrowing money at higher rates of interest than would otherwise be necessary.

It seems to me the straightforward approach would be to effect the control through a spending ceiling which restrains the spenders rather than the debt limit to restrict the Treasury.

The CHAIRMAN. Could you elaborate a little bit on what you say—effective steps taken to prevent advances in Federal spending over the next 2 years. I am just wondering how you would accomplish that.

Mr. WALKER. I would hope that the Congress would take strong steps to make certain that the current appropriations and new obligation authorities are held in check as much as possible in view of our responsibilities to hold back spending.

I think the Executive has an important function to play. That is if the Executive is asking for, as it is, a $11 or $12 billion cut in Federal taxes, it should also be willing to exercise a strong degree of restraint over Federal spending as reflected in the new budget submitted in January.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. Mr. Walker, there are a number of features of this proposal of yours that I think are excellent. I noticed that you say that among the reasons for a tax cut is the fact that it would contribute at least a partial solution for "the unsatisfactory rate of utilization of the Nation's resources including manpower," in other words, that it would decrease unemployment and decrease the idle overhead of fixed capital, and bring a greater utilization of the capital already existing.

I wonder if you would explain just how a tax cut would do this.

Mr. WALKER. Senator Douglas, we think it would operate through several routes. The two most important effects that have been emphasized in the national discussion of this issue, particularly over the past year or 18 months, are first in helping to stimulate consumption demand for goods and services on the part of the population, which in turn steps up your production activity and gives rise to greater demand for labor, and also tends to bring unused capacity into use.

Senator DOUGLAS. May we pause there for just a minute. In other words, that there is a creation of additional monetary purchasing power which results in increased demands for consumer goods which in turn leads to reemployment of people and those people with more money in their pockets will spend more, who in turn will reemploy still others, and you get a cumulative effect therefore.

Mr. WALKER. Sir, we are in agreement if I can restate this just a little bit. There will not be a creation of additional monetary purchasing power as envisaged here. It will mean that the private sector of the economy and the consumer will be able to keep part of the money which would otherwise be taken by the Government, and which the consumer would tend to spend to some extent in these consumer goods industries which are so important.

Senator DOUGLAS. Would there be a curtailment of purchasing power in other directions?

Mr. WALKER. In what other directions, the business sector?

Senator DOUGLAS. That is more purchasing power would be released to the taxpayers. Is there any curtailment in other directions?

Mr. WALKER. Not necessarily. We are getting into the question here of how any accompanying deficit would be financed.

Senator DOUGLAS. That is exactly the point.

Mr. WALKER. Yes.

Senator DOUGLAS. You are not proposing a reduction in present expenditures. You are merely proposing that in the future expenditures not be increased.

Mr. WALKER. That is correct.

Senator DOUGLAS. Would not this inevitably result in a governmental deficit?

Mr. WALKER. Yes, sir, it will be accompanied by a deficit.

Senator DOUGLAS. And would not the Government have to borrow from the banking system?

Mr. WALKER. Not necessarily from the banking system. For example, during the past 3 years we have total Federal deficits of in the neighborhood of $16 billion or so, around $16 billion of deficits in the past 3 years, where as a matter of fact Government security holdings of commercial banks have declined during this same period.

The Government can borrow to finance any such deficit from nonbank sources, so there is no creation of monetary purchasing power, but nevertheless it reduces the drag on economic expansion and growth in the economy.

Senator DOUGLAS. Let me raise this question: If there is no net addition by the banking system through the creation of credit, the Government borrows from private sources, does it not take funds which private sources would otherwise invest in business?

Mr. WALKER. I think that to reach a judgment on that point we can simply look at the record over the past 2 or 3 years, that there has been plenty of credit available.

The long-term interest rates have varied very little during a period of economic expansion, substantial economic expansion, even though we still have an unacceptably high rate of unemployment. So that we cannot say on an a prior basis that simply because the Government borrows from nonbank sources that you are reducing total ability to spend in the economy.

Senator DOUGLAS. There must be according to your reasoning then a great deal of liquid capital funds in the possession of corporations not invested in productive enterprises but seeking outlets in Government securities.

Mr. WALKER. There is a great deal of liquidity, Senator, in practically all of the private sectors of the economy. Consumers are very liquid, as evidenced by the tremendous increase in time deposits in commercial and savings banks, in savings and loan shares, and other instruments of this type.

I think the central question is why this money, which is seeking investment, is not moving more quickly into productive equipment and new plant capacity. Here I would emphasize the second and we think the more important prong of the tax cut, that there is not sufficient incentive for investment.

A reduction in the corporate tax rate—and we would like to see a larger reduction—would have an even greater effect to pull this money into productive investment by raising the after-tax return.

Senator DOUGLAS. Let me come back to the point I was originally trying to establish. I tried to find out whether you believe in the so-called multiplier theory.

Mr. WALKER. I believe in a multiplier effect, yes.

Senator DOUGLAS. A multiplier effect.

Mr. WALKER. Effect. I personally would not classify it as a theory. There is certainly a multiplication of an impact. If I spend $1, there will be some further effects in the economy as a result.

Senator DOUGLAS. Have you tried to work out what you think the multiplier would be so that for, say, a $10 billion decrease in taxes, what would you regard as the net stimulative effect?

Mr. WALKER. I think this depends to a considerable extent on the structure of the tax cut.

If the multiplier theory as you refer to it means that we have a very simple relationship of say two to three times—a multiplier of two to three times the amount of funds that are spent—then I would reject that theory.

I think that this completely overlooks the impact of incentive to invest, which is the mainspring of economic advance in our economy, and has been for 200 years. You cannot put in simple formula the impact on private incentive of a reduction in the tax burden.

Senator DOUGLAS. Assuming no change in the incentive to invest, what would you regard as the probable multiplier coming from a reduction in taxes?

Mr. WALKER. I have seen figures ranging around two to three times or more.

Senator DOUGLAS. And you do not regard those as unreasonable?

Mr. WALKER. No, I do not. But this would mainly apply to the consumer portion of the tax cut.

Senator DOUGLAS. I understand. Now an increase in consumption will of course in part utilize existing capital more fully, and hence send up the rate of return of existing businesses.

Mr. WALKER. If it is low-cost capital, efficient capital, if it is efficient equipment.

Senator DOUGLAS. It will more fully utilize the existing equipment.

Mr. WALKER. Some of this may be high cost.

Senator DOUGLAS. I understand.

Mr. WALKER. And you know, as a professor of economics, we can reach the point where the cost and profit curves cross—where unit costs increase, it will not then be a lower cost per unit.

Senator DOUGLAS. Now that brings us to the second point. In part it will create a demand for additional capital, will it not?

Mr. WALKER. Yes, sir.

Senator DOUGLAS. At an accelerated rate, and we therefore bring in the accelerator principle to supplement the multiplier, isn't that true?

Mr. WALKER. Yes, sir, we agree that an increase in consumer spending will also stimulate investment spending.

Senator DOUGLAS. Good. So that the stimulus to investment must be added to the multiplier of two or three.

Mr. WALKER. Correct.

Senator DOUGLAS. We have had the Congress and the Joint Economic Committee working this out, and while the second point is difficult, they come out with a combined multiplier and accelerator of approximately four.

Mr. WALKER. I would add to that the impact from the reduction in the taxes which would give a higher aftertax return to business investment.

Senator DOUGLAS. I understand. That is another.

Now if this is true, a $10 billion tax cut should have a net stimulative effect of $40 billion. There is a margin of error on one side or the other. How many people do you think a net increase of $40 billion would reemploy?

Mr. WALKER. That depends on so many assumptions, Senator, as to the nature of the demand, what type of spending it is. I would simply say that under current circumstances it should have a significant impact on the unemployment figure.

Senator DOUGLAS. Would you think that 2 to 2¼ million would be an excessive estimate?

Mr. WALKER. I would rather not be pinned down to a particular figure.

Senator DOUGLAS. The average ratio of capital per worker is somewhere between $15,000 and $20,000 per worker.

Mr. WALKER. In the manufacturing industry.

Senator DOUGLAS. In manufacturing, yes, and of course in the service industries it is less. The general average in society is less than this.

Would not this therefore, if you have a net stimulative effect of $40 billion, reemploy at a minimum somewhere between 2 and 2¼ million people?

Mr. WALKER. No, sir. Again I don't want to be pinned down to specific figures, but you seem to be translating an increase in GNP to an increase in capital investment.

Senator DOUGLAS. You yourself have said that an increase in consumption will lead indirectly to an increase in capital investment.

Mr. WALKER. Yes.

Senator DOUGLAS. And that therefore this should be added to the increase in consumer demand.

I don't insist that the multiplier is four. I say it is somewhere around four. It might be more, it might be less. But if it is four, then a tax cut of $10 billion would have a net stimulative effect of $40 billion, and $40 billion would certainly reemploy a great many more workers, and if, as is true, the ratio of capital to labor in the country is less than $20,000 per worker, it seems to me most conservative to estimate that you could get from 2 to 2¼ or possibly 2½ million more workers employed.

I mean that is the sheer arithmetic. And while those figures should not be taken as precise, aren't they fairly safe approximations, or at least to put it this way, Dr. Walker, would you pronounce them unreasonable?

Mr. WALKER. I will not at this time pronounce them unreasonable, but I would like to take a closer look. They do not seem outside the bounds of possibility.

Senator DOUGLAS. Very good.

Mr. WALKER. There would not be that sort of reduction in unemployment, however.

Senator DOUGLAS. I want to congratulate the American Bankers Association as having improved its economic analysis, Mr. Chairman, and recognizing the facts of life more correctly than it has perhaps in the past.

I want to congratulate you. This may hurt you, Dr. Walker, but I want to congratulate the American Bankers Association in getting a literate economist to be the executive head of its organization. We are really making progress.

There are certain features of your statement with which I might differ, but I prefer at the moment to emphasize agreement rather than disagreement. I want to congratulate you, Dr. Walker, on your honesty, and through you I want to congratulate the American Bankers Association.

I hope my praise does not lead to your dismissal or demotion.

Mr. WALKER. I am sure it won't, Senator, and I thank you very much. I would reemphasize again and I think the best way to do it succinctly is to repeat a statement we made in our testimony before the House Ways and Means Committee, that although we do agree that an increase in consumption spending is important and should be aimed at in this tax cut, nevertheless dollar for dollar the greatest impact on economic growth, creation of jobs, new investment, and the advancement of our economy, will come from the cut in the corporate tax rate.

Senator DOUGLAS. Well now, don't break up a beautiful friendship. Don't confuse savings and investment. In the old days we used to treat them as identical, but there is many a slip between savings by the individual and a corporation, and actual investment. But we are having such an excellent time, Dr. Walker, that I won't stress that. I merely ask you to think this over tonight when you go to bed.

Mr. WALKER. Thank you.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. I am not an economist or a professor, so by now I am thoroughly confused by this developing friendship, and I need a little more enlightenment.

We start with a figure of $40 billion, which Senator Douglas says represents an approximation of the total of the multiplier and accelerator effect.

Then we take a figure of $16,000 as the investment required for a new job, and then we divide the 16 into the 40, and assume that this is going to produce 2½ million new jobs.

Now, is all this $40 billion to be produced by this magic process all going to go into the kind of investment that produces new jobs?

Mr. WALKER. No, sir. I don't think it will.

Senator BENNETT. I can't believe that it can, because we have been told that we have unused capacity, and I would assume that to a certain extent the increased purchasing power will be absorbed in the existing unused capacity.

McGraw-Hill estimates that 22 percent of our capacity—I am sorry, that 22 percent of our productive facilities and equipment, is obsolete, inadequate, high cost, and $40 billion if it all went in, would not replace this 22 percent.

So let's come down to earth. Would you care to make a guess, assuming the $40 billion effect of the multiplier theory, as to what percentage of the $40 billion might go into the kind of investment that would create new jobs, and how much would be absorbed in the consumption process against existing facilities?

Mr. WALKER. I would not like to make a precise guess, Senator. I would emphasize that it is our feeling that although an increase of consumption and investment would help to alleviate the unemployment problem, although we do believe that, we also believe that long range solution to the unemployment problem is not simply a matter of total spending or total effective demand.

We have problems involved of a structural nature, of a technological nature. A portion of the problem today is cyclical, but we do not believe it is the major portion.

Consequently I don't want to destroy the budding friendship that developed today with Senator Douglas, but I do disagree with him on that part of his analysis.

Senator BENNETT. If we could solve all of our economic problems including the problem of employment simply by investing dollars without any concern for the existence of markets or cost of production or anything else, this would be a very simple problem. But actually there are a lot of these other ugly practicalities that involve themselves here.

So the chances are that whatever purchasing power may be released by this tax bill, a very large part of it will be absorbed without any appreciable effect on either investment or unemployment.

I am sure the company that I am connected with has sufficient unused capacity that we could increase our sales 15 or 20 percent without having to go out and buy new equipment, or without needing to put too many new employees on the payroll. We have got a lot of other problems to solve before that happens.

Mr. WALKER. May I comment on that?

Senator BENNETT. Yes.

Mr. WALKER. I agree with you very much that to say that this reduction in income taxes is going to be a panecea is quite misleading, and we try to avoid this reference. We think it will have some effect to help alleviate the problem of unemployment.

The point that you were making that I think is particularly significant, both from the standpoint of our long-range economic growth and our balance-of-payments problem, is that so much of this unused capacity is not efficient. It is high cost capacity.

A properly structured tax cut can help stimulate business to modernize. Even though the steel industry is operating at less than capacity, it is still investing a very large amount of money. This is going into modernization, and it is all to the good from the standpoint of our balance of payments.

So to think of this tax cut solely in terms of helping to utilize, in the short run, underutilized resources is to see only one facet of it as opposed to many other facets.

Senator BENNETT. Yesterday we had the representative of the AFL-CIO speaking in the place of President George A. Meany, who took the general position that none of this tax cut money should to into investment, that there should be no tax relief for corporations, that the bill should be stripped of its provisions which might benefit corporations in investments, and that it should all be channeled directly to the taxpayers with incomes of less than $5,000, and that this was the key to the solution.

Actually we have a package here. We are trying to provide some relief for the investing side of our economy, some for the consumption side, and I think we had better be careful not to assume that all of it should go one way or all of it should go the other way.

There is one feature of this tax bill on which we have had some interesting testimony, the question of the way the benefits of the bill are polarized.

The benefits for the lowest income groups are high, the benefits for the top rates are high because of the reduction of the marginal rates, and the people in the middle are the ones who seem to get less benefits. Did you observe this particular situation in the bill?

Mr. WALKER. We do not believe this is an ideal change in the pattern of tax rates. If we had free choice and free play on it, I think we would probably recommend some changes.

We are very concerned about the degree of progressivity in our tax structure, the impact it has upon incentive.

In the House we did testify and we would still support here a top marginal rate of 50 percent on the simple grounds of equity, that any person in this country ought to be able to keep at least half of every dollar he makes consistent with the President's and Secretary Dillon's argument that the corporate rate should be cut below 50 percent, for basically the same reasons.

However, when you do examine—and I think I have the proper table on page 5 of the excellent description which your Joint Committee on Internal Revenue Taxation has presented—we note that, with the exception of the very lowest range of income, the reduction in tax liability from the rate standpoint ranges from about 15½ percent up to about 19 to 20 percent—higher than that in the very lowest ranges, it is true.

We cannot carp at this. This is a fairly reasonably structured tax cut, and we hope that the unleashing of incentives indicated by this action will, in the future, lead you gentlemen and your associates in the House to conclude that further reduction in the tax burden will benefit the economy.

Senator BENNETT. I have no further questions at the moment, Mr. Chairman.

The CHAIRMAN. Senator Long?

Senator LONG. I suppose you have heard the proposal that I made recently that for those persons who are not benefiting from most of the advantages that give lower rates, who are not planning any reductions for contributions, not claiming capital gains in a great number of the situations, and are not claiming percentage depletion or claiming interest on tax-exempt bonds, that those people would have the benefit of a 50-percent top rate.

Has your association had the opportunity to consider the proposal I made prior to your testimony here?

Mr. WALKER. Not precisely, Senator. This would be a cut 50-percent average rate, is that correct?

Senator LONG. Right.

Mr. WALKER. Yes.

Senator LONG. In other words, because there are a great number of people who might be paying taxes at rates as high as 91 percent or under the new bill as high as 70 percent, when it is fully effective, but who are not paying that on all of their income, who are getting a lot of their income tax exempt and taking the charitable deduction for the full amount and things of that sort, I find much appeal to a 50-percent rate for people who are actually paying on all their income.

I am sure you realize that, almost of necessity, a great number of people have felt compelled to so arrange their affairs that they just would not be paying in that bracket.

When they see the Government taking 80 or 90 percent of their income, they say "We just can't do this, we have got to find some better way to do it."

Would you perhaps agree that those who are actually paying an effective rate of 25 or 30 percent really don't have much to complain about?

In other words, if they are taking advantage of all opportunities that a good tax lawyer and accountant could provide for them to get their effective tax rate down to around 25 percent, that they probably are not as deserving of tax relief as someone who is actually paying on all of his income?

Mr. WALKER. We would certainly endorse the objective involved to try to make the law less complex, and to reduce the effort that is expended to try to reduce the tax burden.

I think we would probably prefer the approach that I mentioned a few months ago, a top marginal rate of 50 percent will achieve the goal by definition that no one would pay over 50 percent of his income in taxes.

Senator LONG. Well, why does he need that, if he is getting the full benefit of charitable deductions in the private foundations which his children will control, and if he has full benefit, his program is arranged to invest his money in tax-exempt bonds and to capitalize on stock options and all the other devices that are available to the extent that he is paying an effective rate of 10 or 12 percent.

What difference would it make to him if he is availing himself of all the tax avoidance possibilities available to him? I don't have any criticism of a person who avails himself of the avoidance possibilities that are inherent within the law.

I am not like some people who feel that a man owes a certain amount of taxes whether the law says it or not. I think he owes only what the law says he owes. But wouldn't it be better to make the tax reductions available to a person who is actually paying that effective ate of over 50 percent?

Mr. WALKER. I think it would, sir. I think that one of the problems is we are talking about two different types of people.

I have particularly in mind, and correct me if I am wrong, I believe that for a single person he crosses over into this 50 percent bracket at a taxable income of around $18,000 or so. This is not the type of person you are talking about.

Senator LONG. No.

Mr. WALKER. These are the people that are moving up in industry, in management, in Government, in other activities that are so crucially important to our economic growth and advancement, but any modification that would reduce the extension of effort to just simply pay lower taxes I think certainly would deserve a careful look.

Senator LONG. I think you have made a good statement here. Thank you very much.

Mr. WALKER. Thank you.

The CHAIRMAN. Senator Dirksen?

Senator DIRKSEN. Mr. Walker, I suppose you have contact with the industrial leaders of the country.

Mr. WALKER. Yes, sir.

Senator DIRKSEN. It seems to me so singular that after an 8 month's wrestling match in the Ways and Means Committee and in the House of Representatives, either on the tax message with specifics in the bill, and the volume of mail that has been evoked all over the country—and I can say to you we have had a lot of mail on the tax bill—I recall only a few letters that have come to my attention where, in pleading for enactment of this bill, the company or the individual in question would somewhere in his letter say, "If you enact this tax bill, we are prepared to invest an additional $10 million or $5 million or $1 million or $100 million in plant and equipment, and to expand and to put new products on the market," and to do all the things that some of these embroidered words indicate would happen as a result of the tax bill.

Now, who has come to you and said, "If they will only get out this tax bill we are ready to dump a whole lot of money into our industry and create new jobs and expand markets"? What has been your experience?

Mr. WALKER. First of all, Senator, I have talked over with a number of people, not only through contracts with the leaders of industry but through economists' organizations, business economists, and others who are very close to the decisions made in industry, and know that the tax burden and the tax drag has been deterring investment in new plant and equipment.

Secondly, we feel that the evidence of the past year of the impact of the revised depreciation guidelines of the Treasury and of the enactment of the investment credit by the Congress has had a significant and, to a considerable extent, identifiable effect on new investment in plant and equipment.

Last spring the McGraw-Hill Co., which makes surveys of new investment in plant and equipment, stated that their inquiries reflected that companies were increasing their plant and equipment spending this year as opposed to last by several billion dollars, and that around 40 percent of this seemed to come as a result of the new depreciation guidelines and the investment credit.

We believe that that if not absolutely convincing evidence, it is nonetheless very suggestive of what we have been talking about in economic courses for years, that the rate of return on new investment is a significant factor as to whether it will take place or not.

Senator DIRKSEN. Isn't it rather strange that they don't say to us——

Mr. WALKER. I wish they would.

Senator DIRKSEN. They should, because then you would have something specific into which you could sink your molars and say evidently they mean it, because this is in the nature of a commitment.

Mr. WALKER. I don't quite understand it. Even before the investment credit was enacted, there were many businessmen that doubted it would have much of an effect, but I think the record is indicating it is having a considerable effect.

Senator DIRKSEN. In your statement you say—

we view discipline in Federal spending as the essential requirement for reaping the benefits which tax reduction is capable of providing.

Have you any specific recommendations for spending discipline? You were in the Treasury. What was your capacity and what were your duties in the Treasury?

Mr. WALKER. I was Assistant to the Secretary of the Treasury, and his principal economic adviser in the preceding administration.

Senator DIRKSEN. Then you ought to be fairly bursting with suggestions as to spending discipline.

Mr. WALKER. I am not sure I am bursting with suggestions. It is our strong feeling, and has been since this debate got underway some 15 or 18 months ago, that there should be a leveling off in Federal spending during the transition period to lower tax rates, and that there is nothing unreasonable about requesting or urging joint action by the administration and the Congress, or if that cannot be obtained, at least by the Congress which ultimately controls the purse strings, to make certain that this leveling off does take place during that period of time.

Senator DIRKSEN. Let's take some specifics. It will probably be the first of December, based on the present rate of progress in the Appropriations Committee, that the Senate considers the independent offices appropriation. That will involve all the regulatory agencies, the Tennessee Valley Authority, the Veterans' Administration, and a good many others.

Have you any specific recommendations with respect to the level of appropriation contained in the 1964 bill?

We would simply emphasize here that looking across the board on this thing, that if Congress is willing to reduce the tax burden in the neighborhood of $11 billion, that it should be able and willing to hold, not reduce necessarily, just hold spending at current levels.

This is very difficult under our sort of diffuse or even splintered appropriations process, and this is something that I think concerns all thinking citizens, and we in the American Bankers Association are devoting our research activities now to a study of this question of the appropriations process.

But it seems to us this is so important that the Congress would be justified in new departures and even unorthodox approaches of at least holding up the remaining appropriations bills, and looking at them all in one package and saying, "Now what do we need to meet this goal over the next 2 or 3 years?" Most of the bills are still remaining, major bills, except defense as I understand it.

Senator DIRKSEN. Doubtless you are familiar with the rather tearful entreaties which have come from our secondary educational institutions for money for buildings, either in the form of loans or grants, but grants if they can get them.

The other day we passed a bill that committed the Government to $720 million in that field. Do you think that should have been approved under the formula that you present here?

Mr. WALKER. I am not qualified to comment on that particular bill. I would simply state that I think it is the primary responsibility of the people at the State and local levels to take care of that sort of spending.

Senator DIRKSEN. On Monday next we shall begin the 19th annual brawl on foreign aid assistance. The House made a very sizable reduction, and the Senate has restored a very substantial amount of money.

Have you any specific suggestions with respect to that, in view of this spending discipline that you think we should follow?

Mr. WALKER. Only to say that my own sympathies would tend to be more in the direction of the House activity than the Senate activity or the Senate committee activity.

Senator DIRKSEN. That is all.

The CHAIRMAN. Thank you very much, Dr. Walker.

Mr. WALKER. Thank you.

Senator BENNETT. Mr. Chairman, may I just raise one other question. I was interested in your statement that you thought the investment credit had had a significant effect on investment plant and equipment.

Of course, I don't know what "significant" is, but I am looking at the economic indicators for September 1963. In 1961 total manufacturing investment was $13.68 billion. In 1962 it was $14.68 billion.

In 1963, when this incentive became available, it was $15.59 billion. In other words, before the incentive was available, manufacturing was investing approximately $1 billion a year, a little more. In 1963 it was a little less than $1 billion.

When you look at the total investment of all new plant and equipment from 1960 to 1961, it went down. From 1961 to 1962 it went up by $3 billion, and from 1962 to 1963 it went up by a $1.7 billion figure. So it seems to me this is within the pattern of change, and does not represent a very significant change.

In other words, I am one of those who believes that the people who had planned investment went ahead with it and were able to get the windfall provided by the investment credit, and that those who had not planned it did not suddenly rush out to invest in order to get the credit.

So I think the attitude that this was, a great incentive and an attitude that is taken by some of the witnesses that business got their's last year and therefore they should not have any more this time is not borne out very dramatically at least by the figures.

Mr. WALKER. Well, sir, I think there is a great deal in what you say. We simply have not had enough time yet.

The Revenue Act of 1962 was finally approved in very late September, was it not, a year ago. The revised depreciation guidelines for most industries were available only in midsummer.

As a consequence it seemed quite significant to us that the McGraw-Hill survey, which pointed to a 7-percent rise in this total spending for 1963, indicated that businessmen attributed more than 40 percent of the increase to the tax credit and revised depreciation guidelines. I don't want to put too much emphasis on this, but at least in the manufacturing sector, between 1952 and 1962 you had an increase of only 2 or 3 billion in this total spending, and you had an increase slated for this year of $1 billion.

I think what this illustrates, that this thing goes up and down for many different reasons. It will take some time to judge the ultimate impact, but I agree with businessmen in general that the tax burden has been a drag on investment.

Senator BENNETT. So do I. There is another factor in this situation which we forget occasionally, and that is that the net impact on the tax reduction on the corporate rate will not be felt, the complete impact, until 1970, because of the speedup in the payment pattern.

Mr. WALKER. From a cash flow standpoint.

Senator BENNETT. Yes.

Mr. WALKER. From a cash flow standpoint. From the standpoint of the profit-and-loss statement, from the standpoint of planning for future investment, the effect would be very soon, and a very large effect very soon for small businesses with a reversal of the normal and surtax rate which would not be affected by the speedup.

Senator BENNETT. That is right, but there are all these other factors.

Mr. WALKER. That is right.

Senator BENNETT. That affects this question of, Do we buy new plant and equipment?

Then going back to my own experience in running a small manufacturing plant, you buy new equipment when you develop a new product or a new process. That is probably the chief reason.

While it may be theoretically desirable from an economic point of view, you don't go out and junk your existing equipment just because by buying another machine you can reduce your cost 2 or 3 percent. So that the decision as to whether or not we have new equipment will depend in part on innovation and all the rest of these things.

I have also been very much intrigued by another set of figures which may be a little outside of the range of this hearing. But we talk about incentives for investment in productive processes.

In 1950 the corporate return was 8 percent of the gross national product. Now it is down to 4.7 percent of the gross national product.

In other words, the profitability of business, we have got the profit squeeze and it is a very real one, and in a dozen years it squeezed out nearly half of the share that the productive side of our economy could expect, at least the corporate side.

So that this tax reduction is small, for instance, in its impact, would be small in comparison with the impact of policies which would enable the corporations to regain their profit rates of even 5 or 6 or 7 years ago.

Mr. WALKER. That is why we emphasize that this is not a panacea. You put your finger on these other problems, and the question of control of costs that are crucial in the long run to the success of our economy. This is only one contribution in our judgment.

Senator BENNETT. In your statement—and I agree with its objective—you encourage us to hold our expenditure levels, our expenditures at the present level, and you rightfully remember that it is Congress that finally passes the appropriation bill.

But in the situation such as we have at present, with a "strong President," we in Congress, particularly on the opposite side of the political fence, see a President who is very much disturbed when we try to cut his recommended appropriation bill.

Isn't this a joint responsibility which must be shared by the Executive under our present pattern of Government operation? It seems to me that if we had the same determination and vigor shown by the administration to cut, to hold or cut expenses that is being shown to try and get a tax bill passed, we would move toward that goal without too much difficulty.

But when the pressure from the administration is for more new programs and a higher, an ever-increasing budget, it is pretty hard to put the burden on Congress to ask them to fight the Executive and reduce the amounts he recommends. I have no further comment.

Senator DOUGLAS. Mr. Chairman, may I follow up?

Mr. Walker, I was much interested in your testimony about the proportion of the investment credit which has been translated into new investment. I take it you included in that the higher depreciation rates which were granted last year as well.

As I understand it, the total of the investment credit plus the higher depreciation rates amount to a refund or a diminished tax burden on industry of about $2½ billion a year.

Mr. WALKER. Two and a quarter I believe.

Senator DOUGLAS. And as I understand it you said that 40 percent of this had gone into investment.

Mr. WALKER. No, sir. I said that McGraw-Hill reported that of the projected increase in business capital spending for 1963, according to their survey, 40 percent of this increase was attributed by businessmen to the impact, the favorable effect, of the investment credit and the new depreciation guidelines.

Senator DOUGLAS. What was the total amount of the increase?

Mr. WALKER. About 7 percent up to a total of $40 billion. This has been scaled back now, which would be in the general range of around $2 billion or so. These are very early figures. We are going to have to wait and see for the next couple of years how this really works out.

Senator DOUGLAS. I saw one set of figures, and I have the clipping somewhere, that they came out with a figure of $1.1 to $1.3 billion increase in capital equipment.

Mr. WALKER. Total plant and equipment.

Senator DOUGLAS. No, increase.

Mr. WALKER. Yes, the total increase, the increase in total plant and equipment.

Senator DOUGLAS. Yes.

Mr. WALKER. It is from $37.3 to $39 billion.

Senator DOUGLAS. You have the indicators?

Mr. WALKER. Yes, page 9.

Senator DOUGLAS. I have those here.

Mr. WALKER. $37.3 to $39.1 billion.

Senator DOUGLAS. That is $1.8 billion.

Mr. WALKER. $1.8 billion.

Senator DOUGLAS. Part of that is the growth factor.

Mr. WALKER. If you look at those figures back over several years, there is some growth factor there, but it is a pretty irregular one.

Senator BENNETT. It goes up and down.

Mr. WALKER. If the McGraw-Hill figures can be carried through with the SEC commerce figures, which is what these are, implicitly approximately $700 or $800 million of this increase would have been attributed to the impact on profits of the investment credit and the impact on cash flow of both the investment credit and the depreciation guidelines. The depreciation guidelines do not increase profits, they reduce profits.

Senator DOUGLAS. That is just the point. The tax benefit of $2.5 or $2.225 billion gives rise to something less than $1 billion increase in actual investment, or only about 40 percent is translated into investment, and 60 percent goes elsewhere, presumably into corporate funds not reinvested.

That is precisely what Senator Gore and I have been urging—not urging, but stating. We are very glad to get confirmation on this point from so excellent a source.

Mr. WALKER. They came awfully late in the year, Senator. They haven't had a fair test yet.

Senaator BENNETT. Isn't it true that you don't get the investment credit unless you make the investment?

Mr. WALKER. That is correct.

Senator DOUGLAS. Pardon me. You get it on investment that you would make anyway.

Senator BENNETT. My point is——

Senator DOUGLAS. Not on added investment. That is what some of us tried to provide.

Senator BENNETT. Will the Senator let me finish my point?

Senator DOUGLAS. Certainly.

Senator BENNETT. My point is that you are dealing with two factors here. You are dealing with the change in the depreciation schedule and the investment credit.

Now, the statement was made that some of this went into profits. You have made the point that depreciation does not increase profits. It lowers them.

The second point, that unless you make the investment, you don't get the investment credit. So, except under very unusual situations, I can't see how the combination of these things could actually increase profits in the year in which the combination operates. Do you agree with me?

Mr. WALKER. I certainly agree under the circumstances that it is far too early to assess the benefit or the impact on corporate profits.

Senator DOUGLAS. I would just like to clarify the record to this degree, that the investment credit is not paid on increases in investment. It is paid on total investment, and there could be no increase whatsoever and still be a 7-percent investment credit, which would result in a reduction in net revenues to the Government, and an increase in retained profits to corporations.

Senator BENNETT. The word "increases" is confusing to us. If company A decides to invest $1 million, and did invest $1 million, it got the investment credit whether it made that decision in 1961 or 1963, whether it would have made the investment if there had been no credit.

But the fact that it did make the investment generated the credit. If it made the investment and got the credit, the credit made no increase in its profits, caused it to make the investment anyway in order to get the credit.

Senator DOUGLAS. Has the Senator finished?

Senator BENNETT. Yes.

Senator DOUGLAS. It may not in gross profits, but in profit after taxes it is very much so. It retains profits after taxes.

Of course it has an increase because the taxes are diminished. After taxes it would increase certainly because taxes diminish.

Mr. WALKER. Since the credit is given only for investment in productive equipment, which ultimately raises our efficiency and creates more jobs, I think it helps both our balance-of-payments position and also helps reduce our employment difficulties.

Senator BENNETT. But it does not show up in the year in which the investment is made.

Mr. WALKER. Not this effect that I am talking about. It will gradually accrue over time.

The CHAIRMAN. Thank you very much, Dr. Walker.

The next witness is Mr. Keith Funston of the New York Stock Exchange. Mr. Funston, take a seat, sir, and proceed.

STATEMENT OF G. KEITH FUNSTON, PRESIDENT, NEW YORK STOCK EXCHANGE; ACCOMPANIED BY ALGER B. CHAPMAN, JR., VICE PRESIDENT OF THE EXCHANGE; WESTON VERNON, JR., COUNSEL FOR THE EXCHANGE; AND STAN WEST, ASSOCIATE RESEARCH DIRECTOR OF THE EXCHANGE

Mr. FUNSTON. Mr. Chairman, gentlemen, my name is G. Keith Funston. I am president of the New York Stock Exchange. My home is in Greenwich, Conn. With me today are Alger B. Chapman, Jr., vice president of the exchange; Weston Vernon, Jr., of Milbank, Tweed, Hadley & McCloy, counsel for the exchange; and Stan West, associate research director of the exchange.

I have been listening with great interest to this broad and learned economic discussion that has been going on, and I am afraid that I am going to suffer very much by comparison, because my statement is going to be pretty much of a nuts-and-bolts presentation.

Senator DOUGLAS. Mr. Funston, you were once a college professor and president yourself.

Mr. FUNSTON. Yes, sir.

Senator DOUGLAS. So don't disavow your former occupation.

Mr. FUNSTON. Having been that, and having seen what a distinguished performance went on, and having some standard by comparison, is why I am very humble.

Let me say at the outset that I support the principal purpose of H.R. 8363 as stated by the report of the Ways and Means Committee—

to lower tax rates so that our free enterprise system can itself generate the higher rate of growth which our economy requires.

It seems to me that the provisions of the bill should be analyzed in the light of this broad statement of purpose. Does it actually reduce barriers to investment? Will it provide increased incentive for business investment? Will it stimulate economic growth? Will it strengthen free enterprise? Such, I submit, are the tests that the proposals in this bill must pass. It is in that spirit that I offer these comments on the parts of the bill that affect the investment community.

The House bill can accomplish these objectives in several ways, particularly via rate reduction. The long-overdue reduction in the corporate tax rate to 48 percent should help to boost corporate investment. The reduction in individual income tax rates, while unfortunately adding to the steepness of progression in the middle brackets, does recognize the stifling effect of the high upper bracket rates. Scaling down the rate structure from 20.91 to 14.70 percent should significantly encourage individual initiative and investment.

Two changes in the area of capital gains are also notable. These are the proposed reduction in the tax rate for gains on securities held over 2 years and the removal of the 5-year limitation on capital loss carryovers. In sharp contrast to these forward-looking provisions is the proposed repeal of the 4-percent dividend credit—a measure that would be completely inconsistent with the stated purposes of the administration and the House Ways and Means Committee.

I should like to address my remarks first, therefore, to the taxation of dividend income, as provided in House bill 8363. This bill seeks to eliminate the 4-percent dividend credit while raising the exclusion from $50 to $100.

THE DOUBLE TAXATION OF DIVIDEND INCOME

The present dividend credit exclusions were adopted in 1954 as modest initial steps in relieving the double tax on corporate earnings distributed as dividends. Instead of enacting the additional relief which was envisioned at that time, frequent attempts have been made to repeal the 1954 provisions.

These attempts—including the latest in H.R. 8363—are puzzling in light of the basic inequity of the double tax. This double tax occurs because stockholders' earnings in a corporation are subject first to a corporate income tax of up to 52 percent. Then, the remaining dollars distributed as dividends are taxed again at personal income tax rates. Such treatment is not imposed on wages, interest, rent, or any other form of income.

The fact that double taxation exists should no longer be in doubt. It is referred to in the committee report on H.R. 8363 and in the Treasury's testimony. Double taxation is clearly recognized in the proposal that the dividend exclusion be raised to $100 as a substitute for the 4-percent dividend credit. Thus it seems to me there is no disagreement in principle but only on the means of affording relief.

THE $100 DIVIDEND EXCLUSION—PARTIAL RELIEF ONLY

Although the larger $100 exclusion is a welcome partial solution to the double taxation problem—and indeed was proposed in 1954—it is not an adequate substitute for the combined credit/exclusion. Together, the credit/exclusion blend complete relief for a limited amount of dividends—presently $50—with percentage relief applicable for all dividends above that amount. On the other hand, a $50 or $100 exclusion alone arbitrarily grants total relief for a small amount of dividends, and then relief drops sharply as dividend income rises above the exclusion point. As long as relief must remain partial, the best way to provide it fairly for persons in all income levels is by combining the effects of both the exclusion and the credit.

The idea of increasing the exclusion to $100 and eliminating the 4-percent credit is intriguing on the surface, because it presumably benefits many investors of relatively modest means. The Treasury has estimated, for example, that dividend recipients on 2 million tax returns would be better off if the exclusion were increased and the 4-percent credit abolished. However, according to the Treasury's own calculations, 1.7 million tax returns with dividends would be no better off, while an additional 2.5 million would be worse off. In other words, more shareholders would be hurt than helped by this proposal.

The majority of the investors on the 2.5 million returns facing higher taxes are not high-income shareowners. Nearly 60 percent of them have adjusted gross income of less than $10,000. Indeed, a typical stockholder (with an average household income of $8,600) would pay 12 percent more tax on his dividends under the $100 exclusion proposal than with a 4-percent credit and $50 exclusion.

(The tax increase on dividend income table follows:)

Tax increase on dividend income for the average shareowner under administration proposal

[Married couple: $7,750 salary plus $850 dividends [1]]

	4-percent credit/$50 exclusion	$100 exclusion
Dividends received (after present exclusion)	$850	$ 850
Additional $100 exclusion		$100
Taxable dividends	$850	$750
Marginal rate (new schedule)	0.19	0.19
Tax	$161	$142
Less 4-percent credit	$34	
Net dividend tax	$127	$142
Percentage increase		12

[1] Average dividend income in adjusted gross income for returns between $8,000 and $9,000 according to Preliminary Individual Statistics of Income, 1961. The average shareowner had an annual household income of $8,600 in 1962.

Mr. FUNSTON. The proposal to raise the exclusion from $50 to $100 would cost an estimated $70 million in tax revenues, while elimination of the 4-percent credit would yield the Treasury $370 million. Thus, investors as a group would find the taxes on their dividends increased by $300 million.

One wonders how a measure which reduces total dividend tax relief by $300 million can stimulate investors to supply more capital for investment. The overall impact of the House bill provisions on dividends would diminish potential funds for investment and offset the reduction in personal rates for many middle-bracket investors.

In short, the exclusion was originally designed to provide additional relief to small investors as a supplement to the credit. It should continue to be viewed that way and not as a substitute. In achieving the administration's objective of promoting economic growth and providing fair tax treatment for all investors, total relief should be increased, not reduced.

The exchange has favored, ever since 1954, a $100 exclusion coupled with the 20-percent credit which is allowed in Canada. We would favor retaining in the bill the $100 exclusion as a belated step to do what was proposed 9 years ago. But the exchange would oppose the increase of $50 in the exclusion if it were merely a device to scuttle the 4-percent credit.

The 4-percent credit should be retained now and in fact expanded to 10 percent as soon as budget considerations permit, because:

(*a*) It is a symbol that recognizes the inequity of double taxation and offers a base upon which to build in the future.

(*b*) It provides incentive for investment in equities by removing a portion of the tax disadvantage imposed on investors who choose stocks as a medium of saving.

(*c*) It provides some encouragement to management to pay out more dividends to stockholders.

WEAKNESS OF ARGUMENTS AGAINST THE CREDIT

Having discussed the reaons for supporting the credit-exclusion approach rather than the proposed larger exclusion alone, I would next like to comment briefly on the major criticisms made against the 4-percent dividend credit:

Criticism No. 1: It benefits stockholders in the higher income brackets more than those in the lower brackets.

The distribution of relief from the credit has been the subject of much statistical juggling since its enactment in 1954. Examples have been given to this and other committees purporting to show that more relief is granted to low-income investors and that more relief is granted to high-income investors. There is no clear-cut generalization that can be made on this subject; it all depends on what one wants to see.

Suffice to say that, in enacting the credit/exclusion in 1954, Congress believed that they would benefit primarily the low-income investors. The majority report of the Senate Finance Committee stated:

> * * * the method of adjustment * * * affords greater relief for the low-income investor than for those at higher income levels. The percentage reduction of tax under the combined dividend exclusion and credit is greatest in the lowest bracket and declines progressively as the income level rises.

The Ways and Means Committee made essentially the same statement in its 1954 report.

The percentage relief is the same for everyone—up to 4 percent of taxable dividends. It applies equally to high- and low-income investors. High-income taxpayers, of course, pay a heavier tax on their dividends because of their larger security holdings and highly progressive personal income tax rates. Although percentage relief may give these investors larger dollar savings, the tax saving is small as a percent of their total taxes.

The lower income taxpayer, on the other hand, finds that the 4-percent credit represents a large percentage reduction of his total taxes. In that sense, therefore, the 4-percent credit is more meaningful to the small investor.

If the dividend credit is more valuable to the high-income investor, the same reasoning would have to apply to the proposed $100 dividend exclusion. Yet the Treasury abandons the logic by which it objects to the credit when it advocates a higher dividend exclusion alone. The fact of the matter is that the combination of the credit and exclusion represents a sensible approach to a difficult problem; both should be retained.

Criticism No. 2: It has not encouraged new equity financing.

The dividend credit is said by some to be an inadequate stimulus to new equity financing. Certainly the credit was never expected to produce a dramatic upsurge in equity financing; it was only intended to be a first step toward reducing unfair double taxation. The simple fact is that the advantage of a 4-percent credit was small in 1954, and remains small today, in relation to other means of raising capital. The deduction of interest on borrowed money, for example, far outweighs the modest benefits of a 4-percent credit—or even the 10-percent credit considered by Congress in 1954. Since then such measures as the liberalization of depreciation allowances and the investment credit have increased the attractiveness of alternative sources of funds for capital spending. But nothing has been done to encourage equity investment.

The credit was an important first step in the right direction. How the income from an investment is taxed affects an investor's willingness to risk his savings. It is my belief that the dividend credit does sometimes tip the scales in favor of equity investment against the overwhelming advantages of other forms of financing corporate growth. But it would be unrealistic to expect it to make giant strides against increasing odds. Nevertheless, without any dividend credit, the percentage of equity financing might have been even less than it has been.

Criticism No. 3: Corporate rate reduction will remove as much double taxation as the credit.

The reduction in corporate rates is a long promised measure that has been postponed again and again since the end of the Korean war. Although clearly not designed to alleviate double taxation of dividends, lowering the corporate rate would, of course, slightly reduce the burden of the double tax. Since H.R. 8363 would leave the corporate tax at a still high level of 48 percent, a strong bias in favor of debt financing would remain and the extent of double taxation would be well above the modest relief of a 4-percent credit. Whatever the rates, the dividend tax problem merits special attention, as long as two separate taxes are levied on corporate earnings.

In any event, the extent of benefit to stockholders from reducing the corporate rate has been exaggerated. In Treasury examples, the entire amount of the cut in corporate rates is unrealistically assumed to be passed on directly to the stockholders. This overstates the actual effect. In practice, the benefits of the reduced rates may be retained for reinvestment, passed on directly to consumers in the form of lower prices, or paid to employees in higher wages. Some of what remains may be passed through to investors as dividends. It does not seem fair to take $300 million out of investors' pockets now with no assurance that they will ever be reimbursed.

The corporate income tax is generally assumed to be shifted forward to consumers by those who argue that no double taxation exists. By assuming that a cut in the tax would accrue in full to the stockholders, the Treasury implies once again a double taxation of dividends with the full burden on stockholders. Recognizing the existence of the double tax is half of the problem of accepting proper relief for its elimination. Certainly Congress should not take the backward step of outright repeal of the dividend credit, which would only be partly compensated for by a $50 increase in the exclusion.

RELATIONSHIP TO RATE REDUCTION

The proposal for repeal of the credit has been tied to the proposed reductions in the personal income tax. Unless the credit is repealed, the Treasury contends that the reduction in individual tax rates would have to be moderated. This has worked as a powerful lever against the dividend credit and confused the real issue of the merits of the present provisions.

The increase in dividend taxes, according to the Treasury, is offset by the reduction in personal income rates. But these reductions benefit all taxpayers. In other words, the Treasury is telling investors they are eligible for the relief available to all taxpayers only if they accept more stringent taxation of their investment income. This is like filling the tank of a stalled car with gasoline, while draining all the oil out of the crankcase.

To some the credit is not necessarily the ideal form of relief for dividends above $100. But a combined credit/exclusion was the deliberate choice of Congress in 1954—after careful study—as the most practical approach toward partially righting the inequity of double taxation. Until a thorough study of alternative approaches produces a better method, the 4-percent credit should be retained, while the exclusion rises to $100. The exchange urges that H.R. 8363 be amended so as to retain the 4-percent credit. We also recommend that the $100 exclusion be left in the bill.

THE TAXATION OF CAPITAL GAINS

The House bill proposes several praiseworthy reforms for capital gains taxation:

1. Reduction of the percentage inclusion on gains realized after 2 years from 50 to 40 percent, with a maximum tax rate of 21 percent.
2. Indefinite carryover of unused capital losses.
3. Definition of capital assets eligible for the lower percentage inclusion rate to include securities and real estate.

The exchange endorses these proposals and urges their enactment as a good start in encouraging the investment and mobility of capital.

As you know, the exchange has long urged changes along these lines. In testifying before the Ways and Means Committee earlier this year, I endorsed a percentage inclusion rate of 30 percent and a shortened holding period of 3 months. We still believe these provisions more nearly fulfill the administration's desire for greater economic growth, increased revenues, and greater mobility for investment funds. However, we welcome the current proposals as sound steps in that direction.

REDUCTION OF INCLUSION RATE

The stimulative effect on revenues from reducing capital gains rates has been substantiated in an independent study made for the New York Stock Exchange by Louis Harris & Associates, Inc. The survey of investors' buying and selling patterns several years ago carefully analyzed the potential revenue effect of a reduced capital gains rate. A major conclusion was that an inclusion rate of 25 percent—50-percent cut in present tax—would immediately unlock a tremendous amount of capital appreciation and more than double Federal revenues from the capital gains tax.

The results of this survey indicated the potential revenue impact from lowering the inclusion rate would be substantial. Even with the moderate reduction from 50 to 40 percent, the committee report on H.R. 8363 estimates that revenues would increase by $450 million in the first year.

TAXATION OF CAPITAL GAINS AT DEATH

The taxation of capital gains at death is not part of the tax bill before this committee. Such a provision was in the administration's original tax program but was discarded by the Ways and Means Committee as impractical and unwise. In testimony before the Senate Finance Committee, Secretary Dillon—with debatable logic—has sought to tie this proposition to the House-passed tax rate relief on capital gains.

The attempt to couple a tax on gains at death with other provisions of capital gains taxation makes no sense logically or economically. It overlooks the fact that appreciated assets are already subject to estate tax rates ranging up to 77 percent. And it mocks the Treasury's concern that:

> The proposals with respect to capital gains taxation are designed to improve the fairness of the tax system and promote economic growth * * * the comparatively high tax rates on capital gains were intended for an earlier wartime period and are inappropriate today because they tend to retard capital formation and mobility.

We can make no economic progress if "liberalization" in one area is always to be matched by restriction in another.

It does seem logical to me to increase the projected budget deficit by throwing away the $450 million of revenue that would flow from a lower capital gains inclusion rate in the first year. Furthermore, I cannot understand why the administration, which has professed concern about "the mobility and flow of risk capital," would suggest abandoning a tax revision that could increase capital realizations by an estimated $17 billion over a 4-year period. It would be much more logical to consider the question of a tax on gains at death in a review of estate and gift taxation—not in a bill to ease income taxes.

The exchange recommends that Congress retain the present tax treatment of capital gains at death or gift. This approach is dictated by law, equity, and simplicity. At the same time, the administration's goal of achieving economic growth within a fair tax system requires that the capital gains inclusion rate be reduced at least to the extent provided in H.R. 8363.

CARRYOVER OF CAPITAL LOSSES

For small investors with inadequate gains to offset losses, the House bill proposes to extend the loss carryover indefinitely. The Treasury has estimated that almost $300 million of capital losses are wasted annually due to the present 5-year limit on carryover losses. The extension of this period will, as Secretary Dillon has said, "especially benefit smaller investors who suffer greatest loss, relative to their incomes, under the existing limitations." It will also increase funds for reinvestment and the willingness to invest capital in new and risky enterprises. The exchange endorses this provision to help remove the inequities in this area.

TAX POLICIES OF OTHER COUNTRIES

In the area of both dividends and capital gains, our present tax system works against capital investment and individual investors. Most other industrialized countries have recognized the stifling effect of high tax barriers on investment and are considerably more enlightened in their taxation of capital gains and dividends than we are in this country.

Countries which treat dividend income more liberally than the United States include Canada, Japan, the United Kingdom, and half of the countries of the European Economic Community. No major industrialized country, including all the aforementioned, taxes capital gains. (See exhibit A for more detailed information.)

SUMMARY OF RECOMMENDATIONS

I believe that we can learn from the examples of our competitors abroad when it comes to encouraging venture capital. The proposed liberalizing of the tax treatment of capital gains and losses in H.R. 8363 is a step in this direction. On the other hand, the proposed repeal of the dividend credit directly contradicts this action.

President Kennedy last month told the Nation that a tax cut can help balance our international accounts by "making investment in America more attractive than investment abroad." To be consistent with this goal, a more enlightened approach to the taxation of dividends and capital gains seems essential.

Thus, the exchange recommends as a beginning, adoption of the provision in H.R. 8363 for taxation of capital gains and losses. At the same time, we urge that, in addition to approving the modest increase in the dividend exclusion to $100, the Senate reinstate the 4-percent dividend credit.

(The tables referred to follow:)

EXHIBIT A

Tax treatment of capital gains—Selected countries (as of October 1963)

Country	Personal capital gains tax on securities	
	Holding period (months)	Marginal rate, after holding period (percent)
United States	6	25
European Economic Community:		
Belgium	None	None
France	None	None
Germany (West)	6	None
Italy	None	None
Luxembourg	12	None
Netherlands	None	None
Canada	None	None
Japan	None	None
United Kingdom	6	None

Relief from double taxation of dividends—Selected countries (as of October 1963)

Country	At corporate level (lower tax on distributed earnings)	At individual level
United States		4-percent tax credit.[1]
European Economic Community:		
Belgium		15-percent tax credit.[2]
France		
Germany (West)	36-point reduction	
Italy		8-point reduction.
Luxembourg		
Netherlands		
Canada		20-percent tax credit.
Japan	10-point reduction	10-percent tax credit.
United Kingdom		39-percent tax credit.

[1] After exclusion from income of 1st $50 of dividends.
[2] Imputed dividends added to gross dividends and also taken as a tax credit.

The CHAIRMAN. Thank you very much.

Senator Long?

Senator LONG. Mr. Funston, you have a computation on the credit against exclusion. You recognize, don't you, that if this bill is passed the way it is at this moment, that this couple would have a tax reduction of about $144 due to the rate cut?

Mr. FUNSTON. Yes, I do.

Senator LONG. Minus the $15 that you are talking about that they are losing here, so that would be about $129 net tax reduction, plus that with the corporate tax cut of four points, that couple would probably get about an extra $75 in income after taxes.

Mr. FUNSTON. Sir, I don't see the second point.

Senator LONG. Assuming the corporation as a result of its tax cut passed on through additional dividends.

Mr. FUNSTON. Yes, sir; that is the point, but that would not happen. That is an assumption that that would not happen for the reasons I have given, plus the fact that corporations under this bill, which I have not mentioned in my statement, are going to be faced with the necessity to pay more tax over a period of years, because of accelerated pay-as-you-go payments, so that they are not going to have essentially as much money to pay out in dividends as it is thought of as a result of this bill. Then getting to the first point——

Senator LONG. Let's cover the first point.

Mr. FUNSTON. Right.

Senator LONG. If the rate cut went into effect, then the rate cut could give a tax reduction of about 10 times as much as they would lose by the effect of losing the dividend credits compared to the $100 exclusion.

Mr. FUNSTON. Yes, they would, sir, but the point is that that same tax cut should occur to everybody no matter what their source of income is.

The point that I am making is that just because this one individual happens to have dividend income, he is going to get less of a tax reduction because of the cut in the rate than the chap who has income that is not generated by dividends.

I don't think that is fair. I think that in a bill of this sort where you are going to reduce taxes, it ought to be reduced for everybody the same. The man who has some dividend income should not have to take less as the price of getting a tax reduction. I don't think it is fair.

Senator LONG. I have also suggested just as one member of this committee that we must try to provide some relief for the fellow who is actually paying at these high rates as compared with the person who is getting the benefit of the large amounts of charitable deductions and the exclusion on dividend income.

He will continue to get the capital gains on stocks he held and on bonds that he held for more than 6 months. What would be your reaction to that type of proposal?

Mr. FUNSTON. We would favor it very much, sir. I am familiar with it.

I don't know what the revenue impact of the proposal would be, but from what I have read in the papers, I believe that it would be minimal. I would think that it would be a very good addition to the bill; it might well prove to be an experiment that if successful could at a later date be applied to much lower income levels. This might be an answer to the one thing we are trying to find, a much simpler way to collect taxes and make it fair to everybody. So we would favor it.

Senator LONG. I would hope to see it applied to persons with lesser incomes. The Treasury's advice to me is that they are fearful to try that in the early stages, because a miscalculation or a loophole within this proposal that they cannot forsee would cost the Treasury a great amount of money, but they would be willing to experiment with it on a limited basis which I propose.

I am pleased to see that you would favor it. I think the persons with income derived largely from dividends, for example, who are not engaged in the many tax avoidance possibilities of which I can conceive, would be benefited by such a proposal as that.

It seems to me as though the fellow who is actually paying taxes on all this income is entitled to some consideration. I don't find too much sympathy for the fellow who made the $5 million and paid no income tax at all. It seems to me that he is cared for well enough the way the law is written now.

Thank you very much, sir. If you want to comment on it, you may.

Mr. FUNSTON. I was just about to say that we will support this in all ways we can.

I think probably, too, the fellow who has an income of $5 million and is not paying any taxes is probably giving most of it away to charity or something.

Senator LONG. He is, I am sure, a lot of it I am sure, but not necessarily. It could be, for example, a lot of it could be in tax-exempt securities and a lot of it could be as a result of short-range things where temporarily it would reduce his income.

You know of the many possibilities just as I do where temporarily a person could avoid the possibility of taxes, in addition to the charitable contributions, my thought being that the person who is paying these rates is entitled to more relief than the fellow who is not paying.

Mr. FUNSTON. Right.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. I would like to yield to Senator Dirksen and claim my turn a minute later.

The CHAIRMAN. Senator Dirksen?

Senator DIRKSEN. Mr. Funston, have you ever entertained the idea of retaining this $100 exclusion and then picking a cutoff point for the 4-percent dividend credit?

As you testified, it would be open at all levels of dividend income. What about a $5,000 limit, if there is any merit to this criticism that the larger income recipient of dividends has an advantage over the smaller? You have a combination here you see, retain the $100 exclusion and limit the 4-percent credit to a dividend income up to $5,000. It could be $10,000.

Mr. FUNSTON. Senator, I think that would definitely not solve the problem at all, because the point is that this 4-precent credit should apply to all dividend income no matter how big it gets.

We are not interested in this 4-percent credit because it helps as it is alleged, but this is very debatable and I will speak to it in a minute, because it helps rich people, because I don't believe it does.

We are trying to speak for any group of people. We are trying to speak for all investors and to the concept that double taxation exists, that it is unfair, and if it is unfair, it is unfair at whatever income level or wherever it exists. The only thing that you can do is to remove it.

To say that a man who has $100,000 in dividend income is not entitled to a 4-percent relief when you decide that double taxation is inequitable, and it ought to be removed, does not seem to me to be germane to the point.

Now, about this whole question of who gets the benefits of the 4-percent credit. Undoubtedly people in higher income brackets get more of the dollar tax savings because they own more stocks and have more dividends and pay a higher, up to a 90-percent tax rate on these dividends. So any percentage relief will help them more.

Senator DIRKSEN. I appreciate your contention, and also the broad principle from which you approach it.

Mr. FUNSTON. Yes.

Senator DIRKSEN. But I think in terms of a legislator, and of all the euphemisms politics is the art of the possible. I remember there arising on the Senate floor this item in other years and I remember generally other arguments that were made. Now say what you will, this is going to be under fire on the Senate floor.

Mr. FUNSTON. Right.

Senator DIRKSEN. Because it has been under fire before, and mainly because the contention was made that the smaller income recipient of dividends is probably at a disadvantage. I doubt it very much, but that is neither here nor there for the moment.

What can you get in the hurly-burly of discussion in the preparation of the tax bill?

Mr. FUNSTON. Well, I don't know that, but 2½ million people, 2½ million taxpaying families as a minimum would be affected adversely by this, so that if you make this change, you are hurting 2½ million stockholders, which I think is a sizable amount.

You also would be taking steps to further discourage investment in equities. You would be taking steps to further discourage people from becoming stockholders, getting new stockholders.

I don't know why it is suddenly necessary to take these steps, if you really believe the purpose of this tax bill is to encourage investment and encourage growth.

Senator DIRKSEN. Now suppose as a thoroughly practical proposition in the legislative field this is as much as you could get; namely, a

$100 exclusion and a 4-percent credit up to $5,000. The answer would be what?

Mr. FUNSTON. A 4-percent credit. In other words, you would say the $5,000 would be the maximum tax relief that could be afforded, and that will be the equivalent of a total dividend income of 25 times that much, is that what you are saying? In other words, that in effect you would be saying that anyone who had over $125,000 worth of dividend income would not benefit from the 4-percent credit?

Senator DIRKSEN. Whatever the arithmetic is.

Senator BENNETT. Will the Senator yield?

Senator DIRKSEN. Yes.

Senator BENNETT. Do you mean that only the first $5,000 of dividend income would be subject to the 4 percent or a net after the 4 percent had been applied?

Senator DIRKSEN. $5,000 of net dividend income would fall within the provisions.

Senator BENNETT. That's what I thought you meant, and I was sure Mr. Funston was going off in another direction.

Mr. FUNSTON. I was. So that would mean that on $5,000, you would take 4 percent of that, and that would mean that the maximum that any individual could claim would be $200.

Senator DIRKSEN. No, no. I mean that his net dividend income up to $5,000 would fall within that dividend credit. It would be 4 percent of $125,000.

Mr. FUNSTON. In other words, if a man had $200,000 of dividend income, 4 percent on that would be $8,000.

Senator DIRKSEN. That is correct.

Mr. FUNSTON. Therefore, he would be cut off of everything between $5,000 and $8,000.

Senator DIRKSEN. That is right.

Mr. FUNSTON. Well, that is a very "iffy" question as to whether that would be brought about. I would rather see it left the way it is now, and have the 4-percent credit put back in its entirety. But I think that it is a substitute that we would certainly accept.

Senator DIRKSEN. You remember the action that the Senate took on this whole subject of dividend credit and exclusion.

Mr. FUNSTON. Yes, sir; I remember that.

Senator DIRKSEN. So here you have a bill with a $100 deduction, but no 4-percent credit.

Mr. FUNSTON. And we do not think that that is anywhere near as good a bill for the purposes of encouraging investment as it would be if the 4-percent credit were put back. That is what we are recommending.

Senator DIRKSEN. I have no way of knowing what the impact would be except in the hands of those who enjoy a 4-percent credit up to an income of $5,000. It would be helpful for a rather broad bracket of taxpayers.

Mr. FUNSTON. Oh, yes. Your suggestion, if I get it straight, would certainly take care of most all. In effect it would allow a 4-percent credit for most all taxpayers, because very few taxpayers have dividend income of $125,000 or over.

Senator DIRKSEN. It would pretty nearly meet the contention you make here.

Mr. FUNSTON. Yes; it would. It would indeed.

Senator LONG. I just want to be sure that I understand what the proposal is. Is it the proposal that we would allow a 4-percent credit on $5,000 of dividend income, which would work out to a $200 credit, or that we would allow a 4-percent credit on $125,000 of income, which would work out to a $5,000 tax credit? I just want to know which the Senator is proposing.

Senator DIRKSEN. The credit involves the $5,000 of income. That would be $125,000 of dividends, and you would have a credit up to that point. Beyond that of course you would not.

Senator LONG. That would be a $5,000 tax credit.

Senator DIRKSEN. The amount can be reduced. It can be $2,000, $1,000, $3,000.

The CHAIRMAN. In other words, that would be a ceiling.

Senator DIRKSEN. Yes.

Senator DOUGLAS. I am still not clear about this. Is it a 4-percent dividend credit on $125,000 or on $5,000?

Senator DIRKSEN. On $125,000.

Senator DOUGLAS. Up to a $5,000 tax credit.

Senator DIRKSEN. Now if you make it $2,000, that would mean a dividend income of $50,000.

Senator DOUGLAS. It is the difference between a $200 tax credit and a $5,000 tax credit.

Senator DIRKSEN. Yes; but the contention here——

Senator DOUGLAS. I am just trying to understand.

Senator DIRKSEN (continuing). Is a completely open-end credit of 4-percent dividends, whatever they may be.

Mr. FUNSTON. Of course, sir, even that is limited. It is limited even now in the law. It is not an open end because you can't claim more than 4 percent of your total taxable income, so that there is a very definite limitation already built into it, so that if a man would have, say, $250,000 of income from dividends, he would not necessarily get 4 percent of that as a deduction even under the present law. It is limited to 4 percent of taxable income.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. Mr. Funston, if I might start with the capital gains feature presented in your paper, I take it that basically you are arguing this reduction in the capital gains tax would encourage the realization of capital gains on securities held?

Mr. FUNSTON. That is right, sir.

Senator DOUGLAS. And this is what you designate as unlocking.

Mr. FUNSTON. Yes, sir.

Senator DOUGLAS. Now may I ask, What is the gain to society from getting a lot of people to unlock their gains from one set of blue chips stocks so that they can buy a different set of blue chip stocks?

What is the social gain to society? Now if I may just add one sentence, I know this leads to larger sales on the New York Stock Exchange. I also know that it leads to larger commissions for brokers. But what is the gain of people selling one set of blue chips and getting another set of blue chips to society as a whole?

Mr. FUNSTON. Sir, to take that first point, again in terms of the securities market, is that if one person were to sell one blue chip and buy another, which I don't believe would normally happen, but if it would, it would create in the stock markets an increase in the supply of securities which would tend to more or less reduce some of these fluctuations that occur because people locked in won't sell, don't want to sell. It creates a limitation on the supply of the very stocks that the institutions all want to buy, and so we believe it would have a leveling out effect in the price.

The second point is that typically it does not happen, I don't believe someone would sell one blue chip and buy another, though they well might. It is hard to generalize. But what happens is the people who are in the blue chips who have had them for so long that they have a sizable capital gain and feel locked in, typically those people would sell, and then would reinvest the money in something that was not quite so blue chippy.

Senator DOUGLAS. It would encourage them to take risks.

Mr. FUNSTON. That is exactly it.

Senator DOUGLAS. Put them in less profitable investments?

Mr. FUNSTON. More riskier investments which they hope in the long run are going to be more profitable.

In other words, this is the type of person that can best afford to take the risk in the new and growing enterprises for which there is a great shortage of equity capital.

Senator DOUGLAS. It is a very ingenious argument, but I am not certain how valid it is.

Certainly your argument is interesting, and I am not condemning you for this, and you are a very able representative of a very necessary institution. But, of course, your members are interested in increasing the turnover of stocks, too, because it means increased income; isn't that so?

Mr. FUNSTON. Yes, sir; but please don't put me in that category. I say this very sincerely, too, because I believe it.

Senator DOUGLAS. I understand.

Mr. FUNSTON. In other words, there are lots of other recommendations that we could make, such as the constructive realization at death, which would improve our volume, which I am not making at all because we don't believe in it.

Senator DOUGLAS. It would have the effect of increasing your volume.

Mr. FUNSTON. Yes; we think that——

Senator DOUGLAS. Even though it does not influence your decision, it would have an incidental byproduct.

Mr. FUNSTAN. That is right, and we think, incidentally, that would be very good for the economy and for our country.

Senator DOUGLAS. I certainly think it is true that the stock exchange performs a very valuable function, but I don't know that the value to society is in precise ratio to the volume of turnover in shares on the stock exchange.

Mr. FUNSTON. I agree with you, sir. There are many times when we wish the turnover was not nearly as great as it was. It is no criteria of value at all, and we don't approach this problem in that light at all.

Senator DOUGLAS. That is fine. Now I have here a pamphlet which you have issued which is based on a survey by Louis Harris & Associates.

Mr. FUNSTON. Yes, sir.

Senator DOUGLAS. And they took a survey of 1,096 individuals.

Mr. FUNSTON. Right.

Senator DOUGLAS. And on the basis of their survey of these 1,096, you project what the increased volume of stock sales would be for the market as a whole.

Mr. FUNSTON. Yes.

Senator DOUGLAS. With a reduction in the capital gains tax, and therefore the alleged immediate increase in revenue to the Government.

Mr. FUNSTON. Yes, sir.

Senator DOUGLAS. Do you place much reliance on these surveys?

Mr. FUNSTON. Oh, I certainly do, sir, and as far as I know this has never been challenged at all.

This is the present technique of getting a relatively small amount of persons interrogated, but make sure that those are representative, are a good cross section of society and drawing conclusions therefrom. I do put credence on it, and this is a very accepted research technique.

Senator DOUGLAS. The Harris group is responsible, I take it, because you hired them.

Mr. FUNSTON. Yes, very much so.

Senator DOUGLAS. Do you regard Dr. Gallup as responsible?

Mr. FUNSTON. I really wouldn't know. We never have engaged him for anything. I know him as a person. I think he is a fine man, yes.

Senator DOUGLAS. Presumably the Gallup polls you would regard as responsible.

Mr. FUNSTON. I would not want to make any blanket commitment because I never have studied the basis for his surveys and his techniques and so on.

Senator DOUGLAS. They are the two leading pollsters I believe—Gallup and Harris.

Mr. FUNSTON. There are others.

Senator DOUGLAS. Gallup, on the whole, does more than Harris, I think.

Mr. FUNSTON. I don't know.

Senator DOUGLAS. Of course you know that according to the Gallup poll, the President is going to defeat decisively any Republican candidate in 1964. Do you believe that?

Mr. FUNSTON. Sir, I came prepared to talk about a tax bill.

Senator DOUGLAS. Well, I know, but you are placing great reliance on this poll of 1,096 persons. The Gallup poll, I believe, has 1,500. If the Harris poll is reliable, and the Gallup poll is equally reliable, I want to know whether you have as much faith in the Gallup poll as you have in the Harris poll?

Mr. FUNSTON. Sir, you can't answer that question until you really analyze the basis by which the 1,500 reflect a truly representative opinion.

Senator DOUGLAS. I think Gallup's sampling method is as good as Harris'.

Mr. FUNSTON. But this is 1,500 out of, I don't know how many million voters. The 1,096 was out of a much smaller number of investors—you see, there is a difference in the field of magnitude here. You really can't compare the two.

Senator DOUGLAS. Oh, yes.

Mr. FUNSTON. And I will say this: yes, we have complete confidence in the Harris report, and in its coverage and its integrity and, Senator, it has never been challenged to this day.

Senator DOUGLAS. I will have them take some polls for me too.

Now, I think the Treasury admits that lowering of the capital gains tax will have an immediate effect.

Mr. FUNSTON. Yes.

Senator DOUGLAS. In increasing the volume of stock sales.

Mr. FUNSTON. Right.

Senator DOUGLAS. But is this a continuing effect or does it simply mean that you unlock existing securities which are held, the gains upon which are not realized? That is, is this more or less of a one shot or 2-year effect, and then as you go on in time, a decrease in the rate of capital gains taxation will simply decrease revenues. In other words, it will break the immediate blockage but not have the continuing stimulative effect.

Mr. FUNSTON. I think that the experts who make these computations believe that in general the effect of increased revenue, will continue over a 4-year period at a somewhat diminishing rate, and that it is pretty hard to go beyond 4 years.

The chances are that there will be a leveling off at that time or some decline unless the stimulative effect of the increased mobility of capital and so on and the unlocking of investments will generate more economic activity in the years ahead.

Senator DOUGLAS. As I remember the Harris study, the results of the sample also included the realized gains which were made in 1959. Am I correct in that?

It not merely covered whether they would sell if the tax were reduced, but there is a question also on their realized gains in the preceding year in 1959. Do you have the Harris survey there?

Mr. FUNSTON. Yes, I do.

Senator DOUGLAS. I mean the major survey. Would you turn to page 31.

Mr. FUNSTON. What survey is this, sir?

Senator DOUGLAS. The Harris survey.

Mr. FUNSTON. We have, I think, the same publication that you have.

Senator DOUGLAS. Does that show a blown-up figure, and I don't use that in any invidious sense, that the gains realized on stockholdings by individuals in 1959 amounted to $10.7 billion?

Mr. FUNSTON. Yes, I think that is right.

Senator DOUGLAS. Thank you very much.

Well, now if you look at the special supplement issued by the Treasury on statistics of income in 1959, that will show that on the sales of capital assets reported on individual income tax returns, the total of realized gains on the sale of corporate stock including rights was $5.1 billion, or less than half the blown-up estimate by Harris.

I want to say I have a high opinion of Mr. Harris. Doesn't this indicate that possibly we should sprinkle some salt on his figures?

Mr. FUNSTON. I am sorry: I don't get the point. I don't have the figures before me. But we say $10 billion capital gains in 1959.

Senator DOUGLAS. Or 1959—for 1959.

Mr. FUNSTON. Yes, and then what?

Senator DOUGLAS. And the actual figures given in the Treasury bulletin on statistics of income, several volumes of this come out each year, for the same period show realized capital gains of only $5.1 billion, or less than half the blown-up estimate of Harris.

Mr. FUNSTON. Did you use the words "realized capital gains" advisedly, because the Harris figure is not realized capital gains at all.

Senator DOUGLAS. Are you sure of that?

Mr. FUNSTON. I don't believe so. A realized capital gain is a capital gain that is only good in the tax return and realized.

Now we have a Treasury table here, "Net Long-Term Capital Gains, 1959," by type of amounts, and this shows long-term capital gain of $12,331 million. Then the next section shows corporation stocks of $5 billion.

Senator DOUGLAS. That is the point.

Mr. FUNSTON. That is the one you are talking about, the $5 billion?

Senator DOUGLAS. That is right, sales of corporate stock.

Mr. FUNSTON. Mr. West says that figure should be doubled, because this just represents 50 percent. This is individual returns, so $5.1 billion, and if they put in a 50-percent inclusion, you see that should be doubled and that should be $10 billion.

Senator DOUGLAS. I wonder if we can't get together after the session and compare figures.

Mr. FUNSTON. Yes, sir, we would be very happy to.

Senator DOUGLAS. Now continuing in the field of capital gains, you stated that many countries do not tax capital gains. Do you know whether in those countries capital gains include gains on such items as these. One, depreciable property.

Mr. FUNSTON. Depreciable?

Senator DOUGLAS. Depreciable property: second, real estate: third, timber: fourth, coal royalties: and fifth, I will add iron ore royalties because capital gains treatment is applied to it in the bill: sixth, breeding livestock: seventh, unharvested crops.

Now, these are all included in the American definition of capital gains. Are they included in these European countries or are they taxed as income?

Mr. FUNSTON. Without knowing specifically my general feeling is that they would not be taxed as a capital gains.

Senator DOUGLAS. But taxed as income?

Mr. FUNSTON. No, I don't think they would be taxed as income. I think it is impossible to answer a question like that in generalities, but let's put it this way:

In any foreign country, if there is anything that is close enough to being regarded as capital as for our Congress to agree that it was capital and should be taxed as such, I am sure with the different attitude in Europe, the much more generous interpretation, that none of these things would be attached as income.

Senator DOUGLAS. That is a general belief. I wondered, has anyone on the staff studied this question of the European system?

Mr. STAM. I don't think so. The ordinary theory would be was it held for investment.

Senator DOUGLAS. I ask, Mr. Chairman, that the staff prepare a memorandum which can be presented at the conclusion of Dr. Funston's testimony as to the treatment of these seven types of items that I have mentioned; namely, depreciable property, real estate, timber, coal royalties, iron ore royalties, breeding of livestock, unharvested crops.

(The material referred to follows:)

TAXATION OF GAIN FROM THE SALE OF SECTION 1231 TYPE ASSETS IN SELECTED EUROPEAN COUNTRIES

European countries, in general, tax gain from the sale of property used in a trade or business as ordinary income in the same manner as income derived from other business transactions. This treatment primarily results from the fact the European tax systems treat gain from the sale of such assets as being related to the business of the taxpayer rather than as tax-exempt capital transactions. However, because of the special ways in which income of small businesses, and income of farmers in particular, is generally taxed under European tax systems, treatment of gain as ordinary income does not necessarily result in taxation of the entire gain at tax rates normally applicable to other business income.

A more detailed description of the treatment of gain derived from—

(1) the sale of depreciable personal property and real property used in a trade or business;
(2) the sale of timber with a retained economic interest;
(3) timber cut under a timber cutting contract;
(4) coal and iron ore royalties;
(5) the sale of livestock; and
(6) the sale of unharvested crops with land

in the United Kingdom, the Federal Republic of West Germany, France, and Italy, is set forth below.

UNITED KINGDOM

Under the law of the United Kingdom, income derived from the sale of property is subject to tax only if it is taxable as business income. However, if it is taxable, it is taxed in the same manner as other business property.

Whether gain from a particular sale is subject to tax is a question of fact. No specific criteria has been established for making such determinations. However, the courts have held that one important element that should be present before holding that a gain is taxable is a finding that the asset sold was purchased for the purpose of resale.

Depreciable personal property and real property used in a trade or business

As a general rule, machinery and equipment and land and buildings used in a business are purchased for use in the business and not for resale. Therefore, gain from the sale of such assets is generally treated as a capital gain and is exempt from tax. However, the income tax law provides for a form of recapture of gain as ordinary income to the extent depreciation had been taken on the asset.

Sale of timber with a retained economic interest

In general, actual profits from the operation of woodlands are ignored for tax purposes. However, a presumed income which is generally determined by reference to the value of the property, established for local property tax assessment purposes, is taxable as ordinary income.

Timber cut under a timber cutting contract

Gain from the sale of timber held by a timber cutter under a timber cutting contract is taxable as ordinary income. However, the amount subject to tax may be determined in either of two ways. If the timber cutter so elects, he may pay tax on his actual income from operations which would include any increase in value of the timber held under contract. Alternatively, he may elect to pay tax on the basis of 133⅓ percent of the presumed net income from his operations.

Coal and iron ore royalties

Royalties received by the lessor of mineral properties are taxable as ordinary income without any allowance for exhaustion or depletion. However, deduction is allowed for expenses necessarily distributed for the management or supervision of the property.

Livestock

Gain from the sale of livestock held for draft, breeding, or dairy purposes is taxable as ordinary income. However, if an entire herd is sold and is not replaced within 5 years following the date of sale, the entire gain is treated as in the nature of capital gains and is exempt from tax.

Unharvested crops

If land is sold together with unharvested crops, the portion of the price allocable to the crops will be taxable income or nontaxable capital receipts depending on the nature of the crops sold. If the crops are produced each year primarily as a result of that year's labor, for example, grain and vegetable crops, the sale of the crop with the land gives rise to taxable income. If the crops are produced year after year primarily as a result of natural growth, such as unpicked fruit, sale of the crop with the land gives rise to nontaxable capital gain.

FEDERAL REPUBLIC OF WEST GERMANY

Under German law, income is taxed only if it falls within one of the seven classifications of taxable income described in the income tax law. These seven classifications of taxable income are as follows:

1. Profits from agriculture or forestry.
2. Profits from trade or business.
3. Profits from independent personal services.
4. Employment income.
5. Income from the investment of capital.
6. Rentals (from immovable property or a "conglomeration of property") and royalties.
7. Miscellaneous income, including annuities and other recurrent payments or benefits, and "speculative gains."

The German law makes no distinction between ordinary income and capital gains.

Depreciable personal property and real property used in a trade or business

Income from a trade or business is determined by a comparison of the taxpayer's net worth at the beginning of the year with his net worth at the end of the year. Therefore, any gain from the sale of property used in a trade or business would be reflected as an increase in the taxpayer's net worth, and such increase would be taxable as ordinary income.

Sale of timber with a retained economic interest

The manner in which income from the sale of timber is taxable depends upon the size of the enterprise involved. In general, taxable income from forestry is computed as a percentage of the assessed valuation of the agricultural establishment involved. Assessed values are reported to be extremely low with the practical result that small timber operators generally pay little of no tax on the sale of timber. However, large enterprises are required to report income on a net worth basis so that the increment in the value of timberlands would be taxable as ordinary income. The annual increment in value is determined in accordance with commercial accounting practices.

Timber held under a timber cutting contract

Due to the fact a timber cutter would normally be considered to be engaged in a trade or business, increment in the value of timberlands would normally be reflected as an increase in net worth and taxable as ordinary income.

Coal and iron ore royalties

Royalty income from the sale of coal and iron ore would be taxable as ordinary income to the extent gross royalty income exceeds expenses and cost depletion.

Livestock

The German law does not make specific provision for the sale of livestock held for draft, breeding, or dairy purposes. Therefore, a farmer taxable on a net profits basis (one whose annual turnover exceeds DM200,000, or whose annual profit exceeds DM9,000) would be taxed on such income as is reflected as an increase in his net worth. Other farmers would normally be taxable on such gains only to the extent such items are taken into account in determining average rates of return fixed by statute. However, if the livestock is held as part of a stockbreeding farm, the establishment may be taxed on a net worth basis.

Unharvested crops

In the case of large enterprises, the value of an unharvested crop would be reflected in the net worth of a taxpayer at the end of the year and gain on its sale would be taxed as ordinary income. In the case of small taxpayers who pay tax on the basis of average rates of return, gain from the sale of unharvested crops would appear to be exempt from tax.

FRANCE

Under French law, income is taxed only if it falls within one of six major categories of income. These six classifications of taxable income are as follows:

1. Income from property.
2. Income from business.
3. Income from agriculture.
4. Income from personal services as an employee.
5. Income from noncommercial activity.
6. Income from capital.

The French law makes no distinction as such between ordinary income and capital gains.

In the case of corporations and some individuals, the income tax is determined by reference to actual net income. However, in the case of individuals whose gross income from business does not exceed approximately $80,000 or whose gross income from services does not exceed approximately $20,000, French law provides that taxable income is to be determined by bilateral agreement between the taxpayer and the tax authorities rather than by reference to actual net income. The estimated method of determining income is also the normal method by which individual farmers are taxed. There is a distinction between the two methods, however, in that in the case of business income, the tax authorities and the taxpayer seek to come to an agreement as to the amount of income derived by the taxpayer by reference to his particular activity and circumstances. In the case of agriculture, the estimating process is based on the estimated average income per acre earned by all farmers in the same category, whatever their particular circumstances, rather than on the operations of a particular taxpayer.

Depreciable personal property and real property used in a trade or business

In the case of corporations and individuals with substantial income, gain from the sale of land, buildings, and machinery used in a trade or business is taxable as ordinary income. However, no tax is levied on the gain if the selling price is reinvested in business assets within a specified time. This tax-free "rollover" rule essentially amounts to a deferral, rather than exemption, of income since the basis of the new asset must be reduced by the amount of unrecognized gain.

Gain from the sale of land, buildings, and machinery by individuals who are taxed under the presumed income method would be taxed as ordinary income to the extent considered at the time an agreement fixing an individual's tax liability is reached by the taxpayer and the tax authorities.

Sale of timber with a retained economic interest

In general, gain from the sale of timber with a retained economic interest is taxable as ordinary income. However, in the case of individuals, the direct tracing of such gain into income is difficult since most individuals pay tax on the basis of a presumed income. Corporations engaged in the timber-growing business are required to include gain from the sale of timber in income taxable as ordinary income.

Timber held under a timber-cutting contract

In general, timber cutters would be considered to be engaged in a trade or business. Therefore, corporate timber cutters would be required to report the increment in value of timberlands held under contract as ordinary income when reporting income on an actual basis. Individual taxpayers would normally report as ordinary income an amount agreed to with the taxing authorities. It is difficult to determine how such agreements would be reached under such circumstances.

Coal and iron ore royalties

Mineral royalties received by a corporate lessor are taxed as ordinary income in the same manner as other business income. Mineral royalties received by individual lessors are taxed as ordinary income; however, individuals are allowed a 20-percent standard deduction for costs of administration, insurance, and depletion in addition to actual expenses incurred in connection with the mineral lease.

Livestock

As noted above, income from agriculture is taxed on the basis of the average income derived from agricultural operations of the same category. Therefore, gain from the sale of livestock held for draft, breeding, or dairy purposes is theoretically subject to tax as ordinary income. However, as a practical matter, a particular farmer is not taxed in direct relationship to his gain from the sale of such livestock.

Unharvested crops

The French law does not provide specifically for the manner in which unharvested crops sold with the land are to be taxed. In the case of individuals, this matter would be settled by agreement between the taxpayer and the French taxing authorities.

ITALY

Under Italian law, gain from the sale of an asset is subject to income tax as ordinary income if the asset sold is related to the business of the taxpayer.

In the case of corporations, all gains are treated as business income since all property owned by the enterprise is considered held for business purposes. However, the Italian corporate income tax in effect only applies to taxable income of a corporation to the extent income exceeds an amount equal to a 6-percent return on the assets of the corporation. Thus, although certain gains may be classified as ordinary income, there is no certainty that such gains will be taxed.

In the case of individuals, business income is generally considered to include gain from the sale of assets used in the business. However, in the case of farming, income is computed according to valuation schedules on the basis of area units rather than on the basis of actual income. Moreover, income from some land, including most mountain land, is entirely exempt from income tax.

(Prepared by the staff of the Joint Committee on Internal Revenue Taxation.)

Senator DOUGLAS. I can say, Mr. Funston, that Senator Williams and I were just barely able 12 years ago to prevent chickens from being included in capital gains. We had a terrific battle to exclude chickens. This 6-month period is a pretty short period, but it is a continuing occupation.

Now, there is just one final thing which is not so much a question but certain facts which I think should be put into the record, because they bear upon the distribution of the dividend credit.

I have here in my hand, as a former colleague of mine used to remark, a study, the 1960 survey of consumer finances by the University of Michigan Research Center, which for many years would be included in the Federal Reserve Board bulletin. Therefore it was approved officially by that body.

I may say they have mathematical experts who work on the theory of probability, so I think their sampling is good. They took not 1,096 cases but 2,972 cases.

At page 124 it shows that of these persons, 86 percent did not own any corporate stock. Only 14 percent owned any corporate stock. Three percent owned less than $500 of corporate stock, 2 percent owned between $500 and $999, which would mean 5 percent owned less than $1,000; 4 percent over between $1,000 and $4,999, which would mean that 9 percent owned less than $5,000. Two percent owned from $5,000 to $10,000, 1 percent from $10,000 to $25,000, 1 percent $25,000 and over.

Now, so far as those who own Telstar outerspace stock to receive $125,000 of income, would mean ownership of $5 million of capital stock. The number who own that much would be very minute, because only 1 percent own over $25,000.

Senator DIRKSEN. Paul, will you yield?

Senator DOUGLAS. Surely.

Senator DIRKSEN. There has been a figure bouncing around a long time that there are 17 million shareholders in the country. Now in your statement you mentioned that 2 million would be better off and 1,700,000 would be about in the status, and 2,500,000 would be worse off. That makes 6,200,000. Now, where are the other 11 million?

Mr. FUNSTON. Sir, those are taxpaying units as reported, those are the Treasury figures. Those are based on Internal Revenue Service statistics of a couple of years back, and they are taxpaying units.

The others might be children, educational or charitable foundations, many other kinds of ownership that don't show up in this 6.5 million.

Senator DIRKSEN. Is that a firm IRS or Treasury figure with respect to the number of shareholders?

Mr. FUNSTON. I think it was as of that date with respect to those that reported, yes, sir, of those that reported income tax returns on which dividend income was claimed or dividend income was shown.

Senator DIRKSEN. We have seen no verified figure as to the number of shareholders in the country. I have seen the number bounced around, but I wondered what the results would be.

Mr. WEST. Senator, may I answer that, the 17 million figure comes from a periodic survey that the stock exchange does in the way of a head count of shareowners in the country, based again on sampling techniques.

Senator DIRKSEN. I see.

Senator DOUGLAS. Would you permit me to follow up on that.

Is this the summation of stock owners of individual corporations?

Mr. WEST. This is the stockholders, individual stockholders only, not institutional stockholders.

Senator DOUGLAS. I mean to say are there a half million owners of A.T. & T?

Mr. WEST. This is an unduplicated total of individual stockholders in publicly owned corporations?

Mr. FUNSTON. The share owners of record in the companies that are just listed on our exchange is up some 70 million or something like that, but this is an unduplicated figure.

Senator DOUGLAS. How are you able to eliminate the persons who own stock in multiple corporations? Have you got an IBM computer?

Mr. FUNSTON. Yes. This is a rather complicated thing. What we did is we take samples of corporations of alphabetical segments, and check up from one corporation to another and find out the duplication, and it is all wafted into the total result. The average stockholder owns about three and a half stocks in this country.

Senator DOUGLAS. This would be very interesting to have the statisticians go over this method.

Mr. FUNSTON. It has all been done, Senator, a long time ago. This has all been studied carefully.

Senator DOUGLAS. I send this Michigan Research study down. I would like it back. This is a very reliable outfit.

Mr. FUNSTON. I would like to make a comment on that. We are familiar with the work of this group, and the data that you cite we believe is now too old really.

Senator DOUGLAS. That is 1960.

Mr. FUNSTON. I know, but that is 3 years ago, and the technique for estimating dollar value of stockholdings is subject to considerable error, and there has been a lot of progress made since then.

The Federal Reserve Board pointed out the fault in the previous 1958 survey of consumer finances. They said:

Clearly the survey is not a reliable source of information for aggregate holdings of corporate stock or for holdings by various groups.

The only reason why I say that is not to decry this, because this is something we ought to discuss with you in more detail as to what the figures mean. I think in general the point is that about a third of the stocks are owned by institutions, about a third are owned by people with incomes of $25,000 or over.

Now, the same thing holds true of ownership of all other kinds of property. What we are trying to do, our campaign at the exchange for years has been to broaden the base of share ownership, and we are having tremendous success in doing it. We now have, as Senator Dirksen says, 17 million stockholders. Ten years ago we only had 6.5 million.

What we would like is we want some help in being able to make it possible that there are not 17 million but there are 30 million stockholders. We want to broaden this, and this tax bill that is before you, in making the changes that I suggest, is a vehicle by which you can help do the job by encouraging the people of our country to invest in equity securities and eliminate the discrimination that exists against them.

Senator DOUGLAS. I am simply trying to lay a factual basis for the discussion.

Now, I also hold in my hand part 1 of the hearings before the House Ways and Means Committee including the testimony of the Secretary of the Treasury and the exhibits which he produced.

On page 265 table 10 of that exhibit lists the number of returns with dividends, the total number of returns, and the amount of dividends by the adjusted gross income classes for 1960 tax returns. These are on taxable returns, and the classification is by adjusted gross income classes.

Under $5,000 received 7.2 percent of the dividends, and therefore presumably owned 7.2 percent of the stock.

The $10,000 group received 13 percent of the dividends and presumably they owned 13 percent of the stock, or those with less than $10,000 gross income received 20 percent of the dividends and presumably had 20 percent of the stock.

Those with $10,000 to $20,000 had 18.6 percent of the dividends; from $20,000 to $50,000, 23 percent of the dividends; from $50,000 to $100,000, 13 percent of the dividends; from $100,000 to $200,000, 7.6 percent of the dividends; $200,000 to $500,000, 5.5 percent of the dividends; $500,000 to $1 million, 2 percent of the dividends; and over $1 million, 2.8 percent.

Now you will forgive me if I do a little summarizing. Those with incomes of over $50,000 a year received 31 percent of the dividends. That roughly checks, I think.

Mr. FUNSTON. Yes, sir, but the conclusions that you draw from this are not necessarily that the 31 percent of the stockholders are in those income grades.

Senator DOUGLAS. Oh, no, no, not at all.

Mr. FUNSTON. No.

Senator DOUGLAS. I said that those with gross incomes of over $50,000 received 31 percent of the dividends.

Mr. FUNSTON. The dividends that are reported to the Government.

Senator DOUGLAS. That is correct. You would not say that they were cheating on dividends?

Mr. FUNSTON. Oh, no, but what I am saying——

Senator DOUGLAS. Even though there is no withholding on dividends or interest, you would not say they are cheating, although there is a 10-percent dividend figure that is not reported.

Mr. FUNSTON. I certainly wouldn't, but I am saying that the difference between these taxpaying groups here and the 6 million, there is a big difference involved in the number of people and the 17 million, there are many people who don't report because they have income under $600 or children or——

Senator DOUGLAS. That brings up a very important fact. It is not the total number of stockholders that is so important as the proportion of the dividends received by the different classes.

Mr. FUNSTON. I don't agree with you.

Senator DOUGLAS. Secretary Humphrey always used to give us the total amount of dividends received and the total number of stockholders, and get the arithmetic average, and then say this is what the average person received.

Of course there is, as you well know, a very heavy loading of the ownership in a relatively small group. I simply want to get these facts established, Mr. Funston. You are a very charming gentleman, and I will say very frank.

Mr. FUNSTON. I want to get the fact established back to you. That is this, sir:

I think that in tax law we ought to be more interested in people, in fairness to individuals, to people. We are not talking about percentage accumulations of dividends paid by groups. We are interested in all the people.

I think that we should be concerned not that Joe Jones has $1 million of income, and try to whack him, as we are with the hundreds of people who are small people that we want to encourage to have dividend income and buy securities.

Senator DOUGLAS. I simply want to get the fact here about the distribution of stockholdings. Both of these sets of figures are for 1960, I take it. Now, there is one final point that I would like to make, and then I will stop. You say that there should not be taxation of capital gains at death because there is an inheritance tax.

I know something about the circumstances under which the inheritance tax was originally advocated and imposed. It was never intended as a substitute for the income tax. It was intended as a means of reducing the inequalities in society caused by the passing on of great fortunes from one generation to another. That was the original purpose, and I think it should be entered in the record that it was not intended as a substitute for the income tax.

It was intended as a means of forcing each generation, so to speak, to acquire its own fortune rather than coast on the inheritance of the preceding generation.

That is all, Mr. Chairman.

Thank you very much, Mr. Funston. I see you are a very effective gentleman. You can charm the birds right out of the trees.

Mr. FUNSTON. Thank you.

The CHAIRMAN. Thank you very much, Mr. Funston.

Senator DIRKSEN. I have one other question. That is on the carry-forward of losses at the rate of $1,000 a year, now they have extended that time period of course, and can carry it into the future, but it does seem to me that a person who has a given amount of income, but if he is really to undertake risks in a rather hazardous business, and in the initial period he has some losses, but he can only recoup those at $1,000, but Mr. Whiskers comes along and imposes the income tax on all other income, and it looks to me like there is kind of an inequity to that, that could well be more equitably adjusted under the House bill.

Do you have some views on it?

Mr. FUNSTON. Yes, sir. We traditionally have argued that that figure ought to be $5,000 a year for an unlimited period instead of just $1,000 for a 5-year period. We would still rather see it $5,000 a year, but we think the $1,000 a year over an unlimited time is a good step in the right direction. That is why we support it.

Senator DIRKSEN. But it impedes incentive up to the point that in a hazardous business enterprise a person is not too well inclined to go into it if he thinks that he is going to lose some money and can only recoup it over a long period of years at $1,000 a year.

Mr. FUNSTON. And that is uppermost in the minds of people, and so some people have said it is a case of "if I do it and make out well, the Government takes its share; if I don't make out and lose, nobody shares the loss with me."

Senator DIRKSEN. That is the risk.

Mr. FUNSTON. Exactly.

The CHAIRMAN. Thank you very much, Mr. Funston.

Mr. FUNSTON. Thank you, sir.

The CHAIRMAN. Our next witness is Mr. John L. Connolly of the Council of State Chambers of Commerce. Proceed.

STATEMENT OF JOHN L. CONNOLLY, COUNCIL OF STATE CHAMBERS OF COMMERCE, ACCOMPANIED BY EUGENE F. RINTA, EXECUTIVE DIRECTOR

Mr. CONNOLLY. My name is John L. Connolly and I reside in St. Paul, Minn. I am general counsel of the Minnesota Mining & Manufacturing Co. and chairman of the Federal Finance Committee of the Council of State Chambers of Commerce. I appear before you on behalf of the 30 State chamber organizations listed at the end of my statement. I am accompanied by Eugene F. Rinta who is the executive director of the Council of State Chambers of Commerce. Very shortly I will make a statement as to the position of the different State chambers.

The organizations which I represent here have for several years contended that our high rates of tax on individual and corporate incomes have been a major force in restraining our economic growth. Accordingly, we are gratified to have the opportunity to testify before your committee on a tax bill which denotes concurrence with this view on the part of the present administration and the House of Representatives.

This is not to imply that we support the bill before you, H.R. 8363, without reservation. While this bill is, in our opinion, an improvement in several respects over the legislation proposed by the President, it can and should be further improved. In addition to our reservations with respect to a number of specific provisions in H.R. 8363, we have had serious reservations about supporting a tax reduction without any plan or other concrete evidence of effective budget control. Nevertheless, after extended discussion and debate during the past 15 months, we have decided to support tax reduction at this time with the hope that if given less money the Government will spend less.

There is listed and appended to our statement a list of the chambers of commerce that we represent. This begins at page 9, and I will read the comments of these chambers before proceding with my statement.

The State chamber of commerce organizations endorsing this statement either in whole or in major part are listed below. Specific exceptions include the following: The Empire State Chamber of Commerce does not object as does our statement, to the provisions of the bill limiting the deduction of State and local taxes. The Ohio, East Texas, and Virginia Chambers support the statement with respect to specific features of the bill. However, they take the following exceptions regarding approval of tax reductions under existing budget conditions: The Ohio Chamber of Commerce favors tax reduction only within a balanced budget.[1] The East Texas Chamber of Commerce and the Virginia State Chamber of Commerce favor tax reduction provided it is accompanied by an equivalent concurrent reduction in Federal expenditures.

(The organizations are as follows:)

Alabama State Chamber of Commerce.
Arkansas State Chamber of Commerce.
Colorado State Chamber of Commerce.
Connecticut State Chamber of Commerce.
Delaware State Chamber of Commerce.
Florida State Chamber of Commerce.
Georgia State Chamber of Commerce.
Idaho State Chamber of Commerce.
Indiana State Chamber of Commerce.
Kansas State Chamber of Commerce.
Kentucky State Chamber of Commerce.
Maine State Chamber of Commerce.
Michigan State Chamber of Commerce.
Missouri State Chamber of Commerce.
Montana Chamber of Commerce.
New Jersey State Chamber of Commerce.
Empire State Chamber of Commerce (New York).
North Dakota State Chamber of Commerce.
Ohio Chamber of Commerce.
Pennsylvania State Chamber of Commerce.
South Carolina State Chamber of Commerce.
Greater South Dakota Association.
East Texas Chamber of Commerce.
West Texas Chamber of Commerce.
Lower Rio Grande Valley Chamber of Commerce (Texas).
Salt Lake City, Utah, Chamber of Commerce.
Virginia State Chamber of Commerce.
West Virginia Chamber of Commerce.
Wisconsin State Chamber of Commerce.

[1] At its Oct. 22, 1963, meeting, the Ohio Chamber of Commerce board of directors reviewed its previously established position on Federal fiscal policy and reaffirmed its stand that Federal income tax reductions designed to spur job expansion through greater investment in modern plants and machines are critically needed for the economic progress of the Nation. However, it is the conviction of the board of the Ohio Chamber of Commerce that such tax reductions should be accompanied by and concurrent with appropriate lowering of Federal expenditures, should extend to both personal and business income levies, and should be as large as possible within a balanced Federal budget.

Mr. Chairman, you may wonder why there are not more of the State chambers which take the same position with regard to tax reduction as the Ohio, East Texas, and Virginia chambers have taken; that is, insisting on expenditure reduction from present levels before taxes are cut.

The answer lies in the fiscal record of the last 17 years. Since 1947 we in the Council of State Chambers of Commerce have carried on a continuing active effort to hold down Federal budget expenditures. We have examined every single budget since the 1948 budget and have made recommendations to Congress for reducing them. Unfortunately, we cannot claim any great measure of success in our efforts over the years with the exception of 1948, 1954, and 1955.

Expenditures have been rising much faster than receipts with the result that in the 10-year period ending with fiscal 1964 there has been a net budget deficit of $40 billion. Moreover, a very substantial part of this spending increase has been for purposes other than national defense, interest, space, and international programs. Since 1954 domestic nondefense program costs have risen from $12.2 billion to an estimated $26.4 billion in 1964. This is an increase of 116 percent.

With this record before us, we can only conclude that there will be no reduction of present high tax rates in the foreseeable future if we must wait for tax reduction within a balanced budget. Accordingly, we have reluctantly come to the conclusion that we must try another course; that is, the course of attempting to force spending retraint by cutting tax rates and receipts.

TAX REDUCTION AND EXPENDITURE CONTROL

The State chambers of commerce have for years been active advocates of prudent Federal fiscal policies which would provide for balanced budgets in most years and a balance over the business cycle. In advocating this course the State chambers, directly and through their Washington research office, have given far more attention to Federal expenditure reduction and control than to any other Federal issues with which they are concerned. Consequently, it was with considerable doubt that they viewed the wisdom of tax reduction under the existing budget conditions when the subject was widely discussed a year ago.

On the other hand, we have had to admit that our efforts on behalf of economy have not been nearly successful enough to give us hope that tax reduction within a balanced budget could be attained within the foreseeable future. But reductions of individual and corporate tax rates are, in our opinion, so clearly and urgently needed for the good of the economy that we have decided to support such reductions despite the present unfavorable budget situation. The few exceptions to this position taken by individual State chambers have been noted earlier in this statement.

We believe that the statement of intent in section 1 of the bill and the House debate relating to the section will be useful. We recognize, of course, that it in no way provides assurance that the Congress or the President, who has stated accord with the section, will make a determined effort to restrain Government spending. If it were practicable to legislate a plan to control and reduce expenditures, we would certainly support such legislation. Practically, however, we have little hope for legislative enactment of budget control or a budget ceiling, which greatly disappoints us.

Thus, as a last resort, we urge as strongly as we can that the administration and the Congress clearly demonstrate their intent to bring spending under sufficient control to provide for budget balance at an early date. Such a demonstration should include laying aside the currently pending new spending measures, elimination of existing nonessential spending, and reduction of the costs of existing lower priority programs. Some real progress has been made toward this end so far in the current session, particularly in the House. But much more remains to be accomplished in the remaining weeks of the session. We trust that the House will live up to the commitment for spending restraint that its Members made in voting for the tax bill.

INVESTMENT NEED IS INADEQUATELY RECOGNIZED IN H.R. 8363

Our reservations with respect to the details of H.R. 8363 relate largely to its unduly heavy emphasis on the side of increasing aggregate dollars in the hands of consumers as compared to increasing funds and incentives for greater capital investment.

There is little evidence in economic statistics that stagnation exists at the consumption level but the data for recent years clearly points to such a situation with respect to capital investment. Personal income, disposable personal income, and personal consumption expenditures have all risen every year since 1956, including the recession years. Personal savings have also risen steadily with the exception of 1959 and 1960 when they fell off in spite of higher disposable income. On the other hand, capital investment expenditures reached a peak of $37 billion in 1957 and that total was not again reached until 1962.

The table in appendix A based on Commerce Department statistics shows that personal income has risen an average of 4.8 percent each year since 1956, disposable personal income has risen 4.6 percent on the average, and consumer expenditures have risen 4.8 percent a year. Personal savings have risen at the slower average rate of 2.6 percent and capital investment at a rate of only 1.6 percent. In comparing the data for 1962 and 1956, it is noted that gross personal income, disposable personal income and consumer expenditures were all up more than 30 percent. Capital expenditures reached an all time record level in 1962 but still were only 6.6 percent above 1956.

The advocates of tax reduction to create additional consumer purchasing power argue that tax reduction to spur investment is not essential because our industry generally already has overcapacity. For evidence of overcapacity they cite the fact that many industries are operating at rates considerably below 100 percent. They ignore the fact that much of the existing capacity is obsolescent and uneconomic under current cost and competitive conditions. Secretary Dillion cited this fact when he testified before the Ways and Means Committee on May 3, 1961, in support of the investment tax credit. He said:

The average age of our plant today is 24 years. While this is an improvement over the immediate postwar years, our plant is much older than during the twenties. Much more serious is the fact that the average age of our business machinery and equipment has been rising over the past decade. It now averages more than 9 years, and from 1954 to 1959 the stock of equipment over 10 years old rose by 50 percent. While no comparable figures are available for Western Europe, all the information we do have indicates that the plant and equipment of our friends and competitors are considerably younger than ours.

In addition to the huge potential investment demand in the need for modernization of our industry, another large potential investment demand is in the development of new and better products and processes and new businesses. It is this area in which incentives and availability of investment funds are particularly inhibited by high progressive income taxes and high corporate taxes. And it is through investments for new and better products and processes and for the creation of new business that the greatest possibility exists for creation of new jobs. Merely increasing consumer demand for existing products would not necessarily create a need for a proportionate increase in employment.

As I have already indicated, we believe H.R. 8363 is too heavily weighted toward consumption with the benefits to investment probably being insufficient to accomplish the economic growth objectives of the bill. In order to correct this situation we urge moderation of the steep progression in the middle income rates for individuals in the House bill and meaningful rate reductions for corporations without any "take back" provisions such as the accelerated payments schedule. We would suggest that an early objective should be an individual rate schedule with a top rate not exceeding 50 percent.

STRUCTURAL CHANGES

Exclusive of the table of contents, H.R. 8363 is 304 pages in length. Title II entitled "Structural Changes" starts on page 28 and continues to page 277, or a total of 250 pages. The other 54 pages deal solely with tax rate changes and the declaration of intent of section 1. The revenue estimates on pages 12 and 13 of the report of the Ways and Means Committee indicate that the net change in revenues from structural changes and the minimum standard deduction for the calendar year 1965 is an increase of $570 million.

The administration has expressed a sense of urgency about the prompt enactment of tax reductions. We suggest that an effective way to accomplish this objective is for your committee to deal only with the subject of income tax rate reductions and defer to the future the reconstruction of our tax system. Many of the structural changes in H.R. 8363, including the minimum standard deduction, are controversial, fit no logical pattern, unnecessarily complicate the tax code, do not qualify in any true sense as tax reform, and result in no important net revenue effect.

But if your committee decides that provisions other than rate changes must be included in the tax rate reduction bill, we submit for your consideration a brief statement of our views on those changes in H.R. 8363 that have been considered by our group.

Current payment of corporate tax liabilities: We are opposed to the provision accelerating the payment of taxes of those corporations with annual tax liability in excess of $100,000. The schedule of accelerated payments would substantially nullify the benefits of rate reduction of the next 7 years. The proposal would create difficult compliance problems for industries with sharp seasonal fluctuations. In many instances it is hard enough now for calendar year corporations even to estimate income by the required September 15 filing date. In their cases, an April 15 first estimate dated would pose a virtually impossible problem. We believe the proposal should be rejected as a measure which largely defeats the purpose of corporate rate reductions, creates severe compliance problems for seasonally fluctuating industries, and serves no other useful purpose than to provide some temporary relief for an adverse budget situation.

Minimum standard deduction: The $300 minimum standard deduction provision would have the same effect as an increase in the personal exemption of low-income taxpayers. It would be particularly applicable to part-time wage earners, and we see no reason why they should not pay some tax. We have long believed that in order to secure the greatest popular participation in the cost of Government, a policy of low exemptions should be continued. We, therefore, urge you to reject the minimum standard deduction.

Repeal of dividend credit: Repeal of the modest relief now available to investors from double taxation of corporate earnings paid as dividends is completely illogical. We certainly agree in the need to accelerate economic growth but it does not make sense to us to further penalize an importnt source of capital formation in seeking the objective. Instead of being repealed, the dividend credit should be enlarged at the earliest practicable date. This would be a positive move to encourage more investment in equity capital which is a basic source of economic growth.

Investment credit: Since the Congress saw fit to enact the 7-percent investment credit as a part of our tax structure, we believe that it should be made more workable. We support the changes voted by the House, although we were opposed a year ago to the enactment of the investment credit.

Exclusion of employer-paid premiums on group term life insurance: We are opposed to the provision limiting the exclusion from gross income of employer-paid premiums on group life insurance. Since term insurance accumulates no cash surrender value and the employee has no control over its continuity, we fail to see how an employee receives real income from participating in a group contract. This proposal would jeopardize many longstanding, worthwhile plans. If, nevertheless, your committee believes that properly taxable income is derived from employer contributions, then the measure of income should be the average employer costs for all participants irrespective of age and not the provisions of the House bill.

Sick pay exclusion: We support the House provision limiting the exclusion from gross income to compensation received for periods of illness beyond the first 30 days.

State and local taxes: Limitation of deduction of State and local taxes to property taxes, income taxes, and general sales and use taxes is opposed as discriminatory with respect to States which rely heavily on other types of taxes. In due course, this provision would force affected States to change their tax systems and defeat the purpose of the limitation of deductions. We also oppose the repeal of section 164(b)(5)(B) which permits deduction of taxes levied for local improvements if certain conditions are met.

Personal casualty losses: We support the provision limiting deduction of casualty losses to the extent each loss exceeds $100.

Moving expenses: We support the objectives of the moving expense provisions of the House bill, but the provisions in the bill should be expanded to cover all legitimate costs incurred by new or existing employees in moving to a new job assignment. We also recommend that the loss reimbursement in connection with the sale of a home by reason of a job transfer be considered as a capital transaction. We feel that the moving expenses should be broadened to take in all legitimate expenses incurred by an employee moving from one location to another, whether he is presently employed by the company or is a new employee.

Stock options: Provisions amending existing rules with respect to stock options and stock purchase plans are acceptable with certain exceptions as follows: The existing 10-year period for exercise of stock options and purchases should be retained; the first in, first out rule in the bill for exercise of the outstanding stock options should be eliminated; the holding period should not exceed 2 years; and gains on stock options held over 2 years should be treated as class A capital gains if the capital gains provisions of the bill are enacted. The effective date should be the date of enactment.

Aggregation of oil and gas properties: We take the position that no action should be taken in the depletion area pending the conclusion of the full study which the President has recommended. If, however, your committee believes it must reverse the 1954 rule regarding aggregations of oil and gas properties, we believe such change should not be given retroactive effect. In other words, aggregations permitted beginning in 1954 and extending through 1963 should be continued for future tax computations.

Iron ore royalties: We do not favor the bill's provisions extending capital gains treatment to iron ore royalties.

Capital gains and losses: Reductions of the maximum rate and the inclusion percentage are steps in the right direction, but these provisions are accompanied by considerable complications in the treatment of capital gains. The rate and inclusion reductions should be effected in connection with present capital gains provisions. Indefinite carry-forward of losses for individuals is desirable and it should also be granted to corporations.

Consolidated returns: We support the provision for repeal of the 2-percent penalty tax on consolidated returns. We also believe that the existing provision for taxation to a recipient corporation of 15 percent of the dividends from a domestic corporation should be repealed.

Multiple surtax exemptions: We oppose the levying of a penalty tax of 6 percent on the first $25,000 income of affiliated corporations when consolidated returns are not filed. The penalty tax would tend to discourage investments in new small businesses and would adversely affect many existing small businesses which, though related in ownership, are separately incorporated and operated for legitimate business reasons. That concludes my statement.

24-582—63—pt. 2——32

(The attachment referred to follows:)

APPENDIX A

BILLIONS OF DOLLARS

Calendar year	Personal income	Disposable personal income	Personal consumption expenditures	Personal savings	Capital investment expenditures
1956	332.9	292.9	269.9	23.0	35.1
1957	351.4	308.8	285.2	23.6	37.0
1958	360.3	317.9	293.2	24.7	30.5
1959	383.9	337.1	313.5	23.6	32.5
1960	400.8	349.4	328.5	20.9	35.7
1961	416.4	363.6	338.1	25.6	34.4
1962	440.5	382.7	356.7	26.0	37.4
PERCENTAGE INCREASES OVER PRECEDING YEAR					
1956					
1957 over 1956	5.6	5.4	5.7	2.6	5.4
1958 over 1957	2.5	2.9	2.8	4.7	−17.6
1959 over 1958	6.6	6.0	6.9	−4.5	6.6
1960 over 1959	4.4	3.6	4.8	−11.4	9.8
1961 over 1960	3.9	4.1	2.9	22.5	−3.6
1962 over 1961	5.8	5.3	5.5	1.6	8.7
Average	4.8	4.6	4.8	2.6	1.6
1962 over 1956	33.7	30.7	32.2	13.0	6.6

Source: Economic Report of the President, January 1963, tables C. 15 and C. 34.

The CHAIRMAN. Thank you, Mr. Connolly. Any questions? Thank you.

The next witness is Mr. Walter E. Hoadley of the Armstrong Cork Co.

STATEMENT OF WALTER E. HOADLEY, VICE PRESIDENT AND TREASURER, ARMSTRONG CORK CO., ACCOMPANIED BY JESSE R. SMITH, WASHINGTON COUNSEL

Mr. HOADLEY. Thank you, Mr. Chairman and members of the committee. My name is Walter E. Hoadley, vice president and treasurer of the Armstrong Cork Co., of Lancaster, Pa. I have with me Mr. Jesse R. Smith, our Washington counsel. I also serve as chairman of the Federal Reserve Bank of Philadelphia and as a professional economist. My statement today, however, is as a representative of my company and not as a Federal Reserve official.

Much of what is here has already been said by many of the previous men who appeared before this committee.

Armstrong is a manufacturer of resilient flooring and building materials, consumer products, industrial specialties, and packaging materials. It has annual sales in excess of $325 million, total assets of over $230 million, 17 plants in 12 States, with subsidiaries located in a number of countries of the free world. Our total employment in the United States is more than 16,000, with an additional 3,000 abroad. We have 14,000 shareholders.

I want to thank the committee personally and on behalf of Armstrong for the privilege of appearing here today to present our views. We have a deep and continuing interest in the work of the Congress and great respect for the sincerity and dedication with which Members of this body approach their work.

May I say at the outset that we do not claim to be expert on all phases of such a complicated piece of legislation as the tax bill you now have under consideration. Therefore, it will be my intention to comment brifely only on certain specific aspects of the measure and on its probable general economic effects. The nature of my remarks, as you will see, will indicate our endorsement of the principle that tax legislation should seek to raise revenue for essential Government programs rather than to achieve social reform.

There is widespread agreement now that our present tax system is a major deterrent to acceleration of national economic growth and that a tax reduction is needed in order to reinforce personal and corporate incentives. We certainly agree with this viewpoint because we feel that present tax rates place a severe penalty upon success and materially reduce desire to make added investments. Thus, we firmly believe the work you have at hand is vital to the future growth of the country. An important secondary objective of new tax legislation should be to simplify our tax system which is most complicated. We trust you will work in this direction in your examination of H.R. 8363.

A tax cut per se is not an economic panacea. If it is in an appropriate form, it can help spark increased effort, ingenuity, and risk taking. In considering tax-rate reduction, we recognize that there are sharp differences in theory and opinion as to the best course of action to achieve faster economic growth. On the one hand are those who believe in the so-called purchasing power theory which holds that increasing spendable income in the large, lower income group is the most effective way to stimulate economic growth. On the other hand are those who are convinced that the best way to promote faster and sustainable growth is to increase incentive to investment and job creation. We at Armstrong recognize some validity in both theories. But we contend that revitalized investment incentives will provide the most enduring stimulation to bring about the kind of growth needed for the years ahead. This can be accomplished most practically and immediately by a substantial tax reduction.

A tax cut will, of course, mean some temporary loss of revenue, which must be carefully weighed in projecting the future level of Government expenditures. Genuine restraint in Government spending will be required because continued deficits adversely affect confidence in the soundness of the dollar both at home and abroad. For example, at present a fairly large segment of the general public seems to be concerned about the future financial position of the United States in light of the continued outflow of gold.

The contention that Government spending and Federal deficits will produce sustainable faster economic growth is not very well supported by the record. We have not noticed that they have had a sustained, stimulating effect upon our market opportunities. Rather, the Armstrong Cork Co. and most other companies manage to grow profitably by carefully reviewing the investment possibilities available at prevailing tax rates and by selecting those projects that offer a satisfactory return and reasonably rapid payout.

After commenting on certain specific aspects of H.R. 8363, I want to return to this general topic briefly and discuss some broader implications of a tax cut at the present time as well as the need for further restraint in Government spending as they relate to our Nation's economic future.

While nearly everyone agrees that our Federal income tax rates are too high, there is little or no agreement as to how much and what kind of tax rate relief is needed. We believe the country's long-range welfare requires a more substantial reduction in both individual and corporate rates than is contained in H.R. 8363.

To provide adequate financial reward for the saver, the investor, the innovator, and the risk taker, a market enterprise society must permit them to retain a sufficiently large portion of the fruits of their endeavor to make expanded effort and risk taking worthwhile. While we would not presume to specify the exact amount of reduction needed, the amount provided in H.R. 8363 falls far short of the reductions recommended by a large majority of tax authorities who have given the matter serious study. But even this reduction is an important start and is helpful, provided we recognize that it is only a start. Further reduction in Federal income tax rates is a necessity if we are to expand our economy not only to keep pace with the growing needs and demands of our population, but also to improve our international competitive and balance-of-payments position. We would hope the bill and the report of the Finance Committee will recognize the principle that further cuts in personal and corporate income tax rates are needed as part of a long-range program of tax revision.

We feel strongly on this matter because we know that a meaningful tax reduction will stimulate investment, and hence economic growth and employment. The greatest shortage in the United States now is in the number of new, profitable ideas at existing tax rates.

Our company's evaluation of capital expenditure projects, or our incentive to commit cash, rests largely on the anticipated level of return on capital employed (the ratio of net profit after taxes to total assets employed). Accordingly, we are convinced that capital investment incentives increase as corporate tax rates are reduced. We know of no other more powerful economic force for expansion than to make existing and contemplated investment projects more profitable by a sharp cut in the corporate tax rate.

Similarly, high personal income tax rates reduce incentives for individuals to work and be productive. It has been the experience of many business organizations that capable individuals sometimes refuse to accept more responsible, higher paying positions for income tax reasons.

Nor does the repressive influence of our present tax structure stop here. We depend on hundreds of wholesalers and thousands of retailers, virtually all small businessmen, to distribute a major portion of our product lines. Armstrong, as a manufacturer and employer, can expand and create additional employment only to the extent that our distribution keeps pace. Time and time again in recent years, we have had distributors, dealers, and contractors tell us that further risk taking investment to expand was just not worth the effort as they reached the point where tax disincentives began to exert a negative influence.

As a nation we now face a rather sobering question—how can we hope to accelerate economic growth as long as (1) numerous successful small business managements see little point in trying to expand because of the high toll of personal taxes, and (2) larger corporation managements, despite a strong desire and available funds to expand, confront a lack of investment opportuntics that will be profitable at prevailing tax rates, not to mention strong antibigness campaigns in government? So long as this situation persists, the outlook for accelerated national growth must remain limited.

One other comment should be made concerning tax rate reductions. The amount of reduction proposed for the middle income brackets seems insufficient to give a satisfactory financial incentive to this group that has great influence upon the potential growth of our economy. Moreover, the proposed rates in the middle income brackets are more steeply progressive than in other brackets. Additionally, the maximum rate is still too high.

Turning now to some other features of the bill.

Section 201 would eliminate, over a 2-year period, the present 4-percent dividend credit while increasing the dividend exclusion from $50 to $100. The dividend credit has represented a small effort to mitigate the unfairness of double taxation of corporate profits. Rather than eliminate the dividend credit, this tax bill, we believe, should grant broader relief by increasing the amount of the credit and by providing for eventual elimination of the personal income tax on dividend income.

In this manner we could revitalize investment incentives and help establish the tax climate for a larger dollar volume of investment which is needed to provide jobs for our rapidly growing labor force. The proposed increase in the dividend exclusion is helpful, but alone will not provide sufficient relief from double taxation or any appreciable new stimulant to large-scale investment of risk capital.

On another provision of the measure—we are pleased that the tax bill passed by the House has eliminated a troublesome provision with regard to the 7-percent investment credit. Under this amendment, taxpayers will no longer be required to reduce the basis of depreciable property by the amount of the credit. The original provision was inserted in the Revenue Act of 1962 by the Finance Committee for the very understandable purpose of reducing revenue loss, especially in a deficit year. However, the adjustment to the basis required under the 1962 bill created many difficult problems, particularly for multistate corporations listed on the stock exchanges. These problems were rendered much more complex by a conflict in accounting treatment of the adjustment as determined by the Securities and Exchange Commission and the Accounting Principles Board of the American Institute of Certified Public Accountants. Moreover, a lack of uniformity among State tax authorities in the treatment of the investment credit and the adjustment to the depreciation base made the filing of State income tax returns most difficult. Section 202 of the House bill removes this problem and should be upheld.

The next section of the Revenue Act of 1963 deals with group life insurance. This section, in our judgment, is most unfortunate. Group term life insurance partly paid for by the employer has become a common corporate practice throughout the Nation. It is a practice which has been encouraged by government, industry, and labor—and rightly so, because it provides at low cost a measure of protection for millions of families against the economic loss arising from the death of the principal family income producer. It is difficult for us to understand why this socially desirable protection has been singled out for attack. If the purpose of section 203 of the bill is to curb those plans which heavily favor a few individuals, then the many members of plans with equitable coverage are being unfairly treated. Would it not be better to substitute a multiple of annual earnings—such as two or two and a half times annual earnings—for the $30,000 limitation?

Turning now to the subject of stock options. Mr. Smith has testified before this committee back in July 1961 on stock options. Our position at that time is the same now. We believe that properly drafted and approved restricted stock options exert a strong positive influence for growth. Our restricted stock option plan at Armstrong has proved to be a highly effective management incentive. Coupled with our emphasis on return on capital employed, it has contributed materially to our record of profitable growth. We have issued stock options to over 300 people, which indicates ours is a broadly based plan. More than 90 percent of the stock purchased by these management people is still owned by them.

In the light of this experience, our reaction to the provisions of H.R. 8363 dealing with stock options is somewhat mixed. Certainly no one should quarrel with the requirement that stock option plans be approved by the stockholders. Armstrong's plan, as is the case with plans of most responsible companies, has had such approval. Furthermore, it is reasonable that the option price should be not less than the market price on the date of the grant of the option.

However, the provision which cuts from 10 to 5 years the period during which the option may be exercised, in our view, will materially reduce the effectiveness of the option as an incentive to management for top performance. The value of an option depends upon the market value of the stock, which in turn must depend, over any extended period of time, on the company's performance. And performance is dependent to a large extent on the efforts of management—the people who hold the options. It commonly takes more than 5 years for the efforts of optionees to be translated into improved company performance that is reflected in the market price of the stock.

The reduction from 10 to 5 years would also penalize the able younger members of management who are on their way up. They are not men of independent means. It is no secret that many take up their options with borrowed funds because of the difficulty of saving the necessary money over a 10-year period. A reduction to 5 years would make it still more difficult for them and force many, doubtless, to sell their shares rather than hold them. This defeats one of the prime purposes of option plans; namely, to encourage management to gain a permanent, proprietary interest in the business.

In addition, we think that it is harmful to require a holding period of 3 years for stock acquired under an option. The purchase of stock inevitably involves financial risk, and to require an optionee to hold his stock for 3 years or else suffer punitive tax treatment is unreasonable. In the interest of tax law simplicity, the holding period should be limited to the 2-year holding period which the bill would require for class A capital gains and losses. Thus we can avoid a proliferation of categories of capital gains and losses.

With respect to section 219 of the bill which creates new class A capital gains and losses, I should like to say that we regard this as a desirable amendment. Not only does it provide some measure of tax rate relief, but it should have some healthy effect in making stocks more readily available in the marketplace.

As I indicated earlier, I would like to return now to an examination of the need for restraint in Government spending along with a tax cut in order to assure the steady progress of our economy.

There is growing alarm in many business and financial quarters in this country and abroad over the high and rising level of Government expenditures and the resulting large and persistent Federal budget deficits. Deficits now do not per se result in inflation now. The record clearly shows this. For example, we have had an almost uninterrupted succession of deficits in recent years but have not had inflation in terms of scare buying and rapidly rising prices. Instead, we have had surpluses of goods and many price declines. The reason essentially is that we have had excess capacity and intense sales competition on all sides.

However, chronic Federal deficits certainly set the stage for inflation to occur at some time in the years ahead when the right conditions prevail. It might be said that by piling up deficit upon deficit we are steadily packing the cellar with economic and psychological dynamite. The right conditions could put a fuse to this explosive.

What might be the right circumstances for this to happen? There are many, but the most important are: First, loss of confidence: that is, when the public begins to think it should convert money into goods as a hedge against future loss of purchasing power; and, second, basic shortages in goods resulting from demand having more than overtaken capacity, aggravated by the loss of confidence just mentioned.

What are the chances that these things will happen? Let's take a look at the future to examine some of the forces that seem likely to be operating during the balance of this decade.

We see a rather mixed economic picture for the United States, with the outcome of the tax legislation now before this committee of more than passing significance.

Despite many pressing problems, this country's underlying economic strength currently remains great. The most convincing evidence of strength is the success our economy has had in resisting severe postwar adjustments. This has been especially true since 1957, when certain conditions have prevailed which historically could have been expected to cause a deep recession or even a depression: for example, the virtual absence of shortages, lower family formations, obviously excessive agricultural and industrial capacity, diminished investment returns on private capital, greatly intensified international competition, and lessened world confidence in the dollar. In short, the Nation has thus far succeeded in bringing successfully a major part of what might be termed a "valley of potentially serious postwar adjustment."

In our judgment, a resurgence of natural growth factors now looms on the horizon in the second half of this decade. In our opinion, there will be a rising need for more basic industrial capacity within the next 2 or 3 years. Indeed, some modest improvement in plant and equipment expenditures is already underway. Replacement demand arising out of early postwar purchases of durable goods is gradually assuming important market dimensions. Family formations are starting to increase. Enlarged research programs in recent years are foreshadowing a stepped-up flow of new products and processes, thus accelerating the rate of obsolescence and replacement buying. However, these developments, though encouraging, are not likely to assume major growth proportions for a while.

In the meantime, it is essential that the moderating but still considerable forward momentum currently evident in the economy not be lost. It now appears to us that national economic gains in 1964 very likely will be less than those being achieved in 1963—which in turn are almost certain to be smaller than the advances made in 1962.

While there is widespread optimism toward general business prospects next year, there appears to be somewhat less confidence now than ever a few months ago, and a few signs of potential weakness must not be ignored; for example, in consumer credit, in scattered areas of the building industry, and in international trade with its adverse balance-of-payments overtones. Reports from our representatives in Western Europe also indicate some definite slowing in the rate of economic advance there. Any convergence of economic adjustment forces at home and abroad obviously would pose a more serious threat to U.S. growth and stability than we have faced since the end of World War II.

One of the principal factors contributing to both the economic gains and business confidence this year is that plans for 1963 were made conservatively a year ago in an atmosphere of international tension as well as concern about near-term domestic business prospects. "Beating" corporate sales and profits budgets, such as has occurred widely this year, has been a significant psychological stimulant to improved business and employment in 1963. Perhaps equally important, anticipation of tax relief by early 1964, in our opinion, has caused many individuals and business firms to make spending decisions earlier and on a somewhat greater scale. Consequently, failure of the Congress to enact tax reduction legislation in the next few months is almost certain to cause some psychological letdown and economic slowdown across the country.

The danger is not that a moderate advance will fail to materialize next year, but rather that exaggerated expectations of gains will lead to disappointment and eventually to cutbacks in operations and employment late in 1964 and also in 1965 if signs of weakness begin to accumulate. The most effective answer to this problem, we think, is to be found in public policies which strengthen personal and business incentive and which build confidence at home and abroad. Tax relief legislation which will fulfill these objectives can do a great deal (1) to prevent our economy from dropping into what still remains of the valley of potentially serious postwar adjustment and (2) to assure a more accelerated rate of growth over the longer term period ahead.

At the same time we must have more positive assurance of economy in Government and restraint in spending than have been given thus far. We need a tax cut to increase private incentive and also a curb on Government spending to increase private confidence in the future of the dollar.

Stated in its simplest terms, this seems to be the situation. Shortages do not yet exist, but demand is gradually catching up with capacity. If we do not meet fully the substantial needs for additions and improvements to capacity to be required in the next few years—

by the time the strong natural growth factors mentioned earlier come into play in the last half of this decade—we will have set the stage for a new wave of inflationary psychology and speculation which can undermine our economy. We will, in effect, be dropping the fuse into that basement full of "deficit" dynamite. We could well have a tremendous inflationary surge, followed by a deep and far-reaching economic adjustment which no one wants.

We believe that the best way to protect against future shortages, and thus to prepare against this eventuality, is to begin a program of substantial tax reduction soon as an inducement to invest in added and improved capacity—all in an atmosphere of curbed Government expenditures and rising confidence.

We fully appreciate that this committee does not have responsibility for the control of Federal spending, but the individual members comprise one of the most influential groups in the Congress. Our concern is that we do a better job of balancing Federal revenues and expenditures while encouraging private individuals and businesses to spend and invest more in growth accelerating projects. Achievement of this twofold objective will minimize the threat of economic instability, strengthen our economy to meet Communist competition, help our balance-of-payments problem, and work toward a constantly improving standard of living for all of our people.

Thank you.

The CHAIRMAN. Thank you very much.

Any questions?

Senator LONG. I have read your full statement before you testified, Mr. Hoadley, and I think you have made a very good statement. It is very firm and very concise.

I don't know whether the theory you have advanced might appeal more to a businessman. I noticed that President Eisenhower had suggested that we should reduce the number of troops in Europe. If we do that, that would probably in itself solve our balance-of-payments problem that has been completely out of control for the past several years, would it not?

Mr. HOADLEY. Sir, I happen to be serving on an eight-man committee for the Budget Bureau, and the White House, reviewing the balance-of-payments statistics.

My quick reaction is that the review we have made so far leaves a good deal still unanswered in respect as to the measurement of the problem and the nature of the magnitudes involved.

I doubt seriously whether any development or recommendation per se is likely to solve the balance-of-payments problem per se. The suggestion to which you refer is one which obviously can be made only by an individual who is knowledgeable in the field of our defense.

As a layman I would say if this is a development on which we can have reasonable assurance, obviously this would be a factor of some consequence. I am impressed, however, with the number of contentions as to what the effect is of many of our expenditures or alleged expenditures overseas as far as the American economy is concerned.

In short, what I am saying, Senator, is that in business when we have a problem of a deficit or a potential deficit, we establish quickly priorities as to what we can do and what we can't do. I strongly recommend that we not try to solve the problem as it were by one simple solution, but rather we assign priorities in the judgment of the people best able, and proceed to take action on that score. This may well be one of the high priorities. I am in no position to say personally, although I would hope it would be true.

Senator LONG. Although I am not a member of the same political party as General Eisenhower, it has always been my feeling that the number of troops we are keeping over there in Europe was very excessive, and that of course in the field of foreign aid my general feeling has been that we shouldn't do anything that they are not capable of doing for themselves.

Now, if we leave one or two divisions over there equipped with atomic weapons to back up what those people can provide, it seems to me that they could provide the overall manpower. Likewise, I suppose you know that we still have about $400 million for Western Europe in this foreign aid bill, just sort of by force of habit.

Europe already has enough dollars to empty Fort Knox, but we have about $400 million more for them in this bill. They ought to have a foreign aid program for us the way things are going. Yet we still have $400 million increment in the foreign aid program for them.

Mr. HOADLEY. I share your view, sir, very strongly.

Senator LONG. I don't know where all these economies could be made, but I know on one occasion this Senator had the opportunity to serve as chairman of a subcommittee involving military construction, and with the aid of some engineers we managed to reduce about 23 percent of that construction budget, and challenged them to show us where that would impede defense in the slightest, and they were not able to do it.

They could talk in general terms, but when you say, "Show us a single reduction that will keep you from doing something" they couldn't show it. So there are a lot of possibilities in this budget for major reductions if someone really makes up his mind he is going to do it? Aren't there?

Mr. HOADLEY. I think that is certainly a very constructive attitude and very businesslike, we would say, from the point of view that I am reflecting this morning.

Senator LONG. Thank you very much.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. No questions.

The CHAIRMAN. Thank you very much, Mr. Hoadley.

Mr. HOADLEY. Thank you, sir.

The CHAIRMAN. The committee will adjourn until 10 o'clock Monday morning.

Thank you.

(Whereupon, at 1:15 p.m., the committee was in recess, to reconvene at 10 a.m., Monday, October 28, 1963.)

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Calendar No. 805

88TH CONGRESS } 2d Session } SENATE { REPORT No. 830

1565-

REVENUE ACT OF 1964

REPORT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

TO ACCOMPANY

H.R. 8363

A Bill To Amend the Internal Revenue Code of 1954 To Reduce Individual and Corporate Income Taxes, To Make Certain Structural Changes With Respect to the Income Tax, and for Other Purposes

TOGETHER WITH

Individual and Minority Views

JANUARY 28, 1964.—Ordered to be printed

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CONTENTS

Calendar No. 805

88th Congress, 2d Session | SENATE | Report No. 830

REVENUE ACT OF 1964

January 28, 1964.—Ordered to be printed

Mr. Long of Louisiana, from the Committee on Finance, submitted the following

REPORT

Together with

INDIVIDUAL AND MINORITY VIEWS

[To accompany H.R. 8363]

The Committee on Finance, to whom was referred the bill (H.R. 8363) to amend the Internal Revenue Code of 1954 to reduce individual and corporate income taxes, to make certain structural changes with respect to the income tax, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

I. SUMMARY

This bill, H.R. 8363, the Revenue Act of 1964, provides $11.6 billion of tax reduction scheduled over a 2-year period, the bulk of the relief, however, becoming effective within a month of enactment. The bill will cut back on excessive tax rates which unnecessarily restrain individual and business incentives, it will provide the increased consumer and business purchasing power to assure continued expansion, and it will improve the equity of the tax system.

(*a*) ***Revenue.***—The bill when fully effective in 1965 will reduce tax liabilities of individuals by $9.2 billion and of corporations by $2.4 billion. At constant income levels the bill would reduce receipts by $1.9 billion in fiscal year 1964 and $8.4 billion in fiscal year 1965 (including the $1.9 billion reduction from 1964). Taking into account the effect of this reduction in increasing private expenditures and income, the net effect on revenues is expected by the Treasury Department to be a reduction of $1.7 billion in fiscal year 1964 and $4.3 billion in fiscal year 1965.

(*b*) ***Rate reduction.***—

1. ***Individual.***—As in the House bill, individual rates are reduced from the present range of 20 to 91 percent to a new range of 16 to 77 percent in 1964 and to 14 to 70 percent in 1965. The bill provides that the withholding rate, presently 18 percent, will be reduced to 14 percent, effective within a week after enactment.

2. ***Corporate rate.***—As in the House bill, the tax rate for corporations in 1964 is reduced from 52 to 50 percent and is further reduced in 1965 to 48 percent. In addition, the rate applicable to the first $25,000 of corporate income beginning in 1964 is reduced from 30 percent to 22 percent. Furthermore, corporations are placed on a full pay-as-you-go basis so that ultimately all of their tax liability above $100,000 is to be payable in the year in which it is earned. This is achieved over a 7-year period so that it will not increase corporate cash outlays for tax payments in any year of the transitional period.

(*c*) ***Structural changes.***—In addition to rate changes the bill provides a number of provisions designed to increase the equity of the present tax law. Some of these increase and others decrease the revenue. The major items are:

1. ***Minimum standard deduction.***—The bill provides that each taxpayer may have a minimum standard deduction of $300 plus $100 for each additional exemption. This relieves from tax all single individuals with incomes up to $900, and all married couples with incomes up to $1,600.

2. ***Dividend credit and exclusion.***—The 4-percent dividend received credit is reduced by the bill to 2 percent for 1964, and repealed for subsequent years. The $50 dividend exclusion is increased to $100 for 1964 and subsequent years. In practical effect, this increase is from $100 to $200 for married couples.

3. ***Retirement income credit.***—The bill provides that in computing the retirement income credit the limit on retirement income is to be raised from $1,524 to $2,286 in certain cases where a joint return is filed.

4. ***Investment credit.***—In the case of the investment credit, the bill (*a*) repeals the provision requiring a 7-percent downward adjustment in the basis of property eligible for depreciation to the extent that the investment credit applies; (*b*) prevents regulatory commissions in certain cases from requiring the "flowthrough" of the benefits of the investment credit to the customers of regulated industries; and (*c*) makes other revisions in the investment credit.

5. ***Group term insurance.***—The bill limits the employee exclusion for premiums on group term insurance furnished through the employer to premiums paid for the first $70,000 of coverage.

6. ***Sick pay exclusion.***—The bill restricts the sick pay exclusion, of up to $100 a week, only to those who are absent from work for more than 30 days (and makes the exclusion available only for the period beyond that time).

7. ***Sale of residence by aged taxpayer.***—The bill provides an exclusion from the tax base for the gain attributable to the first $20,000 of the sales price of a personal residence in the case of an individual aged 65 or over.

8. ***Deduction of certain State and local taxes.***—The bill denies a deduction in computing income subject to Federal tax for State and

local taxes other than property, income, general sales taxes, gasoline, and auto license (the principal taxes for which a deduction is denied are alcoholic beverage, cigarette, and selective excise taxes).

9. ***Casualty loss deduction.***—The deduction for personal casualty and theft losses is limited to the amount in excess of $100 per loss (similar to "$100 deductible" insurance).

10. ***Charitable contribution deduction.***—Several changes are made in the charitable contribution deduction: (*a*) The 30-percent maximum deduction is made available generally for contributions to publicly supported organizations other than private foundations; (*b*) the 2-year carryover of charitable contributions for corporations is extended to 5 years; (*c*) a 5-year carryover is provided for individuals with respect to contributions to publicly supported organizations; (*d*) the unlimited charitable deduction is restricted to contributions to publicly supported organizations; and (*e*) charitable contributions deductions for future interests in tangible personal property are denied until the gifts are completed.

11. ***Foreign expropriation losses.***—The bill permits a taxpayer which has sustained a substantial foreign expropriation loss after 1958 to carry over that portion of a net operating loss arising from the foreign expropriation loss for 10 years without any carryback.

12. ***Medical expense deduction.***—The 1 percent limitation, or floor, on medicines and drugs which must be taken into account in determining deductible medical expenses is made inapplicable where the taxpayer or his wife is over 65 and also with respect to such expenses for dependent parents over 65.

13. ***Child-care expense deduction.***—The child-care deduction is revised (*a*) to make it available in the case of a wife who is incapacitated; (*b*) to make it available with respect to care for children up to age 13 (instead of 12); (*c*) the maximum deduction allowable where there are two or more children is increased from $600 to $900, and to $1,000 where there are three or more children; and (*d*) the present limit on the family income in the case of a working wife is raised from $4,500 to $7,000.

14. ***Moving expense deduction.***—A deduction for certain moving expenses—transportation of the household goods and the persons involved, and also their meals and lodging while in transit—is allowed for employees who are not reimbursed for these expenses and also for new employees (an exclusion for these items is already available in the case of old employees who are reimbursed). Old employees who are reimbursed for certain costs and losses in connection with the sale of their old home, occasioned by a move, are permitted to treat the reimbursement as sale proceeds rather than compensation.

15. ***Political contribution deduction.***—The bill allows individuals a deduction, limited to $50 a year ($100 on a joint return) for contributions to any political candidate or political committee to further the candidacy of individuals.

16. ***Intercorporate dividend deduction for certain affiliated groups.***—The bill provides that certain affiliated groups eligible to file a consolidated return, but not doing so, may take under certain conditions a 100-percent deduction for intercorporate dividends received from other members of the group if the group agrees to be treated as a single entity for certain purposes, such as the surtax exemption.

17. ***Face amount certificate companies.***—The bill provides that a "face amount certificate company" shall not be subject to disallowance of a deduction on interest paid with respect to face amount certificates under section 265(2) of the code (relating to interest indebtedness to carry tax-exempt bonds on tax-exempt income) to the extent that tax-exempt obligations do not constitute more than 25 percent of the average of the total assets.

18. ***"Bank loan" insurance.***—An interest deduction is denied for amounts borrowed under a systematic plan to pay premiums on life insurance (certain exceptions are provided).

19. ***Corporate reorganizations.***—The bill provides tax-free status to a stock-for-stock reorganization, where the corporation acquiring the stock exchanges either its voting stock or the voting stock of a corporation which is in control of the acquiring corporation.

20. ***Travel expense deduction.***—The bill repeals the rule, adopted in 1962, which disallows a portion of travel expenses for certain business trips which are combined with a vacation.

21. ***Pension plans.***—The bill permits retroactive qualification for certain pension plans under multi-employer collective bargaining agreements. It also permits a U.S. corporation to extend coverage under its qualified pension, profit sharing, etc., plan to certain U.S. citizens employed by subsidiaries operating outside of the United States.

22. ***Stock options.***—The present tax treatment of employee stock options is further restricted, the principal additional restrictions being: (*a*) the stock when acquired must be held for 3 years or more; (*b*) the option must not be for a period of more than 5 years; (*c*) the option price must at least equal the market price of the stock when the option is issued; (*d*) stockholders' approval for the options must be obtained; and (*e*) the extent to which new options may be exercised when the old options are outstanding is restricted. Separate tax treatment is provided for employee stock purchase plans which are available to all employees on a nondiscriminatory basis under rules which are substantially the same as under present law.

23. ***Installment method.***—The bill treats all revolving credit sales as installment sales for tax purposes and also treats time payment charges as installment sales.

24. ***Deduction of contested liabilities.***—The bill would allow a deduction for the taxable year in which a taxpayer pays a tax or other liability, even though he contests the liability.

25. ***Interest on certain deferred payments.***—Where property is sold on an installment basis and either no, or very low, interest is charged on the installments, the bill provides that an appropriate amount of each installment is to be treated as if it were an interest payment.

26. ***Personal holding companies.***—The percentage of passive income which may result in a company being classified as a personal holding company is reduced from 80 to 60 percent and amendments are made so that the tax cannot be avoided by using rental income or oil or gas or mineral royalties (or working interests) to shelter substantial amounts of investment income, such as dividends and interest, from the personal holding company tax. Other restrictive amendments are also made. Relief is provided for those companies which are not now personal holding companies, but which would be

under the new definitions. They are permitted favorable liquidation treatment in certain cases and also permitted a deduction, in computing the personal holding company income, for paying off existing debts.

27. ***Aggregation of oil and gas properties.***—For the future, oil and gas leases or acquisitions are no longer to be aggregated in determining what constitutes a property for purposes of computing the percentage depletion deduction.

28. ***Iron ore royalties.***—The bill provides capital gains treatment for certain domestic iron ore royalties.

29. ***Life insurance companies.***—The bill makes three changes with respect to the income tax of life insurance companies: (1) It removes the requirement of present law that life insurance companies, and mutual insurance companies electing to be taxed on investment income only, are to ratably accrue market discount on purchased bonds as ordinary income; (2) it extends to 1962 the rule for deductibility of certain distributions to shareholders pursuant to certain mutualization plans; and (3) it assures deductibility of qualified pension plan contributions of mutual insurance companies.

30. ***Regulated investment companies.***—The bill amends the regulated investment company provisions (1) by increasing from 30 to 45 days after the close of the taxable year the time for giving certain notices to shareholders, and (2) by providing that distributions by a unit investment trust liquidating an individual's interest are not to be considered as giving rise to capital gains tax with respect to interests of other investors still in the trust.

31. ***Foreign tax credit on mineral operations.***—The bill provides that any excess foreign tax credit which arises from mineral extraction, because of the percentage depletion allowance under U.S. law, may not be used to offset U.S. tax on income not related to mineral extraction, processing transportation or marketing.

32. ***Sale of depreciable real estate.***—In the case of real estate sold in the future, any depreciation deductions, generally to the extent these deductions exceed depreciation allowable under the "straight line" method (to the extent of the gain), will be treated by the bill as giving rise to ordinary income. However, in the case of property held more than 20 months the amount treated as ordinary income will be reduced by 1 percent for each month of holding over 20, with the result that no amount will be treated as ordinary income in the case of real property held more than 10 years.

33. ***Averaging of income.***—The bill in effect provides for the averaging of income over a 5-year period where the income in the current year exceeds the average of the 4 prior years by more than one-third and this excess is more than $3,000.

34. ***Subchapter S corporations.***—The bill amends the provisions for subchapter S corporations to provide (1) that certain distributions of money made after the close of a taxable year may be treated as made at the close of that year in order to prevent double inclusion of income, and (2) that a corporate member of an affiliated group may elect subchapter S treatment where the only other members of the group are inactive subsidiary corporations.

35. ***Repeal of consolidated returns tax.***—The 2-percent penalty tax, which must presently be paid by corporations for the privilege of filing consolidated returns, is repealed.

36. ***Multiple surtax exemption.***—For corporations where there is common control to the extent of 80 percent or more, the corporations involved generally are limited to one $25,000 surtax exemption for the group or alternatively required to pay a special tax of 6 percent on the first $25,000 of their income. No penalty tax is imposed where a consolidated return is filed for the group.

37. ***Tax lien on automobiles.***—A purchaser, mortgagee, or pledgee of a motor vehicle will not be subject to a Federal tax lien against the motor vehicle, notice of which has been publicly filed, unless the purchaser, mortgagee, or pledgee had actual knowledge of the existence of the lien.

II. GENERAL STATEMENT

H.R. 8363 represents a basic revision of the Federal income tax laws. By substantially reducing individual and corporate tax rates, it is anticipated that this bill will stimulate higher investments and increase consumer purchases. In this manner, the bill is designed to lessen unemployment and to increase the rate of growth of our productive capacity. The bill also contains a series of structural changes in the tax system designed to improve the equity of the system and to close loopholes.

The extensive public hearings held by your committee have provided convincing evidence of the wide area of agreement on the part of the public generally—including representatives of both business and labor—of the need for reducing our present unrealistically high individual income tax rates. At present, they range from 20 to 91 percent and under this bill are reduced to a range of 14 to 70 percent. Also in the case of corporations, by reducing the top rate from 52 to 48 percent, this bill converts the Government from a "senior partner" to a "junior partner" in any business undertaking. The present high income tax rates are a carryover from the tax policy of World War II and the Korean war when the dampening down of investment stimulants and holding the line on consumption were necessary to our wartime effort. These policies are no longer appropriate, however, in our economy today.

Despite the fact that business conditions have been improving over the past 33 months, unemployment still is at the high rate of 5.5 percent, which matches the unemployment rate in the 1954 recession. Since obtaining an unemployment rate of 4.2 percent in 1956, we have experienced a succession of disappointing recoveries in which the unemployment rate has remained disturbingly high; this rate, in fact, has not been below 5 percent since 1957.

Added significance for this persistent high rate of unemployment lies in the fact that the next decade will be a period of unusually high growth in the labor force as the children of the post-World War II era come of age. The annual growth in the labor force as a result can be expected to increase from less than 1 million to about 1½ million. In addition, it is expected that with an improvement in employment conditions, perhaps 1 million people not now seeking work will return to the labor market. This shows quite clearly that the growth rate of our economy must be increased if the requisite jobs are to be found for this expanding labor force.

Although business conditions were generally good in 1963, the level of new investment in business plant and equipment was scarcely 6 percent above the level of investment in 1957, despite the 31-percent increase in the gross national product during this period.

The existence of these underutilized resources of manpower and plant capacity means that it is possible to attain a faster economic growth through tax reduction without significant inflationary pressures. The 5-year stability of the wholesale price index, together with the relatively moderate increase in the consumers' price index, in recent years, is evidence of this. The goal of a balanced growth with stable prices will, of course, also call for restraint in Government expenditures.

Tax reduction is also important as an aid in the reduction of our persistent balance-of-payments deficit. The presence of greater investment incentives and opportunities abroad than at home is the root cause of American capital seeking foreign outlets. The expanding markets resulting from the tax reduction contained in this bill will raise the attractiveness of domestic investment. Moreover, a faster domestic growth rate will result in a larger flow of new products and technological improvements, making our exports more competitive. The substantial improvements in our balance-of-payments position in the last 6 months is further evidence that an improvement in domestic business can aid our foreign balance. This also has been the experience in Europe where is is the rapidly growing and modernizing economies that have strong currencies.

(a) Tax reduction and revenues

The record of economic performance below capacity over the last 6 years has left a heavy mark on the Federal debt. The initial budget forecast for each of the fiscal years 1958–63 was for a budgetary surplus. The actual outcome in 5 out of the 6 years was a deficit with the deficit averaging about $5 billion.

The major factor in each of these deficits was the failure of the economy to expand as predicted. Either the present or proposed tax rates are high enough to produce a substantial budgetary surplus in a few years if there is sufficient growth and the economy operates at a high level. The present rates, however, constitute such a drag on the economy that the rate of growth has been disappointing and the rate of operation remains low. As a result, income and profits are relatively low and tax receipts are lower than would otherwise be the case. This is the principal factor accounting for the budgetary deficits.

The size of tax receipts is attributable to two variables, the tax rates and the tax base. The major thrust of the present tax bill is to provide a long-range expansion in one of these variables—the tax base—and thereby to increase the revenue potential. To accomplish this result the bill encourages the expansion of the private, rather than public, sector of the economy.

The present tax bill, along with a policy of expenditure constraint offers promise of restoring a balanced budget by the fiscal year 1967 or 1968. During a year of healthy growth in our economy the yield of the present tax system will increase in the neighborhood of $5 billion to $6 billion. The reduction in tax rates under this bill is designed to maintain that high rate of growth which will provide sufficient additional revenue to cover the cost of the tax bill in a relatively short period of time.

It may be argued that taxes should not be cut while there is a budget deficit. However, this overlooks the fact that maintaining high tax rates does not produce more revenue unless the tax base expands sufficiently—and the rates themselves inhibit this expansion. It is your committee's considered judgment that with the current rates it would take longer to eliminate the deficit than would be the case with the lower rates of this bill but with the expanded economy induced by this bill.

(b) Expenditure control

The House bill in section 1 contains a statement of policy as to the need to stimulate the economy and in this manner raise revenues. It also states that to further the objective of obtaining balanced budgets in the near future, Congress by this action, recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective.

The accord of your committee with the first of these statements is evidenced by its approval of the tax reduction provided by this bill and in the views expressed above that this legislation will, in the long run, increase rather than decrease revenues.

Your committee is also in accord with the second of these statements. The fact that your committee is reporting this bill after the presentation of the President's budget for the fiscal year 1965 is fortunate in that now the restraint of Government spending not only has been stated as an objective of administration policy but also is evidenced by the budgetary figures themselves. This budget reduces the deficit in the administrative budget by more than one-half from $10 billion to $4.9 billion. It also reflects a substantial decrease in new obligational authority requested and actually provides for a slight reduction—from $98.4 billion to $97.9 billion—in the level of spending for the fiscal year 1965. In view of these considerations, your committee believed that the retention of section 1 of the House bill was unnecessary. Moreover, it is questionable whether expressing declarations of intent in tax legislation would be a desirable precedent. Intent to restrain Government expenditures can best be evidenced by action on appropriation bills as they are presented in this session of Congress.

(c) The structure of tax reduction

This bill provides a balanced reduction between individuals and business firms. In this respect, the bill is much the same as the bill that came from the House. When fully effective, the bill will reduce individual income taxes by $9.2 billion and will reduce corporate taxes by about $2.4 billion. These figures must be evaluated along with the effective tax reduction of 1962 through the investment credit and depreciation reform, the largest share of which went to corporations. Taking the 1962 and 1964 programs together, the share of the reduction going to individuals is about two-thirds and to corporations about one-third, which is approximately the present relative shares of individuals and corporations in income tax liabilities.

Looked at another way, the net individual income tax reduction will reduce present tax liabilities for individuals by just under 20 percent. The combined effects of this bill, depreciation reform, and last year's investment tax credit, will reduce corporate tax liabilities by something more than 19 percent.

The bill equitably distributes tax reduction over the various individual income tax levels. Those at the lowest income levels will receive the largest tax reductions, measured as a percent of the present tax. This reduction of 38.6 percent of present law tax at these levels is due to the sharper reductions in the first bracket rate, the split first bracket, and the effect of the minimum standard deduction. Due to the structural reforms, particularly the repeal of the dividends received credit the amount of tax reduction for persons with incomes of $50,000 or more will average approximately 13.5 percent of their present tax (excluding the alternative capital gains tax). Since the present tax for these individuals is already considerably higher relative to income than it is for those with incomes below $3,000, this 13.5-percent reduction in tax necessarily represents a greater increase in aftertax income.

In addition to a rate reduction the present bill contains a number of provisions designed to increase the equity of the tax system, some of which increase and some of which decrease the total revenue. These provisions are listed in part I above.

The bill also significantly improves the pattern of progression in the tax structure. At the lower end of the income tax scale, the minimum standard deduction will effectively eliminiate tax for all single people with adjusted gross incomes below $900 and for married couples with incomes below $1,600 (with higher minimum levels of $700 for each dependent). Furthermore the division of the present first surtax bracket (which is $4,000 wide for a married couple) into four narrower brackets permits greater proportionate tax reduction for families and single individuals whose total income leaves them close to a poverty level.

At the upper end of the income scale, under the demands of war finance, progression has been carried to the extreme of rates that under peacetime conditions are clearly excessive and inhibit individual initiative. Over the years the Congress has been faced with the necessity of making statutory exceptions, through special deductions, lower capital gains rates and the like, until there now is a wide range of effective rates applicable to people with the same economic income. Your committee's bill deals with this problem by applying the reductions made in these higher brackets to those cases where current rates are excessive and also by removing special benefits in the law which account for part of this divergence in rates.

(d) *Principal changes from the House bill*

Your committee's amendments make a number of changes in the House bill. These are:

(1) The 14-percent withholding rate, scheduled under the House bill to become effective in 1965, is made effective in 1964, 8 days after the enactment of this legislation. This change is needed because lower tax rates will apply to all of 1964 incomes but withholding will continue at 18 percent (rather than the 15 percent provided in the House bill) until this bill goes into effect.

(2) The restoration of the deduction for State and local taxes on gasoline and for other State and local registration taxes on automobiles. Under the House bill individuals who itemize their personal deductions were not to be allowed deductions for these items.

(3) The deletion of the House provision reducing the tax rate on capital gains where the assets have been held more than 2 years. Under the House bill certain capital gains held more than 2 years were to achieve an effective lower rate of tax by the reduction of the percentage of such gains included in income from 50 to 40 percent and by the reduction of the alternative tax rate on these gains from 25 to 21 percent. Your committee believes that further reduction in capital gains should be deferred until Congress has a further opportunity to examine these rates and related problems. Even though the capital gains provisions are not reduced in this bill, those who include half of their capital gains in their regular income tax base (96 percent) will obtain under this bill the same percentage tax reduction on these capital gains as is applicable to other kinds of income.

(4) The taxation of group term insurance paid for through the employer is to apply to the cost of insurance for over $70,000 of coverage rather than $30,000 as provided by the House bill.

(5) A new deduction for political contributions of up to $50 a year for a single person and up to $100 a year for a married couple is provided.

(6) The child-care deduction is liberalized, particularly with respect to working wives. Under present law this deduction is reduced in the case of a working wife by the excess of the family income over $4,500. The bill raises this limitation to $7,000.

(7) A new provision is added limiting the use of excess foreign tax credits arising from mineral extraction. Where the foreign tax on the extraction activity exceeds the U.S. tax, because of the allowance of percentage depletion under the U.S. tax, the resulting excess foreign tax credit may not be used against U.S. tax on income arising from nonmineral activities.

(8) The limitation on the business travel expense deduction enacted in the Revenue Act of 1962 is repealed. Thus there will no longer be an allocation of the travel expense where the taxpayer combines a business trip with a vacation.

(9) A new provision provides that where an employee moves and the employer reimburses him for selling costs on his house and losses incurred on the sale of the house attributable to the fact that it must be sold more quickly than usual, the reimbursement is to be treated as a part of the selling price of the house (rather than as compensation).

(10) Groups of affiliated corporations eligible to file a consolidated return and those eligible which do not do so, will be permitted to take a 100 percent dividends received deduction with respect to dividends received from other members of the controlled group, provided the group elects to take only one surtax exemption and meets certain other conditions.

(11) A new provision is added extending the installment method of accounting to business firms maintaining so-called revolving credit accounts.

(12) A new provision is added to allow taxpayers who suffered losses through foreign expropriation after 1958 to carry these losses forward for 10 years (instead of the usual 3-year carryback and 5-year carryforward).

(13) A new provision liberalizes the retirement income credit. This increases the amounts of retirement income on which the credit is computed to make the credit more nearly analogous to the social security exclusion.

(14) A 5-year carryover of unused charitable contributions is provided for individuals, deductions for gifts of future interests are restricted, and contributions to private foundations are made ineligible for the unlimited charitable contributions deduction.

(15) A new amendment provides that companies issuing face amount certificates may invest up to 25 percent of their total assets in tax-exempt obligations without losing a deduction for interest paid to the shareholders.

(16) A new amendment provides a tax-free status for a stock-for-stock reorganization where the corporation acquiring the stock exchanges the stock of its parent for the stock of the acquired corporation.

(17) A new provision provides for the retroactive qualification of union negotiated multiemployer pension plans where these pension plans are subsequently qualified.

(18) A new provision makes possible the coverage under qualified pension plans of U.S. employees of foreign subsidiaries or of U.S. employees of foreign branches of domestic corporations.

(19) In the case of employee stock options, the House provision is liberalized with respect to the restrictions imposed where one option is outstanding and a subsequent option is acquired and the effective date is changed to apply to options granted after December 31, 1963 (instead of June 11, 1963).

(20) A new provision provides that in the case of contested liabilities, the deduction is to be taken in the year of the payment where this occurs before the contest is settled.

(21) The personal holding company provision of the House bill is liberalized somewhat in the case of the test as to when rent is considered personal holding company income and also with respect to the exemptions for consumer finance companies.

(22) Three new provisions are added with respect to insurance companies, providing additional time for special treatment mutalization distributions, providing capital gains treatment with respect to the accrual of bond discount in certain cases, and correcting a technical error in present law.

(23) Liberalizing amendments are provided giving regulated investment companies more time for the mailing of notices to shareholders and with respect to the treatment of redemptions by unit investment trusts.

(24) An amendment liberalizes somewhat the treatment accorded "small business corporations"; namely, those treated essentially like partnerships for tax purposes.

(25) An amendment provides that a purchaser, mortgagee, or pledgee of a motor vehicle will not be subject to a Federal tax lien against the motor vehicle unless the purchaser, mortgagee, or pledgee has actual notice of the existence of the lien.

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III. REVENUE ESTIMATES

The revenue effect of your committee's bill is shown in tables 1 through 4 below. (Pt. A of tables 1 through 3 refers to estimates under your committee's bill and pt. B in each case to estimates under the House bill.) Estimates in the tables are based on income levels assumed for the calendar year 1963 but do not take into account any "feedback" to the economy anticipated from this bill. Table 1 shows the estimated impact of the various provisions contained in your committee's bill and the House bill upon calendar year 1964 and 1965 tax liabilities and also upon liabilities in the long run. Table 2 shows the estimated effect of your committee's bill and the House bill upon receipts in the fiscal years 1964 and 1965.

Table 1 indicates that your committee's bill can be expected to decrease calendar year 1964 tax liabilities by $7.9 billion and calendar year 1965 liabilities by $11.6 billion (the latter figure includes the $7.9 billion reduction). The calendar year 1965 effect is virtually identical with the long-term effect of the bill before taking into account any impact of the reductions upon the economy. Of the $11.6 billion reduction in 1965, $9.2 billion will go to individuals, or nearly 80 percent of the total. Revenue raising structural changes for the calendar year 1965 amount to $740 million but are partially offset by other liberalizing provisions reducing the net increase to $160 million.

Table 2 shows that your committee's bill will decrease revenues in the fiscal year 1964 by $1.9 billion and in the fiscal year 1965 by $8.4 billion (the latter figure includes the $1.9 billion reduction). These figures are considerably lower than the calendar year liability figures for the same year; first, because of the fact that the fiscal year ends in the middle of the calendar year; and, second, because the calendar year data are shown on the basis of liability rather than receipts. Liabilities indicate the amount of tax liability attributable to income of the year in which it is earned; receipts show the actual amount collected in the year in question. Since collection tends to lag behind the accruing of the liability, tax reductions show up in later years when shown on a "receipt" basis than when shown on a "liability" basis.

It is important to note that it is not expected that actual tax revenues in the fiscal year 1964 and future years will be reduced by the full $1.9 or $8.4 billion referred to above. It is anticipated that income levels in these years will be substantially higher as a result of the economic stimulus of the tax cut and will generate revenues significantly offsetting the budgetary impact of these rate reductions.

The stimulative effects of the tax reduction are expected to produce, according to the Treasury Department, relatively modest amounts of increased income in the first months, with the result that the "feedback" effect on the fiscal year 1964 revenues is expected to amount to only $200 million. As a result, the gross tax loss of $1.9 billion for the fiscal year 1964 is expected to be reduced to $1.5 billion after the "feedback" effect. The Treasury Department has estimated that the increased revenues from the rise of income, however, will amount to about $4 billion in the fiscal year 1965. Thus, the Treasury estimates that while tax reductions during that year would lose an estimated $8.4 billion of revenue at 1963 income levels, the net cost after allowing for the revenues generated by the expansion in income and profits induced by the tax program would be limited to approximately $4.3 billion. The expansionary effect of the tax reductions on future years' revenues can be expected to be considerably larger than for the first 2 years. The order of magnitude was indicated in the discussion in part II.

Part A of table 3 shows by adjusted gross income class the distribution of changes in estimated tax liabilities for individuals when your committee's bill is fully effective. This table shows this distribution for each of the major rate and structural changes. These data are shown both in terms of amount of tax liability involved and the percentage change each of these is of present tax liability. It indicates that the rate changes alone would decrease tax liability by 20 percent while the structural changes would increase tax liability by 0.3 percent, resulting in the net reduction of 19.7 percent. Part B of table 3 presents similar data under the House bill.

Table 4 compares the tax liability effect of your committee's amendments with the House bill. This table indicates that in the calendar year 1964 your committee's amendments would decrease tax liabilities $680 million more than the House bill, in 1965 your committee's amendments are expected to decrease tax liabilities $395 million more and in the long run $185 million more.

The impact of the capital gains provisions is excluded from table 3 because of the difficulty of showing these changes by adjusted gross income class. Part A of table 1 sets forth the overall effect of the changes in the taxation of capital gains under your committee's bill: an increase of $115 million in calendar year 1964 tax liabilities, $120 million in 1965, and $50 million in the long run.[1]

As set forth in part A of table 2, the estimated overall revenue loss, before taking into account acceleration of corporation tax payments, is $2.2 billion in fiscal year 1964. This is $400 million less than was estimated in the budget. According to the Treasury Department this difference is due to the assumption of an earlier effective date in the budget document for institution of the 14-percent withholding. Similarly, according to the Treasury Department, the $9.3 billion revenue loss ($8.4 billion plus $900 million of accelerated corporation tax payments) estimated in part A of table 2 for fiscal year 1965 is greater than the loss shown in the budget by approximately $1.1 billion. The difference is ascribed primarily to $400 million due to the change in date of the reduced withholding and to the $680 million due to changes in structural provisions as shown in table 4.

[1] When this $115 million estimate for 1964 under your committee's bill is compared with the $295 million estimate under the House bill (pt. B of table 1) as subsequently revised to $215 million, the effect of your committee's action as compared to action by the House is a decrease in tax liability of $100 million in calendar year 1964 (see line 7 of table 4). Similarly, when the $120 million estimated increase in calendar year 1965 tax liabilities under your committee's bill is compared with the $170 million estimate under the House bill (pt. B of table 1), as subsequently revised to $80 million, the effect of your committee's action as compared to action by the House is an increase in tax liability of $40 million (see line 7 of table 4).

TABLE 1.—*Revenue bill of 1964, H.R. 8363—Estimated decrease in tax liability*[1] (−) *and increase* (+) (*before feedback*) *of provisions of bill*

[In millions of dollars]

A. AS APPROVED BY SENATE COMMITTEE ON FINANCE

	Calendar year 1964 liability			Calendar year 1965 liability			Long run liability		
	Individual	Corporate	Total	Individual	Corporate	Total	Individual	Corporate	Total
A. Tax program:									
Rate changes: Basic rates	−6,310	−1,320	−7,630	−9,470	−2,190	−11,660	−9,470	−2,190	−11,660
Structural changes:									
(a) Revenue raising:									
1. Group term insurance	(2)		(2)	(2)		(2)	(2)		(2)
2. Bank loan insurance	+5		+5	+5		+5	+10		+10
3. Sick pay inclusion	+110		+110	+110		+110	+110		+110
4. Deduction of personal taxes	+190		+190	+190		+190	+190		+190
5. Casualty loss deduction	+50		+50	+50		+50	+50		+50
6. Aggregation of mineral properties		+40	+40		+40	+40		+40	+40
7. Personal holding companies	+15		+15	+15		+15	+15		+15
8. Repeal of dividend credit and increase in exclusion	+120		+120	+300		+300	+300		+300
9. Multiple corporation provisions		+30	+30		+30	+30		+30	+30
Total, revenue raising	+490	+70	+560	+670	+70	+740	+675	+70	+745
(b) Revenue reducing:									
10. Medical expense deduction	−10		−10	−10		−10	−10		−10
11. Child care allowance	−20		−20	−20		−20	−20		−20
12. Moving expenses	−105		−105	−105		−105	−105		−105
13. Income averaging	−40		−40	−40		−40	−40		−40
14. Minimum standard deduction	−320		−320	−320		−320	−320		−320
15. Repeal 2-percent tax on consolidated returns		−50	−50		−50	−50		−50	−50
16. Political contributions	−25		−25	−5		−5	−15		−15
17. Travel expenses	−5		−5	−5		−5	−5		−5
18. Installment sales treatment		[3] −140	−140		−10	−10		−10	−10
19. Expropriation loss carryover		(2)	(2)		−5	−5		−5	−5
20. Retirement income credit	−10		−10	−10		−10	−10		−10
Total, revenue reducing	−535	−190	−725	−515	−65	−580	−525	−65	−590
Total, structural changes	−45	−120	−165	+155	+5	+160	+150	+5	+155
Total, rate and structural changes, tax program	−6,355	−1,440	−7,795	−9,315	−2,185	−11,500	−9,320	−2,185	−11,505

Capital gains revisions (including induced effects):									
1. Unlocking of capital gains from general rate reduction	+130		+130	+130		+130	+50		+50
2. Sale or exchange of real estate		[3]	[3]		+5	+5		+15	+15
3. Sales of residences by taxpayers aged 65 or over	−10		−10	−10		−10	−10		−10
4. Capital gains treatment of iron ore royalties		−5	−5		−5	−5		−5	−5
Total, capital gains revisions	+120	−5	+115	+120	0	+120	+40	+10	+50
Total, tax program	−6,235	−1,445	−7,680	−9,195	−2,185	−11,380	−9,280	−2,175	−11,455
B. Revision of 1962 legislation:									
1. Repeal of requirement to reduce basis by investment credit	−20	−140	[4] −160	−25	−170	[4] −195	−25	−170	−195
2. Allow investment credit for elevators and escalators		−10	−10		−10	−10		−10	−10
Total, revision of 1962 legislation	−20	−150	−170	−25	−180	−205	−25	−180	−205
C. Total, revenue bill of 1964	−6,255	−1,595	−7,850	−9,220	−2,365	−11,585	−9,305	−2,355	−11,660

See footnotes at end of table, p. 17.

TABLE 1.—*Revenue bill of 1964, H.R. 8363—Estimated decrease in tax liability*[1] (−) *and increase* (+) (*before feedback*) *of provisions of bill*—Continued

[In millions of dollars]

B. AS PASSED BY HOUSE OF REPRESENTATIVES

	Calendar year 1964 liability			Calendar year 1965 liability		
	Individual	Corporate	Total	Individual	Corporate	Total
A. 1963 tax program:						
Rate changes	−6,310	−1,320	−7,630	−9,470	−2,190	−11,660
Structural changes:						
(a) Revenue raising:						
1. Group term insurance	+5		+5	+5		+5
2. Bank loan insurance	+5		+5	+5		+5
3. Sick pay exclusion	+110		+110	+110		+110
4. Deduction of personal taxes	+520		+520	+520		+520
5. Casualty loss deduction	+50		+50	+50		+50
6. Aggregation of mineral properties		+40	+40		+40	+40
7. Personal holding companies	+15		+15	+15		+15
8. Repeal of dividend credit and increase in exclusion	+120		+120	+300		+300
9. Multiple corporation provisions		+35	+35		+35	+35
Total, revenue raising	+825	+75	+900	+1,005	+75	+1,080
(b) Revenue reducing:						
10. Medical expense deduction	−10		−10	−10		−10
11. Child care allowance	−5		−5	−5		−5
12. Moving expenses	−60		−60	−60		−60
13. Income averaging	−40		−40	−40		−40
14. Minimum standard deduction	−320		−320	−320		−320
15. Repeal 2-percent tax on consolidated returns		−50	−50		−50	−50
Total, revenue reducing	−435	−50	−485	−435	−50	−485
Total, structural changes	+390	+25	+415	+570	+25	+595
Total, rate and structural changes, 1963 tax program	−5,920	−1,295	−7,215	−8,900	−2,165	−11,065

Capital gains revision (including induced effects):						
1. 50- to 40-percent inclusion [5]	+340		+340	+210		+210
2. Sale or exchange of real estate		([2])	([2])		+5	+5
3. Carryover of losses	−30		−30	−30		−30
4. Sales of residences by taxpayers aged 65 or over	−10		−10	−10		−10
5. Capital gains treatment of iron ore royalties		−5	−5		−5	−5
Total, capital gains revision	+300	−5	+295	+170	0	+170
Total, 1963 tax program	−5,620	−1,300	−6,920	−8,730	−2,165	−10,895
B. Revision of 1962 legislation:						
1. Repeal requirement to reduce basis by investment credit	−20	−125	[4] −145	−25	−160	[4] −185
2. Allow investment credit for elevators and escalators		−10	−10		−10	−10
Total, revision of 1962 legislation	−20	−135	−155	−25	−170	−195
C. Total	−5,640	−1,435	−7,075	−8,755	−2,335	−11,090

[1] At levels of income estimated for the calendar year 1963.
[2] Less than $2,500,000.
[3] Includes relatively small loss attributable to individuals.
[4] Treasury Department estimate; estimate of Staff of Joint Committee on Internal Revenue Taxation is $245,000,000 for 1964, and $305,000,000 for 1965.
[5] Includes amounts shown in part A as "unlocking due to general rate reduction."

TABLE 2.—*Revenue bill of 1964, H.R. 8363—Estimated decrease in fiscal year receipts* [1] *(−) and increase (+) (before feedback) of provisions of bill*

[In millions of dollars]

A. AS APPROVED BY SENATE COMMITTEE ON FINANCE

	Fiscal year 1964 receipts			Fiscal year 1965 receipts		
	Individual	Corporation	Total	Individual	Corporation	Total
A. Tax program:						
Rate changes:						
Basic rates	[2] −2,200		−2,200	[2] −7,760	−1,320	−9,080
Acceleration of corporate payments		+260	+260		+900	+900
Total	−2,200	+260	−1,940	−7,760	−420	−8,180
Structural changes:						
(a) Revenue raising:						
1. Group term insurance				(3)		(3)
2. Bank loan insurance				+5		+5
3. Sick pay exclusion				+110		+110
4. Deduction of personal taxes				+190		+190
5. Casualty loss deduction				+50		+50
6. Aggregation of mineral properties					+40	+40
7. Personal holding companies				+15		+15
8. Repeal of dividend credit and increase in exclusion				+120		+120
9. Multiple corporation provisions					+30	+30
Total, revenue raising				+490	+70	+560
(b) Revenue reducing:						
10. Medical expense deduction				−10		−10
11. Child care allowance				−20		−20
12. Moving expenses				−105		−105
13. Income averaging				−40		−40
14. Minimum standard deduction				−320		−320
15. Repeal 2-percent tax on consolidated returns					−50	−50
16. Political contributions				−25		−25
17. Travel expenses				−5		−5
18. Installment sales treatment					[4] −140	−140
19. Expropriation loss carryover					(3)	(3)

20. Retirement income credit				−10		−10
Total, revenue reducing				−535	−190	−725
Total, structural changes				−45	−120	−165
Total, rate and structural changes, tax program	−2,200	+260	−1,940	−7,805	−540	−8,345
A. Capital gains revisions (including induced effects):						
1. Unlocking of capital gains from general rate reduction				+130		+130
2. Sale or exchange of real estate					(3)	(3)
3. Sales of residences by taxpayers aged 65 or over				−10		−10
4. Capital gains treatment of iron ore royalties					−5	−5
Total, capital gains revisions				+120	−5	+115
Total, tax program	−2,200	+260	−1,940	−7,685	−545	−8,230
B. Revision of 1962 legislation:						
1. Repeal of requirement to reduce basis by investment credit				−20	−140	[5] −160
2. Allow investment credit for elevators and escalators					−10	−10
Total, revision of 1962 legislation				−20	−150	−170
C. Total, revenue bill of 1964	−2,200	+260	−1,940	−7,705	−695	−8,400

See footnotes at end of table, p. 21.

TABLE 2.—*Revenue bill of 1964, H.R. 8363—Estimated decrease in fiscal year receipts* [1] (−) *and increase* (+) (*before feedback*) *of provisions of bill*—Continued

[In millions of dollars]

B. AS PASSED BY HOUSE OF REPRESENTATIVES

	Fiscal year 1964 receipts			Fiscal year 1965 receipts		
	Individual	Corporation	Total	Individual	Corporation	Total
A. 1963 tax program:						
Rate changes	−2,430		−2,430	−7,530	−1,320	−8,850
Acceleration of payments		+260	+260		+900	+900
Total	−2,430	+260	−2,170	−7,530	−420	−7,950
Structural changes:						
(a) Revenue raising:						
1. Group term insurance				+5		+5
2. Bank loan insurance				+5		+5
3. Sick pay exclusion				+110		+110
4. Deduction of personal taxes				+520		+520
5. Casualty loss deduction				+50		+50
6. Aggregation of mineral properties					+40	+40
7. Personal holding companies				+15		+15
8. Repeal of dividend credit and increase in exclusion				+120		+120
9. Multiple corporation provisions					+35	+35
Total, revenue raising				+825	+75	+900
(b) Revenue reducing:						
10. Medical expense deduction				−10		−10
11. Child care allowance				−5		−5
12. Moving expenses				−60		−60
13. Income averaging				−40		−40
14. Minimum standard deduction				−320		−320
15. Repeal 2-percent tax on consolidated returns					−50	−50
Total, revenue reducing				−435	−50	−485
Total structural changes				+390	+25	+415
Total rate and structural changes, 1963 tax program	−2,430	+260	−2,170	−7,140	−395	−7,535

Capital gains revision (including induced effects):						
1. 50 to 40 percent inclusion				+340		+340
2. Sale or exchange of real estate					(3)	(3)
3. Carryover of losses				−30		−30
4. Sales of residences by taxpayers aged 65 or over				−10		−10
5. Capital gains treatment of iron ore royalties					−5	−5
Total, capital gains revision				+300	−5	+295
Total, 1963 tax program	−2,430	+260	−2,170	−6,840	−400	−7,240
B. Revision of 1962 legislation:						
1. Repeal requirement to reduce basis by investment credit		−15	−15	−20	−125	[4]−145
2. Allowing investment credit for elevators and escalators		−5	−5		−10	−10
Total, revision of 1962 legislation		−20	−20	−20	−135	−155
C. Total	−2,430	+240	−2,190	−6,860	−535	−7,395

[1] At levels of income estimated for the calendar year 1963.
[2] Assumes effective date for withholding change of Feb. 22, 1964.
[3] Less than $2,500,000.
[4] Includes relatively small loss attributable to individuals.
[5] Treasury Department estimate· estimate of Staff of Joint Committee on Internal Revenue Taxation is $245,000,000.

TABLE 3.—*Revenue bill of 1964, H.R. 8363—Change in tax liability*[1] *resulting from rate and structural changes for individuals when fully effective*

A. AS APPROVED BY SENATE COMMITTEE ON FINANCE

Adjusted gross income class (thousands of dollars)	Rate change	Structural changes														Total structural changes	Total rate and structural changes
		Group term and other insurance	Sick pay exclusion	Limitation of deductions	Casualty loss deduction	Personal holding companies	Dividend credit and exclusion	Medical care deduction (aged)	Child care allowance	Moving expenses	Income averaging	Minimum standard deduction	Political contribution	Travel and entertainment	Retirement income credit expense		
	[In millions of dollars]																
0 to 3	−400	(2)	5	5	(2)	(2)	(2)	(2)	(2)	(2)	---------	−170	(2)	(2)	(2)	−160	−560
3 to 5	−1,020	(2)	20	20	5	(2)	10	(2)	−10	−25	---------	−100	(2)	(2)	(2)	−80	−1,100
5 to 10	−3,905	(2)	55	80	25	(2)	30	(2)	−10	−40	(2)	−50	(2)	(2)	−5	+85	−3,820
10 to 20	−2,285	(2)	25	45	15	(2)	50	(2)	(2)	−25	−10	---------	(2)	−5	−5	+90	−2,195
20 to 50	−1,150	(2)	5	20	5	(2)	85	−5	(2)	−10	−20	---------	−10	(2)	(2)	+70	−1,080
50 and over	−710	10	(2)	20	(2)	15	125	−5	(2)	−5	−10	---------	−5	(2)	(2)	+145	−565
Total	−9,470	10	110	190	50	15	300	−10	−20	−105	−40	−320	−15	−5	−10	+150	−9,320
	Change as a percent of present tax																
0 to 3	−27.6	(2)	0.3	0.3	(2)	(2)	(2)	(2)	(2)	(2)	---------	−11.7	(2)	(2)	(2)	−11.0	−38.6
3 to 5	−25.3	(2)	.5	.5	0.1	(2)	0.2	(2)	−0.2	−0.6	---------	−2.5	(2)	(2)	(2)	−2.0	−27.3
5 to 10	−21.3	(2)	.3	.4	.1	(2)	.2	(2)	−.1	−.2	(2)	−.3	(2)	(2)	(2)	+.5	−20.9
10 to 20	−18.0	(2)	.2	.4	.1	(2)	.4	(2)	(2)	−.2	−0.1	---------	(2)	(2)	(2)	+.7	−17.3
20 to 50	−17.0	(2)	.1	.3	.1	(2)	1.3	−0.1	(2)	−.1	−.3	---------	−0.1	(2)	(2)	+1.0	−16.0
50 and over	−17.0	0.2	(2)	.5	(2)	0.4	3.0	−.1	(2)	−.1	−.2	---------	−.1	(2)	(2)	+3.5	−13.5
Total	−20.0	(2)	.2	.4	.1	(2)	.6	(2)	(2)	−.2	−.1	.7	(2)	(2)	(2)	+.3	−19.7

B. AS PASSED BY THE HOUSE OF REPRESENTATIVES

Adjusted gross income class (thousands of dollars)	Rate change	Structural changes												Total
		Group term and other insurance	Sick pay exclusion	Limitation of deductions	Casualty loss deduction	Personal holding companies	Dividend credit and exclusion	Medical care deduction (aged)	Child care allowance	Moving expenses	Income averaging	Minimum standard deduction	Total	
	[In millions of dollars]													
0 to 3	−400	(2)	5	10	(2)	(2)	(2)	(2)	(2)	(2)	----------	−170	−155	−555
3 to 5	−1,020	(2)	20	50	5	(2)	10	(2)	−5	−15	----------	−100	−35	−1,055
5 to 10	−3,905	(2)	55	220	25	(2)	30	(2)	(2)	−25	(2)	−50	+255	−3,650
10 to 20	−2,285	(2)	25	130	15	(2)	50	(2)	(2)	−15	−10	----------	+195	−2,090
20 to 50	−1,150	5	5	60	5	(2)	85	−5	(2)	−5	−20	----------	+130	−1,020
50 and over	−710	10	(2)	50	(2)	15	125	−5	(2)	(2)	−10	----------	+185	−525
Total	−9,470	15	110	520	50	15	300	−10	−5	−60	−40	−320	+575	−8,895
	Change as a percent of present tax													
0 to 3	−27.6	(2)	0.3	0.7	(2)	(2)	(2)	(2)	(2)	(2)	----------	−11.7	−10.7	−38.3
3 to 5	−25.3	(2)	.5	1.2	0.1	(2)	0.2	(2)	−0.1	−0.4	----------	−2.5	−.9	−26.2
5 to 10	−21.3	(2)	.3	1.2	.1	(2)	.2	(2)	(2)	−.1	(2)	−.3	+1.4	−19.9
10 to 20	−18.0	(2)	.2	1.0	.1	(2)	.4	(2)	(2)	−.1	−0.1	----------	+1.5	−16.4
20 to 50	−17.0	0.1	.1	.9	.1	(2)	1.3	−0.1	(2)	−.1	−.3	----------	+1.9	−15.1
50 and over	−17.0	.2	(2)	1.2	(2)	0.4	3.0	−.1	(2)	(2)	−.2	----------	+4.4	−12.6
Total	−20.0	(2)	.2	1.1	.1	(2)	.6	(2)	(2)	−.1	−.1	−.7	+1.2	−18.8

[1] Excludes effect of capital gains provisions and repeal of the requirement to reduce basis by amount of investment credit.

[2] Less than $2,500,000 or 0.05 percent.

TABLE 4.—*Action by Senate Finance Committee on H.R. 8363 resulting in significant change in tax liability over House bill, calendar years 1964 and 1965 and long run*

[Millions]

	Change in tax liability from House bill		
	1964	1965	Long run
1. Deduction for political contributions	−$25	−$5	[1] −$15
2. Liberalized deduction for child care expense	−15	−15	−15
3. Elimination of allocation of travel expenses	−5	−5	−5
4. 100 percent intercorporate dividend deduction for certain affiliated groups	−5	−5	−5
5. Restoration of deduction of State and local gas tax and auto registration fees	−330	−330	−330
6. Allowance to reimbursed employee, as part of sales price, of selling costs and loss on forced sale of house	−45	−45	−45
7. Elimination of general capital gains provision	−100	+40	+260
8. Allowance of installment sales treatment for revolving credit plans	−140	−10	−10
9. Permitting election of 10-year carryforward without carryback for expropriation losses	([2])	−5	[2] −5
10. Increasing from $50,000 to $70,000 the minimum group-term life insurance subject to tax	−5	−5	−5
11. Liberalize retirement income credit on certain joint returns	−10	−10	−10
Total	−680	−395	−185

[1] $25,000,000 for presidential election year; 50 percent of that amount for congressional election year and 25 percent for off year; average about $15,000,000 per year.
[2] Less than $2,500,000 in 1964 and practically exhausted by 1970.

IV. GENERAL EXPLANATION

A. RATE CHANGES

1. *Individual income tax rates (sec. 111 of the bill and sec. 1 of the code)*

The most important change made by this bill is the individual income tax rate reduction. The bill, in both the House and your committee's versions, provides an individual income tax rate reduction of $9.47 billion spread over the 2 calendar years, 1964 and 1965. Over this 2-year period, the present rates, which range from 20 percent on the first $2,000 or $4,000 (the former for single persons and the latter for married couples) and 91 percent on incomes over $200,000 or $400,000 are reduced to a range of from 14 percent on the first $500 or $1,000 to 70 percent on incomes over $100,000 or $200,000. This represents an average rate reduction of 20 percent. Approximately two-thirds of this reduction is made effective in 1964 and the remaining one-third in 1965.

Table 5 shows the individual income tax rates under present law and under the House and committee bill, both for 1964 and for subsequent years. A separate table with rates, as nearly as possible halfway between those applicable for single persons and for married couples is provided for heads of households. The withholding tax rate of 18 percent under present law is reduced to 14 percent not only for 1965 and subsequent years but, under your committee's action also for 1964, starting 1 week after the date of enactment. The House bill would have provided a 15-percent rate for 1964. Wage bracket withholding tables provided by the bill reflect similar reductions in withholding tax rates. The 14-percent withholding tax rate is designed to withhold the appropriate amount of tax at an income level of $2,000 for a single person, or $4,000 in the case of a married couple, using the standard deduction.

TABLE 5.—*Individual income tax rates under present law and schedules provided by House and committee bill for 1964 and 1965*

Taxable income brackets (in thousands of dollars)		Present rates	Rates provided under House and committee bill—	
Single person	Married (joint)		1964 [1]	1965
		Percent	*Percent*	*Percent*
0 to 0.5	0 to 1	20	16.0	14
0.5 to 1	1 to 2	20	16.5	15
1 to 1.5	2 to 3	20	17.5	16
1.5 to 2	3 to 4	20	18.0	17
2 to 4	4 to 8	22	20.0	19
4 to 6	8 to 12	26	23.5	22
6 to 8	12 to 16	30	27.0	25
8 to 10	16 to 20	34	30.5	28
10 to 12	20 to 24	38	34.0	32
12 to 14	24 to 28	43	37.5	36
14 to 16	28 to 32	47	41.0	39
16 to 18	32 to 36	50	44.5	42
18 to 20	36 to 40	53	47.5	45
20 to 22	40 to 44	56	50.5	48
22 to 26	44 to 52	59	53.5	50
26 to 32	52 to 64	62	56.0	53
32 to 38	64 to 76	65	58.5	55
38 to 44	76 to 88	69	61.0	58
44 to 50	88 to 100	72	63.5	60
50 to 60	100 to 120	75	66.0	62
60 to 70	120 to 140	78	68.5	64
70 to 80	140 to 160	81	71.0	66
80 to 90	160 to 180	84	73.5	68
90 to 100	180 to 200	87	75.0	69
100 to 150	200 to 300	89	76.5	70
150 to 200	300 to 400	90	76.5	70
200 and over	400 and over	91	77.0	70

[1] Provides ¾ of tax cut in 1964.

The rate brackets provided by the House and committee bill differ from those under present law in that what is now the first bracket is divided into four brackets:

Single persons	*Married couples*
\$0 to \$500	\$0 to \$1,000
\$500 to \$1,000	\$1,000 to \$2,000
\$1,000 to \$1,500	\$2,000 to \$3,000
\$1,500 to \$2,000	\$3,000 to \$4,000

Splitting this first bracket into four brackets has several advantages. First, it makes it possible to have a lower starting rate than would otherwise be possible, given the same revenue loss. Only splitting this first bracket into four parts makes it possible to provide a 30-percent tax reduction for those with the lowest taxable income, who need the tax cut the most. Second, it makes it possible to provide some progression in the portion of the rate structure where none has been provided before. The significance of this is that over half of the taxpayers presently are subject only to the first bracket rate. As among taxpayers in this major group, the present rate structure provides no differentiation in applicable tax rates.

Table 6 shows the percentage of tax rate reduction provided in each rate bracket for 1965 and subsequent years. This table indicates that the new 14-percent rate represents a 30-percent reduction; the 15-percent rate, a 25-percent cut; and the 16-percent rate, a 20-percent cut. The average reduction in these first four brackets is 22.5 percent. Above this level the percentage reductions, up to a taxable income level of about \$50,000 for single persons or \$100,000 for married couples, is as nearly a uniform 15-percent rate reduction as practicable for a smooth progression. Above this \$50,000 or \$100,000 taxable income level, the rate reductions again gradually increase until the top rate is reached at $200,000 or $400,000 where a 23-percent rate reduction is provided. This rate schedule, therefore, provides a minimum reduction of approximately 15 percent for all tax brackets. In addition, it provides extra reductions in the very lowest tax brackets where the impact of the present taxes is the most heavy. It also provides larger reductions in the very highest bracket where it is quite clear the present rates are too steeply graduated. These rates, which were developed during World War II to assure equality of sacrifice, are no longer appropriate under today's conditions.

TABLE 6.—*Individual income tax rates under present law and under House and committee bill for 1965*

Taxable income bracket (thousands of dollars)		Present law rate	House and committee bill	
Single person	Married (joint)		Rate for 1965 and subsequent years	Percentage reduction from present law rates
		Percent	*Percent*	*Percent*
0 to 0.5	0 to 1	20	14	30
0.5 to 1	1 to 2	20	15	25
1 to 1.5	2 to 3	20	16	20 } 22.5
1.5 to 2	3 to 4	20	17	15
2 to 4	4 to 8	22	19	14
4 to 6	8 to 12	26	22	15
6 to 8	12 to 16	30	25	17
8 to 10	16 to 20	34	28	18
10 to 12	20 to 24	38	32	16
12 to 14	24 to 28	43	36	16
14 to 16	28 to 32	47	39	17
16 to 18	32 to 36	50	42	16
18 to 20	36 to 40	53	45	15
20 to 22	40 to 44	56	48	14
22 to 26	44 to 52	59	50	15
26 to 32	52 to 64	62	53	15
32 to 38	64 to 76	65	55	15
38 to 44	76 to 88	69	58	16
44 to 50	88 to 100	72	60	17
50 to 60	100 to 120	75	62	17
60 to 70	120 to 140	78	64	18
70 to 80	140 to 160	81	66	19
80 to 90	160 to 180	84	68	19
90 to 100	180 to 200	87	69	21
100 to 150	200 to 300	89	70	21
150 to 200	300 to 400	90	70	22
200 and over	400 and over	91	70	23

The rate reductions found in table 6 reflect only the marginal rate reduction, or the rate reduction in each bracket. From the standpoint of the reduction in the total tax burden, however, it is important to realize that all taxpayers benefit from the rate reductions in all of the tax brackets below their top, or marginal, bracket. Thus, every taxpayer receives the benefit of the 30-percent reduction in the first bracket, either on his entire taxable income or on his first $500 or $1,000 of taxable income. Table 7 reflects this accumulative effect of the rate reduction provided by the House and committee bill. This is accomplished by showing for the top of each rate bracket—both for married couples and for single persons—the total tax under present law and under House and committee bill for 1965, together with the decrease, in terms of dollars and also percentages, which this represents in present tax liability. This indicates that on an accumulative basis the large rate reduction in the bottom bracket has an important effect on income up to $8,000 for married couples (or $4,000 for single persons) and is of some significance for income levels up to about $40,000 for married couples (or $20,000 for single persons).

TABLE 7-A.—*Comparison of individual income tax liability under present law and under House and committee bill*

MARRIED COUPLE FILING JOINTLY

Amount of taxable income	Tax		Decrease in tax in House and committee bill	
	Present law	House and committee bill	Amount	Percent
$1,000	$200	$140	$60	30.0
$2,000	400	290	110	27.5
$3,000	600	450	150	25.0
$4,000	800	620	180	22.5
$8,000	1,680	1,380	300	17.9
$12,000	2,720	2,260	460	16.9
$16,000	3,920	3,260	660	16.8
$20,000	5,280	4,380	900	17.0
$24,000	6,800	5,660	1,140	16.8
$28,000	8,520	7,100	1,420	16.7
$32,000	10,400	8,660	1,740	16.7
$36,000	12,400	10,340	2,060	16.6
$40,000	14,520	12,140	2,380	16.4
$44,000	16,760	14,060	2,700	16.1
$52,000	21,480	18,060	3,420	15.9
$64,000	28,920	24,420	4,500	15.6
$76,000	36,720	31,020	5,700	15.5
$88,000	45,000	37,980	7,020	15.6
$100,000	53,640	45,180	8,460	15.8
$120,000	68,640	57,580	11,060	16.1
$140,000	84,240	70,380	13,860	16.5
$160,000	100,440	83,580	16,860	16.8
$180,000	117,240	97,180	20,060	17.1
$200,000	134,640	110,980	23,660	17.6
$300,000	223,640	180,980	42,660	19.1
$400,000	313,640	250,980	62,660	20.0

TABLE 7-B.—*Comparison of individual income tax liability under present law and under House and committee bill*

SINGLE PERSONS

Amount of taxable income	Tax		Decrease in tax in House and committee bill	
	Present law	House and committee bill	Amount	Percent
$500	$100	$70	$30	30.0
$1,000	200	145	55	27.5
$1,500	300	225	75	25.0
$2,000	400	310	90	22.5
$4,000	840	690	150	17.9
$6,000	1,360	1,130	230	16.9
$8,000	1,960	1,630	330	16.8
$10,000	2,640	2,190	450	17.0
$12,000	3,400	2,830	570	16.8
$14,000	4,260	3,550	710	16.7
$16,000	5,200	4,330	870	16.7
$18,000	6,200	5,170	1,030	16.6
$20,000	7,260	6,070	1,190	16.4
$22,000	8,380	7,030	1,350	16.1
$26,000	10,740	9,030	1,710	15.9
$32,000	14,460	12,210	2,250	15.6
$38,000	18,360	15,510	2,850	15.5
$44,000	22,500	18,990	3,510	15.6
$50,000	26,820	22,590	4,230	15.8
$60,000	34,320	28,790	5,530	16.1
$70,000	42,120	35,190	6,930	16.5
$80,000	50,220	41,790	8,430	16.8
$90,000	58,620	48,590	10,030	17.1
$100,000	67,320	55,490	11,830	17.6
$150,000	111,820	90,490	21,330	19.1
$200,000	156,820	125,490	31,330	20.0

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Table 8 shows the distribution by adjusted gross income classes (as distinguished from taxable income classes) of both the rate and structural changes provided by the bill when these changes are fully effective. This table also shows the number of taxable returns and tax liability under present law (not including the alternative tax on capital gains), together with the tax liability which will remain when the rate reductions and other changes provided by this bill are fully effective. The table further shows the percentage distribution of the rate, structural, and total changes made by this bill (expressed as a percentage of present tax liability by income class). This indicates that the rate changes on the average represent a 20-percent reduction. The percentage reductions vary within the various income classes from 17 percent for adjusted gross income above $10,000 up to 27.6 percent for incomes below $3,000. Taking the structural changes into account, the overall reduction averages 19.7 percent under your committee's bill and 18.8 percent under the House bill. The reductions under your committee's bill range from 13.5 percent for those with incomes over $50,000 to 38.6 percent for those with incomes under $3,000. Under the House bill this range was from 12.6 to 38.3 percent.

TABLE 8.—*Revenue bill of 1964—Distribution by adjusted gross income class of the full year effect of all tax changes*[1] *made by your committee's bill which directly affect individuals*

Adjusted gross income class (thousands of dollars)	Number of taxable returns (millions)	Tax liability under present law[2]	Effect of revenue bill of 1964: Rate change	Effect of revenue bill of 1964: Structural changes	Effect of revenue bill of 1964: Total	Total tax under revenue bill of 1964
		In millions of dollars				
0 to 3	9.7	1,450	−400	−160	−560	890
3 to 5	10.5	4,030	−1,020	−80	−1,100	2,930
5 to 10	22.9	18,300	−3,905	+85	−3,820	14,480
10 to 20	6.7	12,710	−2,285	+90	−2,195	10,515
20 to 50	1.0	6,760	−1,150	+70	−1,080	5,680
50 and over	.2	4,170	−710	+145	−565	3,605
Total	51.0	47,420	−9,470	+150	−9,320	38,100
		Percent distribution by income class				
0 to 3	19.0	3.1	4.2	−106.7	6.0	2.3
3 to 5	20.6	8.5	10.8	−53.3	11.8	7.7
5 to 10	44.9	38.6	41.2	+56.7	41.0	38.0
10 to 20	13.1	26.8	24.1	+60.0	23.6	27.6
20 to 50	2.0	14.3	12.1	+46.7	11.6	14.9
50 and over	.4	8.8	7.5	+96.7	6.1	9.5
Total	100.0	100.0	100.0	100.0	100.0	100.0
		Percent of tax liability under present law				
0 to 3		100.0	−27.6	−11.0	−38.6	61.4
3 to 5		100.0	−25.3	−2.0	−27.3	72.7
5 to 10		100.0	−21.3	+.5	−20.9	79.1
10 to 20		100.0	−18.0	+.7	−17.3	82.7
20 to 50		100.0	−17.0	+1.0	−16.0	84.0
50 and over		100.0	−17.0	+3.5	−13.5	86.5
Total		100.0	−20.0	+.3	−19.7	80.3

[1] Excluding effect of capital gains provisions and repeal of the requirement to reduce basis by amount of investment credit.
[2] Excludes alternative tax on capital gains.

The tax rate reductions described above take effect as of January 1, 1964, and January 1, 1965. For taxpayers with fiscal years falling partially in either the calendar year 1963 or the calendar year 1964, the bill provides for the proration of the rates applicable in the 2 years involved, according to the number of days in the fiscal year in question which falls in each calendar year.

The tax rate changes provided for individuals by this bill are expected to decrease tax liabilities in the calendar year 1964 by $6.3 billion and in the calendar year 1965 by $9.5 billion. The latter reduction is cumulative and includes the reduction of $6.3 billion for the calendar year 1964.

2. Minimum standard deduction (sec. 112 of the bill and sec. 141 of the code)

(*a*) *Present law.*—Under present law, single taxpayers who take the standard deduction, if they have no dependents, become taxable on income above $667. This represents a standard deduction of 10 percent ($67) plus the personal exemption ($600). For a married couple filing a joint return under present law, income becomes taxable above $1,333. This represents a 10-percent standard deduction ($133) plus two $600 exemptions. Similarly, a married couple with one child becomes taxable on income above $2,000 (a standard deduction of $200 plus three $600 exemptions).

(*b*) *General reasons for proposal.*—In addition to the rate reductions described above, the House and your committee concluded that it was desirable to remove from the tax rolls those persons with minimum incomes and also to provide those with incomes just slightly above these levels a somewhat larger tax reduction than is made available generally through the rate cuts.

The minimum standard deduction that the House and your committee have adopted, and which is described below, removes 1.5 million taxpayers, with very low incomes, from the tax rolls entirely.

The tax relief provided under this provision is almost entirely concentrated in the adjusted gross income classes of $5,000 or less, with much of it concentrated in income levels below $3,000. The total revenue loss anticipated from the minimum standard deduction of $320 million, for example, is distributed as follows:

Adjusted gross income class (thousands of dollars)	Change in tax liability from minimum standard deduction (millions of dollars)	Percentage change in present tax liability
0 to 3	−170	−11.7
3 to 5	−100	−2.5
5 to 10	−50	−.3
10 and over	0	0
Total	−320	−.7

The minimum standard deduction relieves persons at or near the subsistence level of much or all of their tax liability. In this respect the provision is much more economical than a personal exemption increase. The minimum standard deduction in the bill provides a floor of $300 above his exemption for a single person, a floor of $400 above exemptions for a married couple, and one of $600 above exemptions for a married couple with two children. Yet an increase in exemptions of only $100 would cost $2.6 billion, and one of $200 would cost $5 billion in lieu of the $320 million cost entailed in the minimum standard deduction.

(c) *General explanation of proposal.*—The bill provides that taxpayers who use the standard deduction may use either the regular 10-percent deduction or a minimum standard deduction, whichever is the larger. The minimum standard deduction in effect is $300 for the first exemption and $100 for each additional exemption. In the case of a married person filing a separate return, however, the minimum standard deduction is $200 for the first exemption and $100 for each additional exemption.[1] As under present law, the standard deduction, whether a "10-percent" deduction or a "minimum" deduction, may not exceed $1,000 (or $500 in the case of a married person filing a separate return).

Under the bill, a single person would be allowed a minimum standard deduction of $300 which, together with the personal exemption of $600, would mean that he would have no tax to pay until his income exceeded $900. Similarly, a married couple with no children would be allowed a minimum standard deduction of $400 ($300 for the first exemption, plus $100 for the second exemption). As a result, the married couple would pay tax on income only in excess of $1,600. A head of a household with one dependent also would be subject to tax only on income above $1,600, since the minimum standard deduction in this case also would be $300, plus $100 for the dependent. A married couple, both over age 65, would receive a minimum standard deduction of $600; i.e., $300 with respect to the first exemption, and $100 with respect to the three additional exemptions. This together with their four exemptions would mean they would pay no tax on the first $3,000 of income. This would also be true of blind persons with double exemptions.

The income levels under present law and under the bill at, or below, which there would be no tax, are as follows:

Status of taxpayer	Present law with 10-percent standard deduction	Minimum standard deduction provided by bill
Single person	[1] $667	$900
Married couple, no dependents or head of household, 1 dependent	[1] 1,333	1,600
Married couple, 1 dependent or head of household, 2 dependents	[1] 2,000	2,300
Married couple, 2 dependents or head of household, 3 dependents	[1] 2,667	3,000
Married couple, 3 dependents or head of household, 4 dependents	[1] 3,333	3,700
Married couple, 4 dependents or head of household, 5 dependents	[1] 4,000	4,400
Married couple, 5 dependents or head of household, 6 dependents	[1] 4,667	5,100
Married couple, 6 dependents or head of household, 7 dependents	5,333	5,800

[1] The amounts shown above assume that the income level under existing law is reached at exactly the level which would apply if a uniform 10 percent standard deduction were used. However, under present law for taxpayers with income below $5,000, a tax table with brackets is substituted for the uniform 10 percent. This modifies slightly all of the figures noted above. The income levels in these cases according to the tax table are $674, $1,324, $1,999, $2,674, $3,349, $3,999, and $4,649 respectively.

[1] In the case of married couples, where one takes the 10-percent standard deduction, rather than the minimum standard deduction, the other spouse must also take the 10-percent standard deduction. However, both may, if they so desire, elect to take the minimum standard deduction, which, as indicated above, is $200 for the 1st exemption and $100 for each additional exemption in the case of married persons filing separate returns.

Under the bill, taxpayers have the right to change their election with respect to the minimum standard deduction at any time within the period in which they can amend their tax return, that is, generally within the period ending 3 years after the due date filing for a given return.

(*c*)(*i*) *Effective date.*—Generally, the minimum standard deduction applies to taxable years ending after December 31, 1963. However, for taxpayers with fiscal years straddling this date, the bill provides for a portion of the benefits of the minimum standard deduction in the same way as rate reductions, in accordance with the number of days before and after December 31, 1963, in such years.

(*d*) *Revenue effect.*—The minimum standard deduction provided by this bill is expected to reduce revenues in a full year of operation by $320 million.

3. Amendments related to individual income tax rate reductions (sec. 113 of the bill and secs. 37 and 871 of the code)

(*a*) *Retirement income credit.*—Present law provides a tax credit on retirement for passive investment or pension income received by persons generally over age 65. However, the income taken into account for this credit must be reduced for tax exempt social security or railroad retirement income, and for those under age 72 for income derived from work above a specified income level. In computing the credit, present law provides that the income eligible for the credit is to be multiplied by the "rate provided in section 1 for the first $2,000 of taxable income." Under present law, this rate is 20 percent. Under both the House and committee bill, however, since this bracket has been split into four brackets, there are four rates ranging from 14 to 17 percent, applicable to different segments of this first $2,000 of taxable income.

The bill provides that the rate of tax to be used in computing this credit in the future is to be 15 percent. This is as near the middle of the four rates applicable to the first $2,000 of income as is possible, without the use of fractional rates.

(*b*) *Tax on nonresident aliens.*—Under present law, nonresident aliens receiving income from sources within the United States, such as interest, dividends, rents, salaries, wages, etc., are taxed on this income at a flat 30-percent rate (unless applicable tax treaties provide some other rates). However, present law also provides that if the nonresident alien receives more than $15,400 from the specified sources within the United States, then the regular individual income tax will apply with respect to the nonresident aliens' income from sources within the United States (if this results in a higher tax than the flat rate 30-percent tax).

The income level of $15,400 in present law is the point at which a 30-percent flat tax rate with one exemption would be likely to approximate the regular income tax rate with exemptions and with progressive rates. Because of the rate reductions provided by the bill, this income level of approximate equality rises, and has been established in the bill at $21,200.

4. Corporate rate reductions (sec. 121 of the bill and sec. 11 of the code)

Under present law, the total, or combined, corporate income tax rate is 52 percent. It consists of a 30-percent normal tax rate, applying to all corporate income, and a 22-percent surtax rate applying to corporate income in excess of $25,000. Thus, corporations are taxed at a 30-percent rate on the first $25,000 of their taxable income and at a 52-percent rate on their taxable income above that level.

The House and committee bill makes two basic changes in the rate structure provided by present law. First, it lowers the overall rate from 52 to 50 percent for 1964, and to 48 percent for 1965 and subsequent years. Second, it "reverses" the normal and surtax rate in order to provide greater relief for small business. Thus, it provides that the normal tax rate is to be 22 percent instead of 30 percent for 1964 and subsequent years. The surtax rate then, for 1964, is to be 28 percent, and for 1965 and subsequent years, 26 percent. Thus, the bill provides a tax rate of 22 percent (in place of 30 percent) on the first $25,000 of a corporation's taxable income for both 1964 and subsequent years and a tax rate of 50 percent in 1964 and 48 percent in 1965 and subsequent years for the portion of a corporation's income over $25,000 (in lieu of the present 52-percent rate).

This reduction in corporate rates is important because it reverses the trend toward higher and higher corporate rates and also because it again makes the Government a "junior," rather than "senior," partner in any venture a corporation may undertake, insofar as the sharing of corporate income before tax is concerned. This tax rate reduction should be an important factor in improving the rate of profitability for corporations and, therefore, should provide an incentive for business investment and economic modernization and growth. It should also aid corporations in the export market in competing with corporations in other countries, where the corporate rates may not be as high as in the United States.

This tax cut for corporations, when fully effective, will amount to $2.2 billion a year. It should, of course, be viewed in connection with the reduction provided by Congress in 1962 in the form of an investment credit and the reform provided in 1962 in the depreciation guidelines. These taken together provide corporations with a tax reduction of approximately $4½ billion.

The "reversal" of the corporate rates should be a substantial benefit to small business. The substitution of a 22-percent rate for the 30-percent rate represents a rate reduction of nearly 27 percent on the first $25,000 of income, as contrasted to the rate reduction for income above $25,000 of slightly less than 8 percent. Moreover, as indicated in table 9, the benefit of this rate reduction on the first $25,000 of income is appreciable for income levels up to $100,000.

TABLE 9.—*Revenue effect* [1]

Surtax net income class (dollars)	Number of taxable corporations	Computed tax liability, present rates [2] (million)	Normal tax to 22 percent and combined rate to 48 percent	
			Amount of reduction (million)	Percent reduction
0 to 25,000	467,500	$874	$233	26.7
25,000 to 50,000	54,000	636	126	19.8
50,000 to 100,000	25,000	759	94	12.4
100,000 to 1,000,000	25,500	3,427	299	8.7
1,000,000 and over	4,000	18,664	1,438	7.7
Total	576,000	24,360	2,190	9.0

[1] At 1963 levels of income.
Excluding capital gains presently taxed at the alternative rate.

Your committee agrees with the House that it is important to provide a greater rate reduction for small businesses because of their importance in maintaining competitive prices in our economy, and also because of the greater difficulty small businesses have in finding outside funds to finance their expansion. As a result, they have traditionally found it necessary to expand largely out of income remaining after tax.

The rate reductions provided by the House and your committee for corporations apply to taxable years beginning after December 31, 1963, in the case of the reversal of the normal and surtax rates and also in the case of the reduction of the general rate to 50 percent. The reduction in the corporate rate from 50 to 48 percent applies to taxable years beginning after December 31, 1964. For fiscal year taxpayers, with years straddling either of these two dates, the bill provides that the reductions are to be prorated in accordance with the portion of the corporate year occurring after December 31, 1963, or after December 31, 1964.

The decrease of corporate rate from 52 to 50 percent in the calendar year 1964, and the reversal of the normal and surtax rates, is expected to decrease corporate tax liabilities for that year by $1.3 billion. The reduction in corporate tax liabilities for the calendar year 1965 and subsequent years (when the corporate rate will be further reduced to 48 percent) is expected to amount to $2.2 billion. This estimate is cumulative and includes the $1.3 billion loss referred to with respect to 1964 corporate tax liabilities.

5. Current tax payments by corporations (sec. 122 of the bill and secs. 6074 and 6154 of the code)

(*a*) *Present law.*—Under present law a calendar year corporation is required to pay 25 percent of its estimated tax in excess of $100,000 in the third quarter of the year in which the tax liability actually arises, or on September 15. Another one-fourth of this estimated tax is paid in the fourth quarter of the year of liability, or on December 15. The remainder of the tax is paid in two equal installments in the following year, the first installment being due at the same time as the tax return for that year, or on March 15, and the second and final installment being due on June 15. Comparable dates are provided for fiscal year corporations.

This system of paying two quarterly installments with respect to tax liability in excess of $100,000 in the same year in which the liability arises, was initially provided at the time of the adoption of the Internal Revenue Code of 1954. Before that time Congress had, in 1950, provided, in the case of calendar year corporations, that the tax was to be paid in two installments of 50 percent each on March 15 at the time for filing the return and on the following June 15, both of these payment dates being in the year immediately following the year in which the tax liability arose. (Comparable dates were provided for fiscal year corporations.) Prior to 1950, corporate taxes were payable in four installments of 25 percent each, the first two for calendar year corporations being on the dates specified above, and the last two on the following September 15 and December 15—both dates being in the year following the year in which the tax liability arose.

(*b*) *General reasons for provisions.*—As indicated above, corporations presently are only on a partial pay-as-you-go basis. Individuals, on the other hand, either through withholding or through declarations, are on a full pay-as-you-go basis. Both the House and your committee, with respect to tax liability in excess of $100,000, place corporations on essentially the same pay-as-you-go basis as is already true in the case of individuals. This is to be accomplished gradually over a 7-year period. With the corporate rate reduction also provided by this bill, spreading the acceleration in corporate payments over this 7-year period can be accomplished without raising any corporation's income tax payment above its tax for 1963 (assuming the same income level throughout).

At the present time, the larger corporations appear to have sufficient funds to meet their investment requirements. In fact, many of the larger corporations customarily fund their tax liabilities by investing currently in Treasury tax notes or other types of short-term debt. Moreover, the cash and other liquid assets of corporations in 1962 amounted to $68.5 billion, or some five times the aggregate tax liability of these corporations. In any event, since in each year the acceleration in payments is offset or more than offset by the tax reduction, the speedup of corporate payments will not decrease internal funds available at the corporate level for investment. At the same time, the reduction in the rate of corporate tax will increase the profitability of investments, thus encouraging further expansion.

Since the acceleration of the corporate payments has no effect if tax liabilities are $100,000 or less, the smaller corporations which, in many cases, may have a shortage of internal funds available for investment, will not be affected by this provision. Such corporations will have additional funds available for investment through the general 4 percentage point corporate rate cut, and more especially through the 8 percentage point reduction in the tax applying to the first $25,000 of income.

(c) *General explanation of provision.*—Over the 7-year period, 1964 through 1970, the House and the committee bill, in effect, provides, in the case of calendar year corporations, that the two installment payments due on March 15 and June 15 of the year following the year of liability are to be advanced to April 15 and June 15 of the year of liability, leaving the September 15 and December 15 installment payments of 25 percent still due at the same time as under present law. (A comparable advance is made for fiscal year corporations.) Any liability, to the extent that it is not paid by estimated tax payments (for example, does not exceed $100,000), will still be payable in two installments after the close of the year of liability, on March 15 and June 15, in the same manner as under present law. The following tabulation shows the change in the percentage payment dates from present law to the system set forth in the bill when it is fully effective in 1970 and subsequent years:

	Percentage payments	
	Present law	Under bill when fully effective in 1970
Payments in year of liability:		
Apr. 15	0	25
June 15	0	25
Sept. 15	25	25
Dec. 15	25	25
Payments in year following year of liability:		
Mar. 15	25	(1)
June 15	25	(1)

[1] Payments will still be due on these 2 dates with respect to tax liability on the 1st $100,000 of tax and on any amount of underestimates.

The advance in corporate payments described above is achieved under the bill over a 7-year period, commencing in 1964, with respect to tax liabilities arising in that year. For corporations with tax liabilities in excess of $100,000, the bill requires that they make first and second quarterly current payments of 1964 tax in excess of $100,000 of 1 percent in April and June of 1964 (assuming they are calendar year corporations), with these quarterly percentages increasing to 4 percent in 1965, 9 percent in 1966, 14 percent in 1967, 19 percent in 1968, 22 percent in 1969, and then 25 percent in 1970 and subsequent years. These percentages apply only with respect to the portion of the corporations' tax liabilities which exceed $100,000. This gradual shift of the corporate tax payments, with respect to tax liability above $100,000, can perhaps best be seen by the following tabulation.

	Percent of estimated tax to be paid on the 15th day of the—				Percent of tax to be paid on the 15th day of—	
	4th month	6th month	9th month	12th month	3d month	6th month
	of the year of liability				of the year following the year of liability	
1964	1	1	25	25	24	24
1965	4	4	25	25	21	21
1966	9	9	25	25	16	16
1967	14	14	25	25	11	11
1968	19	19	25	25	6	6
1969	22	22	25	25	3	3
1970 and any subsequent year	25	25	25	25	(1)	(1)

[1] Payments will still be due on these 2 dates with respect to tax liability on the 1st $100,000 of tax and on any amount of underestimates.

The percentages of the tax liabilities to be accelerated for each of the years 1964 through 1970 were selected so that the speedup in corporate payments would not exceed the reduction in tax liabilities provided by the bill. The effect of the speedup on corporate tax liabilities for a calendar year corporation having a $10 million tax liability is shown in table 10. As indicated by this table, the combined effect of the rate reduction with the acceleration of corporate payments in all years results in a net reduction in tax payments, even for a corporation with a taxable income of $10 million. Corporations with smaller incomes would fare still more favorably in this respect.

The present provisions exempting corporations from any additional charges for failure to comply with the provisions of the declarations of estimated tax are continued as under present law. Present law provides an additional charge equal to 6 percent per annum for underpayments only if the estimated tax payments fail to come under one of the following four categories:

(1) they amount to 70 percent of the tax shown on the final return after subtracting $100,000 and allowing credits;

(2) they amount to as much as the previous year's tax reduced by $100,000;

(3) they are equal to what last year's tax (less $100,000 and allowable credits) would have been had current rates been applicable to that year's income; or

(4) the installment with respect to the declaration for any quarter is equal to 70 percent of the tax (less $100,000 and allowable credits) due on the basis of the income received to date, placed on an annual basis.

TABLE 10.—*Example of the combined effect on a calendar year corporation of current tax payments and the tax rate reductions provided by the bill (corporation assumed to have $10 million of taxable income and to base its estimates on 75 percent of this income* [1])

Calendar year	Corporation payments		Calendar year	Corporation payments	
	Dollars	Percent of 1963		Dollars	Percent of 1963
1963	5,194,500	100.0	1968	5,145,513	99.1
1964	5,192,332	99.9	1969	5,004,707	96.3
1965	5,126,402	98.7	1970	5,004,707	96.3
1966	5,145,512	99.1	1971	4,793,500	92.3
1967	5,145,513	99.1			

[1] Your committee's bill provides for (1) a reduction of the normal tax rate to 22 percent in 1964; of surtax rate of 28 percent in 1964 and 26 percent in 1965; and (2) 1st and 2d quarter current payments in 1964 and 6 succeeding years of 1, 4, 9, 14, 19, 22, and 25 percent.

(c)(i) *Effective date.*—The changes described above with respect to the acceleration of corporate tax payments start in taxable years beginning after December 31, 1963, and will become fully effective for taxable years beginning after December 31, 1969.

(d) *Revenue effects.*—It has been estimated that this proposal will increase revenues in the fiscal year 1964 by $260 million and in the fiscal year 1965 by $900 million.

IV. GENERAL EXPLANATION

B. STRUCTURAL CHANGES

1. *Dividend credit and exclusion (sec. 201 of the bill* [1] *and secs. 34 and 116 of the code)*

(a) *Present law.*—Under present law, individuals are allowed to exclude from their tax base the first $50 of dividend income. If a husband and wife each have dividend income (or if they have such income jointly), the exclusion claimed on a joint return may amount to as much as $100 of dividend income. In addition, under present law, a credit of 4 percent is allowed against tax for any dividends

[1] The parenthetical references to the bill are to the bill as amended by your committee.

remaining after the $50 or $100 exclusion. This credit may not, however, exceed 4 percent of taxable income.[2]

(*b*) *General reasons for provision.*—In 1954 when the present dividend credit and exclusions were adopted, the committee report indicated that these relief measures were provided because the earnings of a corporation are taxed twice, once as corporate income and again as dividend income when paid out to the shareholders. It was stated that in addition to this being a double tax on this type of income, it also was a deterrent to investment in corporations. The report in 1954 partcularly stressed the effect of the penalty of double taxation in channeling investments in the form of indebtedness rather than equity capital or stock.

In fact, the reduction in the corporate rate by 4 percentage points provided by this bill probably does as much to remove any double taxation involved with respect to corporate distributions as would the continuance of the present 4 percent dividend credit. Moreover, from the standpoint of making funds available for investment in corporate enterprises, this reduction in tax with respect to retained earnings can be expected to have a more important impact on corporate investment than any reduction directed solely toward corporate income which is distributed. This greater encouragement for corporate investment has been provided not only by the corporate rate cut in this bill, but also by the investment credit allowed with respect to business investment in the Revenue Act of 1962. The House and your committee's action in this bill, in making this investment credit available without reduction in the depreciation base, provides still further inducements for business investment.

In addition, the notion that the dividend credit would encourage equity financing does not seem to be borne out by the events which have occurred since 1954. The Secretary of the Treasury has pointed out that the ratio of equity to debt financing by corporations has not increased despite the presence of the 4-percent credit.

The form of the present dividend credit, in any event, is undesirable since it reduces any double taxation by a much larger percentage for the higher income bracket stockholders than it does for those in the lower bracket. Information presented by the Secretary of the Treasury indicated that the dividend credit, even combined with the present exclusion, reduces the extra burden of double taxation by 10.4 percent in the highest income bracket, while reducing it by only 4.3 percent for those subject to the first bracket rate.

In view of these considerations, your committee agreed with the House that it would be better to concentrate relief from any double taxation which it is possible to provide in a dividend exclusion rather than in a dividend credit. The dividend exclusion, in the area operative, completely removes any double taxation. Moreover, increasing the exclusion, as the bill provides, will tend to encourage a broader stock ownership among those with relatively low income. At the same time, the repeal of the credit removes the discrimination in present law in favor of high bracket shareholders. Furthermore, removing the credit even though doubling the exemption available has the effect of raising $300 million of revenue in the calendar year

[2] The dividend exclusion and credit are not allowed for dividends received from foreign corporations, China Trade Act corporations, exempt corporations, corporations deriving most of their income from U.S. possessions, real estate investment trusts, life insurance dividends, dividends from mutual savings banks, domestic building and loan associations, etc., and capital gains dividends from regulated investment companies.

1965 and subsequent years, which in the bill is devoted to further individual income tax rate reductions than would otherwise be possible.

(c) *General explanation of provision.*—In view of the considerations referred to above, the bill, both as passed by the House and as approved by your committee, decreases from 4 to 2 percent the credit against tax allowed for dividends received during the calendar year 1964. With respect to dividends received in 1965 and subsequent years, the credit is repealed altogether. Consistent with the treatment provided when the tax credit was 4 percent of the dividend income, the dividend credit allowable during the calendar year 1964 is to be limited to 2 percent of taxable income received by an individual during that year.

The bill provides that with respect to dividends received in the calendar year 1964 and subsequent years the maximum exclusion per individual with respect to dividends received from a domestic corporation is to be $100, in lieu of the $50 available at the present time. In the case of married couples, where each owns stock separately or where stock is owned jointly and joint returns are filed, the maximum exclusion will be $200 in place of the $100 applicable under present law.

(c)(i) *Effective date.*—As indicated above, the dividend credit is reduced from 4 percent to 2 percent with respect to dividends received in the calendar year 1964 and is repealed with respect to dividends received in 1965 and subsequent years. The dividend exclusion is doubled with respect to amounts received in the calendar year 1964 and subsequent years.

(d) *Revenue effect.*—The combined effect of the reduction and then repeal of the credit and the increase of the exclusion is expected to increase tax liabilities by about $120 million for the calendar year 1964 and by $300 million in the calendar year 1965 and subsequent years when the repeal of the credit becomes fully effective.

2. Limitation on retirement income (sec. 202 of the bill and sec. 37 of the code)

(a) *Present law.*—Present law provides a retirement income credit which in general terms is designed to provide a credit against tax for those making provision for their retirement other than through social security, or railroad retirement or other tax-exempt income, and it is intended that this credit be approximately equal in value to the exclusions provided in the case of social security, etc. Thus, the maximum amount of income with respect to which a retirement income credit may be taken is geared to the maximum social security payment. Moreover, the credit is based upon the amount of pension or investment income of the individual involved, on the general principle that this represents the retirement base built up by those not covered by social security, etc. (or not covered to any appreciable extent). For the same reasons, the amount of income upon which the credit is based is reduced for any tax-exempt social security, railroad retirement, or other similar income received by the individual.

In addition, what amounts to a "work clause" applies to the retirement income credit to make it comparable to social security payments which also are reduced for earned income received by the individual above a specified level. The reduction for earned income in the case of the retirement income credit generally is a reduction of 50 percent for any earned income above $1,200 but not above $1,700, and a 100 percent reduction for any earned income above $1,700.

Social security and the retirement income credit also are correlated in the earnings requirement. To be covered for social security tax purposes, an individual generally must have a minimum coverage of 40 quarters or 10 years, assuming he has been in covered employment for a sufficient period of time. On the same basis, the retirement income credit provides that an individual to be eligible for the retirement income credit must have had 10 years of prior earnings experience, in each year of which he earned in excess of $600. For this requirement a widow or widower may use the earnings experience of the deceased spouse in much the same way as is provided in the case of social security benefits.

(*b*) *General reasons for provision.*—The attention of your committee was called to the fact that in one respect the retirement income credit is not coordinated with the social security program. Under the old age and survivors insurance program, if a husband has the appropriate 40 quarters of coverage but the wife does not, nevertheless, the payment may be made not only with respect to the husband directly but also a supplementary payment of one-half the size of the payment going to the husband may also be made with respect to the wife. The retirement income credit, on the other hand, contains no supplementary payment with respect to a spouse where that individual does not have the requisite prior 10 years' earnings experience. To provide a retirement income credit of one-half the size of that going to the primary wage earner in the family in such a case is the purpose of the amendment added by your committee.

(*c*) *General explanation of provision.*—Your committee has added a new subsection to the existing retirement income credit provision to provide that where the husband and wife have both attained the age of 65 before the close of the year, the maximum income on which the credit may be based is to be increased above the present ceiling of $1,524 by $762, or one-half of the present maximum. This is designed as the equivalent of the supplementary benefit going to a wife under the old age and survivors insurance program.

Where only one spouse has the requisite 10 years' prior earnings experience and receives an increase in his retirement income of $762, this amount is to be reduced by any social security, railroad retirement, or other tax-exempt pension income received by the spouse without the prior earnings experience. In addition, this $762 is to be decreased by any earned income this spouse is currently receiving in excess of $1,200 (on a 50-percent basis with respect to income between $1,200 and $1,700) assuming this spouse has not reached the age of 72.

If one spouse does not have 10 years' prior earnings experience, then the maximum base retirement income of the other spouse is increased by the full $762 (with certain reductions referred to later). On the other hand, if both husband and wife have the requisite 10 years' prior earnings experience and if one of them has less than $762 of retirement income, then the maximum of $1,524 with respect to the other spouse is to be increased to the extent that the retirement income of the other spouse is less than $762. Computations, similar to the reductions referred to above where only one spouse has the ten years prior earnings experience, are required here with respect to tax-exempt income and earnings above the specified levels.

It should be noted that increasing a spouse's maximum allowable retirement income by the $762, or any part of this amount, does not of necessity mean a larger retirement income credit. Whether he can receive a larger retirement income credit in such a case depends upon whether or not he receives sufficient qualifying investment and/or pension income to reach this new ceiling level, which may be as high as $2,286. The credit allowable is 15 percent of this amount.

(c)(i) *Effective date.*—This increase in the retirement income credit applies to taxable years beginning after December 31, 1963.

(d) *Revenue effect.*—It is anticipated that this will result in an annual revenue loss of $10 million a year.

3. Investment credit: Repeal of provision reducing basis of property by 7 percent and other amendments (sec. 203 of the bill and secs. 48 and 1245 of the code)

(a) *Present law.*—Last year in enacting an investment credit, Congress in general allowed a credit equal to 7 percent of certain types of investment (3 percent in effect in the case of most public utilities). This amount may be offset in full against tax liability up to $25,000 and against one-quarter of the tax liability above this level. Property with an estimated useful life of 8 years or more is fully taken into account in computing this credit, property with an estimated life from 6 to 8 years is taken into account at two-thirds of its cost, while property with an estimated life from 4 years up to 6 years is taken into account at one-third of its cost. The credit for the most part is limited to purchases of tangible personal property. As a result, machinery and equipment are the principal types of investment eligible for the credit.

As finally enacted in the Revenue Act of 1962, it was further provided that the base on which depreciation may be taken in the case of assets eligible for the investment credit was to be reduced by the amount of the credit. Thus, for example, where a taxpayer purchased a $100 asset and $7 of this purchase price was allowed as an investment credit, the basis on which depreciation could be computed with respect to the asset was decreased from $100 to $93.

(b) *General reasons for provisions.*—Although the investment credit enacted last year appears to have been successful in stimulating investment, several problems have arisen with respect to this credit which are dealt with in this bill.

First and most important of the changes made is the repeal of the requirement that the basis of property eligible for the investment credit be reduced by 7 percent of the qualified investment. This provision requires that if property costing $100 and eligible for an investment credit of $7 was acquired, the basis of this property for purposes of depreciation (or gain or loss on sale) was to be reduced from $100 to $93.

This provision has proved troublesome to taxpayers since it requires a downward basis adjustment with respect to eligible property, whether or not an investment credit is claimed for the property. Moreover, making this adjustment has presented recordkeeping problems for taxpayers, especially in the case of early retirements, and also severely complicated the statutory language of the investment credit provision.

In addition, this basis adjustment for property severely restricted the incentive effect of the investment credit. In effect, this amendment converted the 7-percent credit into a 3½-percent credit for corporations, plus a 7-percent initial depreciation allowance. This result occurs because the decrease in basis of the asset which may be written off means that the equivalent of approximately one-half of the investment credit is recouped over the life of the asset in substantially the same manner as an initial depreciation allowance. This effect substantially reduces the incentive effect of the credit, since it means that approximately half of the benefits must be restored over the useful life of the asset. In effect, this transforms one-half of the credit into an interest-free loan.

To remove the recordkeeping and accounting problems which have arisen in connection with the basis adjustment provision and also to provide a greater stimulus with respect to the investment credit, the bill, both as passed by the House and as reported by your committee, repeals this basis adjustment provision. It also provides a means whereby over a period of time taxpayers may recoup their basis adjustments already made.

A second problem presented with respect to the investment credit arises in determining the amount of the credit in certain situations in the case of leased property. Under present law a lessor may pass on the benefits of any investment credit with respect to his purchases or other acquisitions to the lessee of the property. This was provided on the grounds that it was the lessee in such cases who was creating the additional market for investment. The existing provision in this respect provides that the amount of the investment credit, if the property is constructed by the lessor, is to be the appropriate percentage of the "fair market value" of the property. However, in all other cases involving leases the investment credit is to be the appropriate percentage of the basis of the property to the lessor. In practice, this has discriminated in favor of manufacturers of equipment relative to independent distributors. Thus, in the case of equipment leased by the manufacturer having a fair market value of $1,000 the investment credit passed through to the lessee in this case will be 7 percent of $1,000 or $70. However, if the same equipment is purchased from the manufacturer by an independent distributor at a dealer's discount of perhaps 25 percent, the basis of the property to the dealer would be $750. Thus, he could pass on an investment credit of only $52.50 instead of the $70. As a result, it is more advantageous for customers to lease the property directly from manufacturers, rather than from independent distributors. Both the House and your committee's version of the bill removes this discrimination by basing the credit in both cases upon the fair market value of the property.

A third problem arises with respect to the treatment of escalators and elevators in the case of the investment credit. Among the categories of property not eligible for the investment credit are buildings and their structural components. Your committee's report indicated that the term "structural components" of a building included such parts of a building as central air conditioning and heating systems, plumbing and electric wiring and lighting fixtures relating to the operation and maintenance of the building. The proposed regulations issued by the Treasury Department with respect to the term "structural components" provide an extensive list of the type of items considered to be structural components and therefore not eligible for the investment credit. Among these items are escalators and elevators. While these regulations are an accurate interpretation of the intention of Congress last year in this respect, nevertheless your committee agrees with the House that it is appropriate to reconsider the treatment of escalators and elevators for purposes of the investment credit. Escalators and elevators are closely akin to assets "accessory to the operation" of a business which presently are eligible for the investment credit. These assets include machinery, printing presses, transportation or office equipment, refrigerators, individual air-conditioning units, grocery counters, etc. In addition, new elevator and escalator equipment represents an important aspect of modernization of plant and facilities.

For the reasons cited above, the bill provides that new elevators and escalators installed after June 30, 1963, and modernization of existing elevators after that date should be eligible for the investment credit. This, of course, also means that elevators and escalators will be treated as coming under the recapture provision enacted in 1962. This in general provides that depreciation deductions taken with respect to such equipment in the future are to give rise to ordinary income to the extent of any gain recognized on the sale of such property.

A fourth modification in the investment credit relates to the treatment of the credit by regulatory bodies. Both the House and Senate committee reports on the investment credit, as well as the statement of the managers on the part of the House with respect to the conference (and the floor statement on the Senate with respect to the conference report) state that the purpose of the investment credit was to stimulate investment by reducing the net cost of acquiring depreciable assets. This is shown by the following quotations. First, in the report of the Committee on Ways and Means of the House on that bill:

> The investment credit will stimulate investments because—as a direct offset against the tax otherwise payable—it will reduce the cost of acquiring depreciable assets. This reduced cost will stimulate additional investment as it increases the expected return from their use. The investment credit will also encourage investment because it increases the funds available for investment. * * *

In the report of your committee on that bill it was stated:

> The investment credit will stimulate investment, first by reducing the net cost of acquiring depreciable assets, which in turn increases the rate of return after taxes arising from their acquisition. * * *
>
> The objective of the credit is to reduce the net cost of acquiring new equipment; this will have the effect of increasing the earnings of new facilities over their productive lives and increasing the profitability of productive investment. It is your committee's intent that the financial assistance represented by the credit should itself be used for new investment, thereby further advancing the economy.

Again, in the statement of the managers on the part of the House with respect to the conference committee, and also in the floor statement of the manager of the bill in the Senate, it was stated:

> It is the understanding of the conferees on the part of both the House and Senate that the purpose of the credit for investment in certain depreciable property, in the case of both regulated and nonregulated industries, is to encourage mod-

ernization and expansion of the Nation's productive facilities and to improve its economic potential by reducing the net cost of acquiring new equipment, thereby increasing the earnings of new facilities over their productive lives.

Despite the statements cited above, the Federal Communications Commission has indicated that it is its policy that any benefits from the investment credit made available by the Revenue Act of 1962 should "flow through" immediately to the customers. In addition, the staff of the Federal Power Commission has recommended the same position. This is clearly contrary to the intent of Congress in enacting this provision and as a result this bill contains a provision to the effect that it was and is not Congress' intention that the Federal regulatory agencies require the benefit of the investment credit to "flow through" in this manner.

(c) *General explanation of repeal of basis adjustment provision.*—In the case of property placed in service after December 31, 1963, the bill, as amended by your committee, repeals the provision in existing law requiring a downward adjustment in the basis of property by 7 percent of the qualified investment. In the House bill the repeal of the provision was for property placed in service after June 30, 1963. This date was moved up by your committee because of the later consideration of the bill by your committee.

In addition, the bill provides that the basis of property eligible for the investment credit which was placed in service before January 1, 1964 (July 1, 1963 under the House bill), is to be increased by 7 percent of the qualified investment for such property, as of the first day of the taxpayer's first taxable year beginning on or after that date—January 1, 1964, with respect to a calendar-year taxpayer.[1]

Where the lessor passed the benefit of the investment credit on to the lessee, present law provides that the deductions allowed to the lessee for payments to the lessor under the lease contract are to be adjusted downward to reflect an amount similar to the amount of basis denied in the case of other than lease property. The bill provides that where this has occurred the Treasury is to provide for upward adjustment in the deductions allowed to the lessee for amounts paid to the lessor to similarly reflect the restoration of basis adjustments in these cases.

The effect of the provisions described above is to provide for no downward adjustment in basis with respect to property placed in service after December 31, 1963 (June 30, 1963, under the House bill). With respect to property placed in service before that time but in 1962 or 1963 and still on hand at the beginning of the taxpayer's first year beginning after that time (January 1, 1964, in case of calendar-year taxpayers) the basis on which depreciation is taken (or gain or loss in the case of sale) for property which was eligible for the investment credit is to be increased by the same 7 percent by which the basis was reduced when the property was acquired. This addition to basis in the case of those computing depreciation on a straight-line basis will be recouped ratably by the taxpayer over the remaining life of the assets. In the case of double declining balance depreçiation the recoupment will occur somewhat more rapidly. This method of handling the

[1] The restoration of basis referred to above is to be reduced with respect to any previous restoration which may have arisen because the property was no longer eligible for the investment credit or because of conversion of industrial property to public utility use, therefore no longer being eligible for the full investment credit.

restoration of the basis in the case of previously acquired investment credit assets makes the taxpayer "whole" without the necessity of refunds.

(c)(i) *Credit for leased property to lessee.*—As indicated above, present law provides that when the investment credit is passed through from the lessor to the lessee the investment credit is to be based on the fair market value of the property if the property was constructed by the lessor, but otherwise is to be determined from the basis of the property to the lessor. The House and your committee's bill provides that the investment credit in these lease cases is to be based on the fair market value of the property, whether or not the lessor created the property. An exception to this rule is provided, however, where the property is leased by a corporation which is a member of an affiliated group to another member of the same affiliated group. In this latter case, since there is no lease to an "outsider," the investment credit will still be determined on the basis of the cost of the property to the lessor. This amendment applies to property, the possession of which is transferred to a lessee on or after the date of enactment of this bill.

(c) (ii) *Treatment of elevators and escalators.* Elevators and escalators have not, up to this time, been eligible for the 7-percent investment credit, since they have been classified as structural components of a building which specifically were not eligible for the investment credit. Both the House and your committee's version of the bill, however, modifies this rule. It provides in the case of elevators and escalators that where their construction, reconstruction or erection is completed after June 30, 1963, or the elevator or escalator is new in the hands of the taxpayer and is acquired after that date, then the cost of the elevator or escalator (or a reconstruction) is to be eligible for the investment credit.

In view of the fact that the investment in elevators and escalators is to be eligible for the investment credit, they also are to be treated as subject to the recapture provision (sec. 1245) enacted by Congress in 1962. However, only depreciation deductions taken with respect to periods after June 30, 1963, are to be subject to this ordinary income recapture where the elevator or escalator subsequently is sold at a gain (and then only to the extent of this gain are these depreciation deductions to be treated as ordinary income). This provision applies only to elevators and escalators sold after December 31, 1963.

(c)(iii) *Treatment of investment credit by Federal regulatory agencies.*—Another investment credit provision in the bill makes it clear that it was the intent of Congress in providing an investment credit in 1962, and that it is the intent of Congress this year in repealing the reduction in basis required with respect to investment credit assets, to provide an incentive for the modernization and growth of private industry, including regulated industries.

As a result, the bill specifies in two paragraphs the intent of Congress as to the treatment of the investment credit by Federal regulatory agencies. It states in the case of public utility property that these regulatory agencies are not, without the taxpayer's consent, for the purpose of establishing the cost of service of the taxpayer, to treat more than a proportionate part of an investment credit (determined with reference to the useful life of the property) as reducing the taxpayer's Federal income tax liabilities. Nor are they to accomplish a similar result by any other method. Public utility property for this purpose includes property of electric, gas, water, telephone, and telegraph public utilities which under present law is eligible for what in effect amounts to a credit of 3 percent.

The bill also provides restrictions for Federal regulatory agencies in the case of other regulated companies—such as natural gas pipelines, railroads, airlines, truck and bus operators, and other types of public carriers—which receive an investment credit of 7 percent of the investment in qualified property. It provides that Federal regulatory agencies are not, without the taxpayer's consent, for purposes of establishing the cost of service of the taxpayer, to treat any investment credit allowed him as reducing his Federal income taxes. Nor are the agencies to accomplish a similar result by any other method.

As indicated above in the case of the public utility property Congress is merely directing the Federal regulatory agencies not to "flow" the benefits of the investment credit "through" to the customers over any period shorter than the useful lives of the property involved. In the case of the other property Congress is directing the Federal regulatory agencies not to "flow" this benefit "through" at any time. This difference in treatment is attributable to the fact that Congress provided what in effect is a 3-percent credit for the public utility property rather than 7-percent credit because in 1962 it was recognized that in their case part of the benefit from the investment credit would be likely to be passed on eventually to the customers in lower rates.

(c)(iv) *Effective dates.*—As indicated previously, under your committee's amendments the repeal of the basis adjustment is to apply with respect to property placed in service after December 31, 1963. However, property placed in service before that time, with respect to which a basis adjustment has already been taken, if still in the hands of the taxpayer on the first day of his taxable year beginning after December 31, 1963, is to receive an upward adjustment in basis.

The amendment concerning the amount of the investment credit in the case of leased property is to apply with respect to property transferred to a lessee on or after the date of enactment of this bill. The amendment made with respect to escalators and elevators in the case of the investment credit applies to those acquired or constructed after June 30, 1963. The recapture rule with respect to these assets applies to dispositions of escalators or elevators after December 31, 1963.

(d) *Revenue effect.*—The repeal of the basis adjustment with respect to the investment credit is expected to reduce tax liabilities by $160 million in the calendar year 1964 and by $195 million in the calendar year 1965 with gradually greater reductions in successive years, according to Treasury estimates; estimates by the staff of the Joint Committee on Internal Revenue Taxation are $245 million and $305 million, respectively. Making elevators and escalators eligible for the investment credit is expected to result in an additional $10 million of loss in the calendar year 1964 and subsequent years.

4. Group term life insurance purchased for employees (sec. 204 of the bill and sec. 79 of the code)

(a) *Present law.*—Under present law, employees are required to include in their income the amount of premiums paid by their employers to provide them with individual life insurance or group permanent life insurance which carries a loan or surrender value. However, the regulations (1.61–2(d)(2)) have provided that the cost of group term life insurance purchased for employees is not includible in their income as compensation although the employer receives deductions for the amounts he pays to provide this protection.

(*b*) *General reasons for provisions.*—As indicated above, this tax-free status for employer-financed group term life insurance is inconsistent with the tax treatment of other types of life insurance protection furnished employees by their employers. While this complete exclusion might have been considered relatively insignificant when tax rates were low, the present relatively high rates as well as the growing volume of group term life insurance now provided makes it particularly inequitable to continue this complete exclusion. The employee in such case receives a substantial economic benefit from this insurance protection whether or not the policy for a specific year leads to a payment to his beneficiary. The provision of this insurance by the employer relieves the employee of substantial costs of providing his own insurance protection for his family which he would otherwise have to provide out of tax-paid dollars.

The House, despite recognizing that the entire cost of this insurance protection represents compensation to the employee, provided an exemption with respect to the premiums paid on the first $30,000 of such insurance because it believed, from the standpoint of the economy as a whole, that it is desirable to encourage employers to provide life insurance protection for their employees. Provision of such a basic amount of insurance does much to keep together family units where the principal breadwinner dies prematurely. Your committee is in accord with the reasoning of the House on this subject but believes that $70,000 represents a more appropriate exemption level. It has also made three other more technical amendments described below.

(*c*) *General explanation of provisions.*—For the reasons given above, the bill as amended by your committee provides that the gross income of an employee for tax purposes is to include the cost of any group term life insurance provided him under a policy carried directly or indirectly by his employer to the extent that the insurance coverage provided is in excess of $70,000 as contrasted to $30,000 under the House bill. The employee will not be charged with any portion of this insurance protection over $70,000 which he provides himself through his own contributions, since insurance protection provided in this manner is paid for out of tax-paid dollars. Moreover, all contributions made by the employee are applied against insurance protection above the $70,000 exclusion level.

The cost of protection above $70,000 is taxed to an employee if it is provided under a plan arranged for by the employer whether the protection the employee receives (over and above that provided by his own contributions) is provided directly by the employer, or indirectly by the employer's charging more than the cost of the insurance to other employees (such as those in younger age brackets) and less to those in the older age brackets, such as the specific employee in question.

(*c*)(*i*) *Exception for retired employees, etc.*—Both the House and your committee's bill provides an exception to the general rule described above where the individual's employment has been terminated and either he has reached the normal retirement age (under the practice followed by his employer) or he has become disabled. In both of these cases it was concluded that it would be undesirable to tax the aged or disabled individual who is no longer working for group term life insurance protection provided to him by his former employer.

Two other exceptions are also provided where the insurance protection provided by the employer will not be treated as compensation to the employee, even though in excess of the $70,000 coverage exclusion. First, it will not be taxed to the employee where the employer directly or indirectly is the beneficiary of the policy since in such cases the employer is in reality providing for his own rather than his employee's interest.

Secondly, the costs of the insurance protection in excess of $70,000 will not be taxed to the employee where the beneficiary of the policy is a charitable organization (of the type described in sec. 170(c) of the code). An exception is provided for such cases because it is recognized that where an employer provides protection for all of his employees, a few of them may not have natural heirs and, therefore, if left to their own choice, might not purchase insurance protection. It was concluded that in such cases, it would be unfair to tax such employees on the cost of insurance protection provided by employers. For this reason, it was thought that where the employee demonstrated his own personal disinterest in the protection by naming a charity as the beneficiary, no portion of the cost of such protection should be considered as income to him. It is not intended, however, that he receive any deduction for a charitable contribution with respect to such assignment.

(c)(ii) *Determining the cost of the insurance.*—The House bill provided that the cost of the insurance protection can be determined under either of two methods. Your committee's bill provides that this cost can be determined only under the first of these methods. Under both versions of the bill this cost can be determined by using a uniform table. In this case, the cost of the insurance is averaged out on the basis of 5-year age brackets, in order to simplify computations which must be made by the employer in informing the employee as to the amount of taxable income. Where cost is determined on the basis of this uniform table it will be determined on the basis of a table published in the Treasury Regulations on this provision.

This table will reflect costs of such protection based upon insurance company experience and, of course, will be changed from time to time as mortality experience or other factors indicate that this is appropriate. Until provided otherwise by regulation, however, the cost per $1,000 of group term life insurance protection can be determined from table 11 below.

TABLE 11.—*Uniform 1-year term premiums for $1,000 of life insurance protection*

[Cost per $1,000 of protection]

Age:	
15 to 19	$1.44
20 to 24	1.73
25 to 29	2.11
30 to 34	2.72
35 to 39	3.65
40 to 44	5.10
45 to 49	7.36
50 to 54	10.87
55 to 59	16.29
60 to 64 [1]	24.67

[1] Those age 65 and over whose employment is not terminated will also have their insurance cost computed on the basis of the 60 to 64 age category.

The second method which would be available under the House bill but not under your committee's amendments provides that an employer, in computing the cost of his employee's protection for tax purposes, may use the actual cost of the policy to him and the employees. In this case also, the same 5-year age brackets as provided under the uniform premium table would be used. Your committee's amendments remove this second method of computation because it has been informed that this method is difficult for employers to compute. Moreover, since the uniform premium table method of computation contains no loading charge, in almost all cases it will in any event result in the lower cost.

Both the House and your committee's version of the bill provides that in the case of employees (not retired), who are over age 64, the cost of protection is not to be increased in such cases, but instead is to continue to be computed on the same basis as those in the age bracket 60 to 64.

(c)(iii) *Deduction for certain contributions provided by House bill but not your committee's amendments.*—The House bill provided a special deduction in computing taxable income for contributions made by an employee toward the purchase of group-term insurance protection in excess of the cost of his own insurance (only above the exemption level). This deduction was provided by the House bill on the grounds that under some group-term insurance plans the younger employees in effect pay for insurance protection provided for those in higher age brackets. It was suggested that this usually occurs where a uniform rate of contribution is required of all employees regardless of age. In such cases, it was indicated that the cost of protection for those who are relatively young may not equal the contribution made by the employees. In view of this, the House bill provided that contributions made by an employee (above the exemption level) to the extent that they exceeded the cost of the protection provided for him were to be deductible by him for tax purposes. Your committee's amendment deletes this deduction. Your committee has taken this action primarily because it believes that the size of these deductions would in any event be relatively small and on the grounds that it is questionable whether these deductions are worth the added administrative burden they would bring for the employer.

(c)(iv) *Example of method of computation.*—To illustrate the method of computing the taxable cost of group term insurance provided under your committee's version of the bill, it is first assumed that the employee makes no contribution toward this protection himself, and then that he makes a contribution of $2 per $1,000 of coverage. The method of computing the inclusion in the employee's gross income is illustrated by an employee age 41 who is provided with $200,000 of group term life insurance protection.

Where employee makes no contribution

Portion of insurance coverage taken into account ($200,000–$70,000)	$130,000.00
Cost of insurance protection per $1,000 for individual age 41 assuming uniform premium table is used	5.10
Amount to be included in income tax base by employee ($5.10×130)	663.00

Where employee makes contribution

Portion of insurance coverage taken into account ($200,000-$70,000)	$130,000.00
Cost of insurance protection per $1,000 for individual age 41 assuming uniform premium table is used	5.10
Total cost of insurance attributable to employee's contribution ($2.00×200)	400.00
Cost of insurance protection above $70,000 exclusion ($5.10×130)	663.00
Amount to be included in income tax base by employee ($663−$400)	263.00

(c)(v) *Reporting instead of withholding.*—The House bill provides that the cost of group term insurance, to the extent taxable to the employees, is to be subject to regular income tax withholding. Your committee concluded that this was unnecessarily burdensome for employers, particularly in view of the fact that so few employees would be affected by the $70,000 exclusion level. Instead, your committee's bill provides for the reporting of this income annually by the employer to the Government, with a copy of the information return also going to the employee. The amount shown on this information return is only the amount payable with respect to an employee which represents taxable income to him. Where he is covered by more than one employer, each employer is to determine the exemption for purposes of the information return in the same manner as if he were the only employer. The type of information return (form 1099) is the same as that already used under existing law to report dividends and interest. The penalties for failure to provide the information are $10 per person unless the failure is due to reasonable cause rather than willful neglect. The total penalties paid by an employer may not exceed $25,000.

(c)(vi) *Effective date.*—The tax treatment provided with respect to group term insurance as described above is to apply with respect to such insurance protection provided after December 31, 1963. The information reporting with respect to this insurance will apply to remuneration paid after December 31, 1963, in the form of group term insurance provided after that date.

(d) *Revenue effect.*—It has been estimated that the enactment of the group term life insurance provision described above will result in an increase of somewhat less than $5 million in revenues in a year when this provision is fully effective.

5. Sick pay exclusion (sec. 205 of the bill and sec. 105(d) of the code)

(a) *Present law.*—Under present law amounts paid to an employee by his employer to continue his wage payments when he is absent from work because he is sick or injured are excludable from the employee's gross income under certain conditions (although deductible by his employer). The exclusion in any case is available only up to $100 per week. In the case of absence from work due to personal injuries, this $100 is the only limitation at the present time. In the case of sickness, however, the exclusion is available only after the first 7 days of absence, unless the employee is hospitalized because of the sickness for at least 1 day during his absence.

(b) *General reasons for provision.*—Your committee agrees with the House that this sick pay exclusion in its present form is not justified. The amounts received by the employee in this case are substitutes for regular wages or salaries which, had they been received as such, would be fully taxable. The wage substitutes in this case are wholly unrelated to the costs involved as a result of illness or injury. Amounts paid by the employer for the medical expense of the employee already are excludable by the employee under other provisions of law (sec. 105(b)) and amounts paid by the employee himself for medical expenses also are deductible elsewhere under present law (sec. 213 of the code) to the extent that they exceed what is considered to be the normal level of medical expenses.

The present exclusion also tends to encourage malingering because it treats the employee who stays at home better than another employee; also is easily abused because an employee who stays home because of a minor injury or illness may obtain an exclusion substantially in excess of any additional expenses he may incur.

The House bill provided, however, that those who have become permanently disabled or who have had long, continuing illnesses or accidents could continue to receive the advantage of this provision. It was thought that persons are likely to have their earnings substantially decreased, at the same time they also may be faced with large medical bills. Moreover, in such cases, the ordinary family financial requirements are likely to continue at their usual level, presenting larger problems for the individual as the period of absence from work becomes longer. Your committee also is in accord with this reasoning, and therefore has continued this provision unchanged.

(*c*) *General explanation.*—For the reasons presented above the sick pay exclusion of present law is amended to provide that wage continuation payments are not to be excludable to the extent they are attributable to the first 30 days of absence because of personal injury or sickness. This means, of course, that this exclusion will be available after the first 30 days of injury or sickness for the long continuing illness and also in the case of those receiving permanent disability pensions before the normal retirement age.

Under present law employers who make wage continuation payments which are not excludable from the employee's income (e.g., payments in excess of $100 a week or payments for the first 7 days in the case of sickness where there is no hospitalization) are required to include these amounts in income subject to withholding and reporting on form W-2. This practice will be continued under the revised provision with the withholding and reporting applying to a larger proportion of the wage continuation payments. Where these payments are made by someone other than the employer, such as an insurance company or a pension trust, the Treasury does not presently require withholding and it is the intention of the House and your committee that this practice be continued. However, these payments are (if made on behalf of the employer) to be included on the W-2 form prepared by the employer and shown on this form as wages or salary.

(*c*)(*i*) *Effective date.*—The amendment made by this provision will apply to wage payments attributable to periods of absence commencing after December 31, 1963.

(*d*) *Revenue effects.*—It is estimated that the provision described above, when fully effective, will result in an increase in revenues of $110 million a year.

6. Exclusion for gain on the sale of a residence by an individual age 65 or over (sec. 206 of the bill, sec. 121 of the code)

(*a*) *Present law.*—Under present law (sec. 1034) where an individual sells his old residence and, within a year of that sale, purchases a new residence (or within 18 months thereafter builds a new residence), the gain on the sale of the old residence is not recognized to the extent that it, plus the cost or other basis of the old residence, is invested in the new residence. This postponement of the taxation of the gain is available only where the new residence is purchased or built within the time specified.

(*b*) *General reasons for the provisions.*—While present law generally provides adequately for the younger individual who is for one reason or another changing residences, it does not do so for the elderly person whose family has grown and who no longer has need for the family homestead. Such an individual may desire to purchase a less expensive home or move to an apartment or to a rental property at another location. He may also require some or all of the funds obtained from the sale of the old residence to meet his and his wife's living expenses. Nevertheless, under present law, such an individual must tie up all of his investment from the old residence in a new residence, if he is to avoid taxation on any of the gain which may be involved.

Your committee agrees with the House that this is an undesirable burden on our elderly taxpayers.

(*c*) *General explanation.*—For the reasons given above, the bill provides an exclusion from gross income for a limited amount of gain received from the sale or exchange of a personal residence in the case of taxpayers who have reached age 65 before the sale or exchange occurs. To be eligible for this treatment, they must have owned and used the property involved as their principal residence for 5 out of the last 8 years before the sale or exchange.

(*c*)(*i*) *Limitations.*—In this provision the primary concern is with the average and smaller homestead selling for $20,000 or less. For that reason, the application of this section is limited so that a full exclusion is provided only for the gain attributable to the first $20,000 of the sales price.[1] Where the sale price of the residence does not exceed $20,000, the entire gain is excluded from income for tax purposes. Where the sale price exceeds $20,000, a proportion of the gain is excluded. The proportion excluded is in the ratio of $20,000 to the actual sale price; for example, if a residence is sold for $60,000 and the gain is $10,000, then the portion of this $10,000 gain which will not be taxable is determined as follows:

Actual sale price	$60, 000
Ratio of $20,000 to sale price ($20,000/$60,000)	⅓
Proportion of $10,000 gain to be excluded from taxable income (⅓ of $10,000)	$3, 333. 33
Remaining gain subject to tax	$6, 666. 67

To prevent taxpayers over age 65 from reusing this section and obtaining numerous exclusions for gains on personal residences, the bill provides that this exclusion is available to a taxpayer and his spouse only once in their lifetimes.

[1] Actually the determination is made on the basis of adjusted sales price which as provided elsewhere in the code is the gross sales price less any so-called fix-up expenses incurred in selling the property. In this regard, see sec. 1034(b)(1).

(c)(ii) *Other rules.*—Since a taxpayer and his spouse may claim the exemption under this provision only once in their lifetimes, the bill provides that the exclusion is elective and may be made or revoked at any time before the expiration of the period for making a claim for credit or refund of tax, generally about 3 years after the year of the sale or exchange. It also was necessary to provide a number of other special rules for the application of this provision. These rules may be described briefly as follows:

1. Where property is held jointly by a husband and wife either as joint tenants, tenants by the entirety or as community property, if a joint return is filed by the husband and wife and one of them satisfies the age requirement of 65 and has held and used the property for the required 5 out of the last 8 years, then both the husband and wife are treated as meeting these requirements.
2. Where the spouse of an individual has died and that spouse held and used the property as a personal residence for 5 out of the last 8 years and had not previously claimed an exemption under this provision, then the individual who is still living will be treated as satisfying these holding and use requirements. (However, the surviving spouse must be age 65 for the exclusion to apply).
3. The bill provides that for purposes of this provision tenant stockholders in a cooperative housing corporation who sell their right to occupy the house or apartment are to be treated in the same manner for purposes of this provision as those who own their residence outright.
4. Any gain realized from the destruction, theft, seizure, requisition, or condemnation of a personal residence is to be eligible for this provision in the same manner as if the residence had been sold.
5. Where a part of a property is used as a personal residence and the remainder as a business or income producing property, the exclusion provided under this provision upon the sale of the property is to be available to the extent that the gain is attributable to the portion of the property owned and used by the taxpayer as his personal residence:
6. In applying this provision, an individual is to be considered as married or single according to his status on the date of the sale or exchange. An individual who is separated under a decree of divorce or separate maintenance on the date of the sale is not considered as married for purposes of this provision.
7. In the case of involuntary conversions and in the case of the sale or exchange of one personal residence for another, gain is not recognized under present law where the total amount realized from the conversion or sale is reinvested within a specified period of time. In addition, the basis of the new property so acquired in such cases remains the same (except for any additional investments over and above the sales price) as the property previously held. Where both the exclusion available for taxpayers over age 65 and either of these two provisions may be applied with respect to the same transaction, the bill provides that the exclusion for those over age 65 is to be applied first. Thus, in the case of the involuntary conversion or the sale of a personal residence and the purchase of another, by a taxpayer who is over age 65, any gain which might be realized upon the involuntary conversion or sale of the residence will be reduced by any exclusion available to the taxpayer under this section. In addition, in the case

where the total amount is reinvested within the specified period the basis of the taxpayer in the newly acquired residence will be his basis for the old residence increased by any exclusion of gain obtained by him under the provision which is reinvested in the new residence (and, of course, increased by any additional funds which he may have invested over and above the amount realized from the first residence).

8. In determining whether an individual has gross income of $600 or more (or $1,200 or more in the case of those over age 65) any exclusion provided under this provision will for that purpose alone be treated as gross income. This assures that the Government will receive proper reporting on amounts claimed as exclusions under this provision.

(c)(iii) *Effective date.*—This provision applies to sales, exchanges, and other dispositions after December 31, 1963.

(d) *Revenue effects.*—This provision is expected to result in an annual revenue loss of $10 million.

7. Denial of deduction for certain State, local, and foreign taxes (sec. 207 of the bill and secs. 164 and 275 of the code)

(a) *Present law.*—The general rule under present law is that taxes paid or accrued by a taxpayer are deductible for Federal income tax purposes. However, an exception to this rule provides that no deduction is to be allowed for certain specified taxes, principally Federal taxes. The categories of taxes which may not be deducted under present law are:

1. Federal income taxes.
2. Federal war profits and excess profits taxes.
3. Federal import duties and Federal excise and stamp taxes (except that these taxes may be deductible as business expenses or taken into account as expenses incurred in the production of income).
4. Estate, inheritance, gift, and similar taxes.
5. Most local improvement taxes.
6. Foreign income and excess profits taxes and similar taxes imposed by U.S. possessions (if the taxpayer elects to take a foreign tax credit for these taxes in lieu of a deduction).

The practical effect of the above listing of taxes is to deny any deduction for Federal taxes paid by the taxpayer (except to the extent that taxes listed in category 3 above qualify as business expenses or expenses incurred in the production of income).

State and local taxes on the other hand generally are deductible, except death and gift taxes and most local improvement taxes. The most important State and local taxes, and the revenues derived from them by State and local governments in 1961, are as follows:

1. Real and personal property taxes, $18 billion.
2. Income taxes, $3.9 billion.
3. General sales and gross receipts taxes, $5.4 billion.

The three categories of taxes indicated above account for $7.5 billion of the total $10 billion of taxes taken as nonbusiness deductions on taxable returns for Federal income tax purposes in 1960. The principal remaining State and local taxes, for which deductions may presently be taken, together with revenues derived from them by State and local governments in 1961, are as follows:

1. Gasoline taxes, $3.5 billion.
2. Auto and drivers' licenses, $1.8 billion.

3. Alcoholic beverage taxes, $0.7 billion.
4. Tobacco taxes, $1.1 billion.
5. Selective sales or excise taxes not included above (such as those on admissions, room occupancy, etc.), $1.8 billion.

(b) *General reasons for the provision.*—The House bill would provide for the continued deduction only of property taxes, income taxes, and general sales taxes. Your committee's amendments provide for the deduction of these three categories of taxes but also restores the deductibility of two categories of taxes which under the House bill would no longer be deductible. These are the excise tax on gasoline (and diesel and other motor fuels), and the taxes for auto registration and driver's licenses.

Your committee finds no disagreement with the House in the reasons given for the desirability of continuing the deductibility of property taxes, income taxes, and general sales taxes. In the case of property taxes, it was suggested that any denial of the deduction would result in an important shift in the distribution of Federal income taxes between homeowners and nonhomeowners. In the case of State and local income taxes, it was suggested that the continued deductibility of these taxes represent an important means of accommodation to take into account the fact that both State and local governments on one hand and the Federal Government on the other hand tap this same important revenue source. A failure to provide deductions in such a case could mean a combined burden of income taxes which in some cases would be extremely heavy. It was further indicated that, if property and income taxes are to be deductible for Federal income tax purposes, it also is important to allow the deduction of general sales taxes. To deny the deductibility of general sales taxes while allowing deductions for the other major revenue sources would encourage State and local governments to use these other resources in place of the sales tax. Your committee agrees with the House that it is important for the Federal Government to remain neutral as to the relative use made of these three forms of State and local taxation.

Your committee believes that much the same reasons which led to the House continuing the deduction of property, income, and sales taxes also suggest the desirability of continuing the deduction of gasoline and auto registration and drivers' licenses. Gasoline taxes are also a major source of State revenue and to deny the deduction of this tax while allowing the deduction of property, income, and general sales taxes tends to encourage States to use other than automotive taxes as their more important revenue sources. Moreover, a failure to provide a deduction for these automotive taxes also could result in an important shift in the distribution of Federal income taxes between classes of taxpayers, i.e., between those who own automobiles and those who do not.

Moreover, your committee is inclined to doubt that it is difficult for a taxpayer to make good estimates of the amount of these State and local automotive taxes as is sometimes suggested. The registration and drivers' license taxes are no more than annual taxes and certainly present the taxpayer with no particular recordkeeping problem. For most taxpayers the amount of gasoline taxes paid can be estimated relatively accurately either from credit sales slips or from the mileage added on a car each year.

Your committee agrees with the House that the other forms of excise taxes do present a recordkeeping problem for taxpayers. Also, it is recognized that these taxes, especially those on alcohol and tobacco products, may be deductible in some States and not in others, depending on the form of State law. As pointed out in the report of the House Committee on Ways and Means, in the case of cigarette and tobacco taxes, 26 States levy taxes which comply with the Federal rules for deductibility. However, 21 States and the District of Columbia have laws which do not meet these standards; and, thus, in these States, no deductions are available for these taxes.[1] There also is a wide variation among the States as to the deductibility of alcoholic beverage taxes. In six States, these taxes are imposed on the consumer and, therefore, are deductible. In addition, in 10 other States, where alcoholic beverages are sold through State liquor stores, the tax also generally is deductible.[2] This variation as to the Federal tax treatment of these various excise taxes is discriminatory as between taxpayers and different States. Moreover, it further complicates the already difficult problem of reporting deductible taxes in these cases. It should be noted, however, that this problem does not exist in the case of the gasoline, registration, and license taxes.

For the reasons indicated above, your committee is in agreement with the House as to the desirability of denying deductions in computing the Federal income tax for certain selective State and local taxes. However, in addition to retaining deductions for property, income and sales taxes, your committee has concluded that it also is desirable to retain deductions for gasoline and auto registration and driver's license taxes. Your committee has also made a modification with respect to limited types of improvement taxes which presently are deductible. As explained subsequently, under your committee's bill, such taxes to the extent now deductible will continue to be deductible.

(c) *General explanation of provision.*—For the reasons given above, your committee's bill provides as a general rule that only the following taxes may be taken as deductions:

1. State and local personal property taxes;
2. State and local, and foreign, real property taxes;
3. State and local, and foreign, income, war profits, and excess profits taxes; and
4. State and local general sales taxes;
5. State and local gasoline taxes (and taxes on diesel and other motor fuels);
6. State and local taxes on registering automobiles and on driver's licenses.

The fact that only these taxes may be deducted as taxes does not mean that other State, local, and foreign taxes may not be deducted to the extent they represent trade or business expenses or expenses incurred in the production of income. A sentence added to the code on this point makes it clear that these other State, local, and foreign taxes may be deducted as taxes when they are of a business nature or for the production of income even though otherwise they might have to be capitalized. Taxes levied on intangible personal property are examples of taxes generally deductible in this latter category since it

[1] Three States, Colorado, North Carolina, and Oregon, do not levy cigarette taxes.
[2] Seven States do not levy taxes on liquor except beer, and in some cases, wine. The beer and wine taxes of these States are not deductible.

can be reasonably supposed that the property subject to such a tax is held either in connection with a trade or business or for the current, or possible future, production of income.

(c)(i) *Taxes which in no event may be deducted.*—Under present law certain taxes, largely Federal taxes, may not be deducted in any case either as taxes or as business expenses or as expenses incurred in the production of income. To make clear the distinction between these taxes for which presently no deduction may be claimed and the other taxes which may be deducted if they represent expenses of a business or in the production of income, in the bill a new section (sec. 275) is added providing that no deduction at all may be taken for certain specified taxes. The taxes listed in this section are listed as exceptions in section 164 of the code under present law, and are moved to the new location in the code merely to emphasize the fact that these taxes cannot in any event be claimed as a deduction.

These taxes are as follows:

1. Federal income taxes;
2. Federal war profits and excess profits taxes; and
3. Estate, inheritance, legacy, succession, and gift taxes;
4. Income, war profits, and excess profits taxes imposed by a foreign country or a possession of the United States if the taxpayer chooses to take a foreign tax credit with respect to these taxes; and
5. Taxes on real property which the code requires to be treated as being imposed on another taxpayer.

Federal import duties and Federal excise and stamp taxes (to the extent not included in the above categories) will continue to be deductible to the extent they can presently be deducted as trade or business expenses (under sec. 162) or as expenses for the production of income (under sec. 212).

(c)(ii) *Definitions of certain deductible taxes.*—The bill defines a personal property tax which may be deducted as an ad valorem tax imposed on an annual basis in respect of personal property.

A general sales tax is defined as a tax imposed on one rate with respect to the sale at retail of a broad range of classes of items. The bill specifies, however, that the fact that food, clothing, medical supplies, and motor vehicles either are exempt from a sales tax or are taxed at a lower rate is not to result in any given tax being classified as not applying to a "broad range of classes of items." However, if any of these specified items are taxed at a higher rate than the general rate applying to other items, or if any other item is taxed at a different rate, no deduction is to be permitted for the tax on these items.

As under present law, deductions may be taken for general sales and gasoline taxes not only where they are imposed on the consumer as such, but also where they are separately stated and where the tax is in fact paid by the consumer.

Included in the definition of a deductible general sales tax by the bill is a "compensating use tax." A compensating use tax, as its name implies, is generally a tax imposed on items brought in from another taxing jurisdiction. In this case, the tax is imposed on the "use, storage, or consumption of the item" since the sale as such does not occur in the taxing jurisdiction in question. For such a tax to be deductible, similar items must be subject to a deductible general retail sales tax in the taxing jurisdiction in question.

(*c*)(*iii*) *Certain local improvement taxes.*—Under present law, local improvement taxes generally are not deductible (although interest or maintenance charges may otherwise be deductible). However, presently an exception is made and a deduction is permitted for local improvement taxes levied by a special taxing district where the district covers at least one entire county, at least 1,000 persons are subject to the tax levied by the district, and the district levies its assessment annually at a uniform rate on the same assessed value for real property as is used generally for purposes of the real property tax. The House would have eliminated this provision on the grounds that it is of limited application and also on the grounds that the continuation of this provision was not desirable. Your committee is in accord with the view that improvement taxes should not generally be deductible. However, in order to prevent the changing of rules of deductibility in this respect after debt has been incurred it has provided for the continued deduction of such taxes (to the extent presently deductible) for the purposes of paying off indebtedness already existing on December 31, 1963.

(*c*)(*iv*) *Effective date.*—The changes made by the above provisions relating to taxes apply to taxable years beginning after December 31, 1963.

(*d*) *Revenue effect.*—The changes made in the deduction of taxes by this section, as amended by your committee, are expected to increase revenues by $190 million in a full year of operation. The changes made by the House bill would have increased revenues by $520 million.

8. Personal casualty and theft losses (sec. 208 of the bill and sec. 165(c)(3) of the code)

(*a*) *Present law.*—Under present law, taxpayers may claim a deduction for losses of property not connected with a trade or business if these losses arise from fire, storm, shipwreck, or other casualty, or from theft. Under present law, these deductions are available without limitation to all taxpayers who itemize their personal deductions.

In addition, under present law, losses incurred in a taxpayer's trade or business or losses incurred in connection with transactions entered into for profit are deductible. The change made by this bill with respect to casualty losses described below does not affect the continued full deduction of these losses as business expenses or as expenses incurred in the production of income.

(*b*) *General reasons for provision.*—Your committee agrees with the House that in the case of nonbusiness casualty and theft losses, it is appropriate in computing taxable income to allow the deduction only of those losses which may be considered extraordinary, nonrecurring losses, and which go beyond the average or usual losses incurred by most taxpayers in day-to-day living. In view of this, it is believed appropriate to limit the casualty loss deduction to those losses or thefts above a minimum amount. The minimum selected was $100 per casualty loss, since this corresponds approximately with the "$100 deductible" insurance carried by many individuals in the United States with respect to such losses. This means that no deduction will be allowed in the case of an ordinary "fender bending" accident or casualty, but that casualty and theft losses will continue to be deductible (over the $100) in those cases where they are sufficient in size to have a significant effect upon an individual's ability to pay Federal income taxes.

(c) *General explanation of provision.*—The amendment made by both the House and your committee's versions of the bill limit the deductibility of personal losses (as distinct from those associated with a trade or business or transactions entered into for profit) to those where the casualty or theft loss exceeds $100. For this purpose, in determining what is a single casualty, it is intended that the law be interpreted liberally. Thus, for example, where an individual's property is damaged by wind from a hurricane and this is followed by additional damage resulting from water, it is intended that the combination of these events be treated as one casualty and, therefore, that all amounts over $100 of damage be deductible.

The $100 limitation applies to a joint return by a husband and wife as well as to a separate return of either. Thus, if a husband and wife file separate returns, each is subject to a separate $100 floor with respect to each casualty or theft, while, if they file a joint return, they are together subject to only one $100 floor with respect to each casualty or theft whether the loss is sustained with respect to jointly, or separately, owned property.

(c)(i) *Effective date.*—This amendment applies to losses sustained after December 31, 1963.

(d) *Revenue effect.*—It is estimated that this provision will increase revenues by $50 million a year in a full year of operation.

9. Charitable, etc., contributions, and gifts (sec. 209(a) of the bill and sec. 170(b) of the code)

(a) *Present law.*—Under present law, individuals are allowed a deduction of up to 20 percent of their adjusted gross income for contributions to or for the use of charitable, educational, religious, etc., organizations generally. An additional 10-percent deduction also is available for contributions to churches, schools, hospitals, certain medical research organizations, and certain organizations affiliated with State colleges or universities. Thus, with respect to contributions in this latter category, a charitable contribution deduction of up to 30 percent is allowed.

(b) *General reasons for provision.*—The House and your committee agree that the availability of this additional 10-percent deduction should be extended to include contributions to many forms of charitable or philanthropic organizations not now covered by this provision. Greater uniformity in the availability of this additional 10-percent deduction is desirable because of the many beneficial activities that are carried on by various philanthropic organizations not now eligible for the 30-percent deduction. This is especially true of many cultural and educational organizations and major charitable organizations not now eligible for the 30-percent deduction.

The additional 10-percent deduction is limited to organizations which are publicly or governmentally supported, however, and this additional deduction is not made available in the case of private foundations. These latter types of organizations frequently do not make contributions to the operating philanthropic organizations for extended periods of time and in the meanwhile use the funds for investments. The extra 10-percent deduction is intended to encourage immediately spendable receipts of contributions for charitable organizations.

(c) *General explanation of provision.*—For the reasons given above, the House and your committee's bill provide that the additional 10-

percent deduction (or 30-percent deduction in total) from a taxpayer's adjusted gross income is to be extended so that it not only is available with respect to charitable contributions to churches, schools, hospitals, etc., but also is available generally in the case of charitable contributions to religious, charitable, scientific, literary, or educational organizations or those for the prevention of cruelty to children or animals (which otherwise meet the conditions set forth in sec. 170(c)(2) of the code). In addition, the 30-percent deduction is to be available for charitable contributions to a Federal, State, or local governmental unit if the contribution or gift is made for exclusively public purposes.

For any of the nongovernmental organizations to qualify for the additional 10-percent deduction referred to above, they must normally receive a substantial part of their support from a governmental unit or from direct or indirect contributions from the general public. "Support" for this purpose does not take into account income received by the organization from exercise of its exempt function. The reference to direct or indirect contributions from the general public prevents what are generally termed private foundations from qualifying for this additional 10-percent deduction. To qualify, the organization must receive support from at least a representative number of persons within the community concerned.

Types of organizations which generally will in the future qualify for this additional 10-percent deduction are those publicly or governmentally supported museums of history, art, or science, libraries, community centers to promote the arts, organizations providing facilities for the support of an opera, symphony orchestra, ballet, or repertory drama, and organizations such as the American Red Cross, United Givers Fund, etc.

(*c*)(*i*) *Effective date.*—This provision applies to taxable years beginning after December 31, 1963.

(*d*) *Revenue effect.*—This amendment is expected to result in a negligible revenue loss when fully effective.

10. Denial of unlimited charitable contributions deduction with respect to gifts to private foundations (sec. 209(b) of the bill and sec. 170(b)(1)(D) of the code)

(*a*) *Present law.*—Under present law, the 30-percent limitation with respect to charitable contributions deductions in the case of individuals does not apply if the taxpayer in the taxable year in question and in 8 out of 10 of the preceding taxable years made a charitable contribution which taken together with his income taxes with respect to each of those years equalled 90 percent or more of his taxable income for the year in question. Under present law, there is no distinction between charitable contributions in the 20-percent category and those in the 30-percent category for purposes of this unlimited deduction. Thus, the charitable contributions taken into account both in the taxable year and in the 8 prior qualifying years can be either those to public type charities or those to private foundations.

(*b*) *General reasons for provision.*—Your committee has added a provision to the bill making the unlimited charitable contribution deduction available only with respect to contributions to publicly supported organizations for much of the same reasons that both the House and your committee only make the extra 10-percent deduction available in the case of these organizations. Your committee believes that the special advantage of the unlimited charitable contribution deduction should not be made available in the case of these private foundations because frequently contributions to foundations do not find their way into operating philanthropic endeavors for extended periods of time. In the meanwhile, the funds are invested and the advantages arising from control of these investments are likely to inure to the principal contributors to the foundations. Thus, your committee concluded that if the 20- or 30-percent limitations with respect to charitable giving are to be removed for those desiring to make large contributions there should be no question that the bulk of the funds involved, within a reasonable period of time, are devoted to the charitable and philanthropic purposes.

(c) *General explanation of provision.*—Your committee's amendment provides that for taxable years beginning after December 31, 1963, the charitable contributions taken into account with respect to the unlimited charitable contributions deduction are to be only those going to publicly supported organizations. Moreover, if the unlimited charitable contributions deduction is elected by the taxpayer, then he is to receive no charitable contribution deduction for amounts going to organizations which are not publicly supported, such as private foundations (even with respect to contributions coming under the 20-percent test, which, without this provision, would allow such contributions).

Similarly, in determining in a subsequent year whether contributions and taxes in 1964 and subsequent years meet the 90-percent test in 8 out of 10 years, contributions to private foundations are not to be taken into account. However, with respect to any year prior to 1964 in determining whether charitable contributions and taxes equal 90 percent or more of the taxpayer's taxable income for purposes of the 8- out of 10-year test, charitable contributions to private foundations may be taken into account in the same manner as under prior law. Thus, for purposes of the unlimited charitable contribution deduction, your committee's bill follows the rules of prior law whenever any year prior to 1964 is taken into account and the new rules applicable with respect to any computation involving 1964 or a subsequent year. As a result taxpayers will not find the rules changed with respect to past years' computations; but, if they hope to obtain the benefits of the unlimited charitable contribution deduction with respect to the future, then for subsequent years they will have to forego any income tax benefits for contributions or gifts to private foundations.

With respect to future years, the unlimited charitable contribution deduction will take into account charitable contributions to: churches; schools; hospitals; specified medical research organizations; certain organizations affiliated with State colleges or universities; Federal, State, or local governmental units, if the contribution or gift is made for exclusively public purposes; and charitable contributions generally to religious, charitable, scientific, literary, or educational organizations or those for the prevention of cruelty to children or animals. However, in this latter case, the charitable organization must receive a substantial part of its support from a governmental unit or from direct or indirect contributions from the general public. Support for this purpose does not take into account income received by the organization from the exercise of its exempt function. The reference to direct or indirect contributions from the general public is designed to prevent gifts to private foundations from qualifying for this unlimited deduction. To qualify, the organization must receive support from at least a representative number of persons within the community concerned.

(c)(i) *Effective date.*—This provision applies to taxable years beginning after December 31, 1963.

(d) *Revenue effect.*—This amendment is expected to result in a negligible revenue increase.

11. Five-year charitable contributions carryover for individuals (sec. 209(c) of the bill and sec. 170(b)(5) of the code)

(a) *Present law.*—As indicated above, individuals are limited to a charitable contributions deduction of 20 percent of their adjusted gross income or up to 30 percent for contributions to churches, schools, hospitals, and contributions to public charities generally. Any charitable contributions in excess of the amount which may be deducted under these limitations in the current year in the case of individuals are wasted. Corporations, on the other hand, although limited to a charitable contributions deduction of 5 percent of taxable income (without this deduction) nevertheless may carry any unused charitable contribution deduction forward and under present law use them in the 2 following years. The House bill adds a provision which extends this carryover of unused charitable contributions for corporations to 5 years (see the discussion below).

(b) *General reasons for provision.*—Your committee has added a provision to the House bill to provide a 5-year carryover of unused charitable contributions for individuals. Your committee sees no reason why a carryover should be made available for corporations while individuals are in effect compelled to waste their contributions in excess of the specified limitation. More important, however, this will make it unnecessary for taxpayers desiring to make a contribution of a substantial nature to a charitable organization to carefully divide the gift into parts, contributing each in a separate year, or perhaps giving undivided interests in a property, up to their applicable limitation, to the charitable organization in each of a series of years. Not only is the present practice complicated for the donor but it also creates problems for the charitable or educational organization. Where they are given undivided interests in a property over an extended period of time, they may find it impossible either to sell or use the property over this same period of time while their interest in it gradually increases from year to year. The allowance of a 5-year charitable contribution carryover for individuals, like the averaging provision contained in this bill, also is another step toward the computation of income for tax purposes over a long period of time rather than on an annual basis.

(c) *General explanation of provision.*—For the reasons indicated above, your committee has added a provision to present law providing a 5-year carryforward for individuals for unused charitable contributions. In making this carryover available, your committee's amendments provide that the only amounts which may be carried forward are excess contributions with respect to which the 30-percent limitation applies (i.e., generally all contributions except those going to private foundations). In determining whether there is any unused charitable contribution to carry forward, the charitable contributions to private foundations are ignored and only those contributions fully eligible under the 30-percent limitation, to the extent they exceed this limitation, may be carried forward.

In the year to which these contributions are carried, if the taxpayer has made any contributions to a private foundation, these are ignored for purposes of determining how much of these charitable contributions carried forward are used up in that year. This can be illustrated by the following example: Assume $500 of unused charitable contributions are carried forward, the individual's 30-percent limitation for the year in question would permit charitable contribution deductions of $1,000, and $400 had been already contributed in that year to private foundations and $300 to publicly supported charitable organizations. In this case the entire $500 carryforward would be considered as used up in that year, although the additional charitable contribution deductions obtained with respect to this $500 would be only $300. This result is obtained by ignoring the $400 of contributions to the private foundation for purposes of determining the extent to which the carryover is used up in that year. Thus, in the example cited, the charitable contribution in the year to publicly supported organizations was $300 and the carryover from the prior year was $500. This would make it possible to use up the entire charitable contribution carryover in that year. The individual could also deduct $200 of the $400 which he contributed to the private foundation. Since under existing law the individual in the example could have claimed a deduction of $700, the use of the carryover permits an additional deduction of $300.

The provision added by your committee also provides that no charitable contribution may be carried to, or through a year with respect to which the taxpayer has elected the unlimited charitable contributions deduction. The carryover was considered unnecessary in such cases because of the fact that no limitations are imposed in these cases. A technical adjustment is also made to prevent a taxpayer from claiming a benefit with respect to the same amount twice, through the interaction of the net operating loss carryover and the 5-year charitable contribution carryover.

(*c*)(*i*) *Effective date.*—The new 5-year charitable contributions carryover provided by your committee's bill will be available with respect to contributions paid in taxable years beginning after December 31, 1963.

(*d*) *Revenue effect.*—This amendment is expected to result in a negligible revenue loss.

12. Five-year charitable contribution carryover for corporations (sec. 209(d) of the bill and sec. 170(b)(2) of the code)

(*a*) *Present law.*—Under present law corporations are allowed a maximum charitable contribution deduction of 5 percent of their taxable income computed without regard to this deduction (and certain other deductions). Any charitable contribution deductions which exceed this maximum may be carried forward and used in the 2 following years to the extent the maximum limitations for those years permit. In the case of tax-free reorganizations, generally, and in the case of the liquidation of a subsidiary, the present law provides that the 2-year charitable contribution carryover, to the extent not used by the prior corporation, is to be available to the acquiring corporation.

(*b*) *Reasons for provision.*—Situations have arisen where corporations have income which varies widely from year to year with the result that in some years they have losses and in other years income. This presents a problem where these corporations have committed themselves to the making of specific annual contributions to local charitable organizations. This frequently is done because of the importance to the local charity of maintaining a relatively stable budget from year to year. However, from the standpoint of the corporation the 5-percent limitation on charitable contributions means that the benefit of the charitable contribution deduction is lost in loss years, or in low income years, unless income is sufficiently high in the 2 immediately following years to not only permit the deduction of the amount carried forward but the usual charitable contributions for those years as well. Frequently this is not a sufficient length of time to enable the full deduction of charitable contributions in such cases.

(*c*) *General explanation of provision.*—In view of the above considerations the House bill substitutes for the 2-year carryforward of unused charitable contributions available in present law a 5-year charitable contribution carryforward for corporations. Your committee has accepted this amendment except that it has amended the effective date as indicated below. The amount which may be carried forward in such cases is the amount of the charitable contributions in excess of the amount which may be deducted within the 5-percent limitation. In the year to which the charitable contributions are carried the charitable contributions of that year are applied first, and then the charitable contributions carried forward with the oldest year from which a charitable contribution is carried forward being applied first. Any unused charitable contributions are carried forward to succeeding years, but if not used up after a 5-year carryforward period, they no longer are available for further deduction.

The 5-year charitable contribution deduction carryover is also made available to acquiring corporations in tax-free reorganizations and to parent corporations in the case of the liquidation of a subsidiary. The acquiring corporation in these cases treats the carryforward of the charitable contribution in the same manner as if it were its own unused charitable contribution being carried forward to the current year.

(*c*)(*i*) *Effective date.*—The 5-year carryforward under the House bill would be effective with respect to contributions paid (or treated as paid) in taxable years beginning after December 31, 1963. Thus, under the House bill a charitable contribution made in 1964 would be the first charitable contribution with respect to which the 5-year, as distinct from the 2-year, charitable contribution carryforward would be available. Under your committee's amendments, the 5-year carryforward of unused charitable contributions will be available with respect to contributions paid (or treated as paid) in taxable years beginning after December 31, 1961. Thus, charitable contributions made in the calendar years 1962 and 1963, (to the extent the former is not used in 1963) will be available as carryforwards to 1964, since in these cases the 2-year carryforward from these years has not yet expired.

(*d*) *Revenue effect.*—This provision is expected to result in a negligible loss of revenue when fully effective.

13. Limitation on charitable contribution deduction for future gifts of tangible property (sec. 209(e) of the bill and sec. 170(f) of the code)

(*a*) *Present law.*—Under present law, if a taxpayer gives property to charity but retains for either his or someone else's life or any other period the use or enjoyment of the property, he receives a charitable contribution deduction for income tax purposes at the time of the gift of the future interest in an amount equal to the present discounted value of that future interest.

(*b*) *General reasons for provision.*—The House report calls attention to the problem where pictures or art objects are given to museums, but the gift takes effect at some future time, usually based upon the life of the contributor or someone else. In the meanwhile, the use of the pictures or art objects is retained in much the same manner as if the contribution of the future interest had not been made. The same enjoyment would occur, for example, if instead of making a gift of a future interest, the taxpayer were to wait until his, or his family's use of the property was completed. If this use was completed at the time of his death, however, no charitable contribution for income tax purposes could be claimed, even though an estate tax deduction would be available.

The report of the House Committee on Ways and Means suggests generally that it is inappropriate for taxpayers using this device to obtain what amounts to an extra charitable contribution deduction for income tax purposes. However, the House report further suggests that in the ordinary case where the contributor retains the right to use the property for his own life that this in fact has been a strong inducement for giving pictures and art objects to museums and other cultural centers in the United States and that in any event much of the problem which has arisen in the past has stemmed from the problem of valuing the pictures and art objects given.

Based upon the consideration outlined above, the House bill provided a general rule which denied deductions for charitable contributions in the form of future interests in tangible personal property, but then made this rule inapplicable where the life interest was retained for the life or lives of the contributor or contributors. Your committee is in agreement with the general rule adopted by the House but believes that the exception making this general rule inapplicable in the case where a life estate was retained by the contributors in effect makes this rule inapplicable to the bulk of the cases which should come under the rule. Your committee sees no more reason for granting a charitable contribution deduction for income tax purposes whether the life interest is reserved for the contributor or someone else. It recognizes that for some taxpayers this may have some temporary effect in dulling the special incentive now existing for giving pictures and art objects to museums and other cultural centers. Moreover, some taxpayers may be induced under this provision to give their pictures or other objects outright during life rather than wait until their death, thereby accelerating gifts to museums and other organizations. In any event, your committee questions whether it is appropriate to provide the special stimulus of an income tax deduction, in addition to a charitable deduction for estate tax purposes, to induce this result.

(*c*) *General explanation of provision.*—For the reasons indicated above your committee's amendments provide that charitable contributions in the form of a future interest in tangible personal property are to be treated as deductible for income tax purposes only when all interests in, and rights to possession or enjoyment of, the property in question has been given up. Your committee has deleted the exception in the House bill making this rule inapplicable in the case of charitable contributions where the only reservation in the gift is that the property is not to be transferred until the death of the contributor or contributors.

Any type of a reservation by the contributor and any reservation in the hands of related persons described in section 267(b) of the code under your committee's action will result in a denial of the charitable contribution deduction as long as the reservations continue.

Although generally this provision is limited to gifts of future interests in tangible personal property the provision also covers fixtures which are intended to be severed from the real property, such as chandeliers, mantels, etc.

(c)(i) *Effective date.*—This provision applies to transfers after December 31, 1963.

(d) *Revenue effect.*—This provision is expected to result in a negligible revenue gain when fully effective.

14. Losses arising from expropriation of property by governments of foreign countries (sec. 210 of the bill and sec. 172(b)(1)(D) of the code)

(a) *Present law.*—Generally, under present law, a net operating loss may be carried back to each of the 3 prior years and then, to the extent of any loss still not offset against income, the balance may be carried forward to the 5 succeeding years—providing a period of 8 years over which a loss may be spread. In two cases under present law, however, longer loss carryover periods are provided. Thus, in the case of corporation suffering losses which are certified as arising with respect to the "Trade Expansion Act of 1962", a 10-year carryover period is provided—a 5-year carryback and a 5-year carryforward. Present law also provides a 10-year carryover period in the case of regulated transportation companies—in this case a 3-year carryback and a 7-year carryforward.

(b) *General reasons for provision.*—Your committee has been informed that since World War II at least 14 foreign governments have expropriated property of U.S. taxpayers. The most significant of these expropriations was that made in Cuba, beginning in 1959 when all U.S. investments in that country were expropriated by the government.

Generally, it is believed that the 3-year carryback and 5-year carryforward for net operating losses provide a sufficient period for the recovering of substantially all business losses. In those cases, however, where this period has proved insufficient, Congress has followed the policy of providing a longer loss-carryover period. This accounts for the 10-year period in present law for those suffering losses arising under the Trade Expansion Act of 1962 and for the 10-year period in the case of regulated transportation companies.

Your committee believes that the expropriations by foreign governments which have occurred in recent years represent another example of larger than usual losses, where the usual 8-year carryover period for losses is inadequate. Therefore, your committee's amendments extend the 10-year loss period, already applied in special cases, to expropriation losses. A 10-year carryforward with no carryback is provided for these expropriation losses. The longer carryforward has been substituted for the 3-year carryback because, if carrybacks were required, the taxpayers might have to forego the benefits derived from using foreign taxes as credits rather than deductions with respect to the back years.

(c) *General explanation of provision.*—Your committee's amendment provides a 10-year carryforward with no carryback for expropriation losses. This is available with respect to expropriation losses arising in taxable years ending after December 31, 1958. Thus, it will include 1959 which was the year the Cuban expropriations began.

To qualify for the 10-year carryforward, the expropriation loss must be at least 50 percent of the total net operating loss for a year. Thus, this extra carryforward period will not be available unless the expropriation loss is a major proportion of a company's net operating loss.

To receive this treatment, the taxpayer must elect the 10-year carryforward on or before the time specified by regulations prescribed by the Secretary of the Treasury or his delegate. However, in the case of past years with respect to which the 10-year carryforward is to be available, namely the years 1959 through 1963, taxpayers are to have until December 31, 1965, to make the elections for these years. In these cases the statute of limitations will be opened for deficiencies or refunds with respect to any years affected by the change and ending before 1964. Taxpayers are also to have an opportunity to make a new election with respect to the foreign taxes for this back period—to take either a deduction or a tax credit as the changed circumstances arising from the longer carryforward of losses (and no carryback of these expropriation losses) warrant.

The types of losses involved are trade or business, or production of income, losses which are "sustained by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or agency or instrumentality of the foregoing * * *." Such a loss is to be considered a "foreign expropriation loss."

A foreign expropriation loss will be treated separately from any remaining net operating loss for the same year. The regular net operating loss for the year will be carried back and used up to the extent of the income in the 3 prior years. Then, if any of the regular net operating loss still remains, it will be carried forward to the next year and used first. Only after the net operating loss is fully applied in the first carryforward year will any expropriation loss from the same year be used in that year. Thus, the expropriation loss will be considered the last portion of the total net operating loss applied in any case, although the expropriation loss for a year will be applied before the regular net operating loss for any succeeding year.

(c)(i) *Effective date.*—This provision applies with respect to foreign expropriation losses arising in taxable years ending after December 31, 1958.

(d) *Revenue effect.*—This provision is expected to result in a revenue loss of approximately $5 million a year in 1965, but it expected to decline appreciably after 1970.

15. One percent limitation on medicines and drugs for those over age 65 (sec. 211 of the bill and sec. 213 of the code)

(*a*) *Present law.*—Under present law, generally only what are considered abnormal medical expenses are deductible. This result is attained by limiting expenses which may be deducted to the excess of these expenses over 3 percent of the individual's adjusted gross income (income after business and similar expenses but before personal exemptions and personal expenses). In computing medical expenses subject to this 3-percent limit, medicines and drugs may be taken into account only if they exceed 1 percent of adjusted gross income. The 3-percent limitation does not apply in the case of the taxpayer and his spouse where either of them is 65 or over nor does it apply in the case of medical expenses of the mother or father of the taxpayer or of his wife where the parent is 65 or over and receives his principal support from the taxpayer. The 1-percent limitation on medicines and drugs, however, applies to everyone without regard to their age.

(*b*) *General reasons for provision.*—The House bill repeals the 1-percent limitation with respect to medicines and drugs insofar as it relates to a taxpayer, or his spouse either of whom is age 65 or over, or to the parent of the taxpayer (or his spouse) where the parent is a dependent of the taxpayer and is 65 or over. The effect of this is to provide that the 1-percent limitation will apply only in those cases where the 3-percent limitation also applies. Your committee is in accord with this action, because it, like the House, believes that it is undesirable to impose any minimum limitation with respect to the deductibility of medical expenses in the case of the aged. It also believes that conforming the application of the 1-percent limitation with the 3-percent limit will simplify the statute somewhat in this area.

(*c*) *General explanation of provision.*—Present law provides that medicines and drugs which otherwise would be taken into account in computing medical expenses (which are either deductible in whole, or to the extent they exceed 3 percent) are to be deductible only to the extent that the total of these medicine and drug expenses exceed 1 percent of the taxpayer's adjusted gross income. Both the House and your committee's version of the bill make this 1-percent limitation inapplicable in the case of amounts paid for the care of the taxpayer and his spouse if either of them has attained age 65 before the end of the taxable year. Both versions also provide that this 1-percent limitation is not to apply to amounts paid for the care of a dependent mother or father of the taxpayer or his spouse if the mother or father has attained age 65 before the end of the year and also is a dependent of the taxpayer. Thus neither the 3-percent limit on medical expenses generally nor the 1-percent limit on medicines and drugs will apply to the categories of persons specified above who are age 65 or over. The maximum limitations on medical expenses, however, continue to apply to these and other persons in the same manner as under existing law.

(*c*)(*i*) *Effective date.*—This provision is to apply to taxable years beginning after December 31, 1963.

(*d*) *Revenue effect.*—This provision is expected to result in a revenue loss of $10 million in a full year of operation.

16. Care of dependents (sec. 212 of the bill and sec. 214 of the code)

(*a*) *Present law.*—Under present law, a deduction of up to $600 is allowed in certain cases for expenses of child care incurred to enable a taxpayer to be gainfully employed. At present, this is available for single women, women who are divorced or separated, or in some cases, deserted, and widows and widowers, having one or more dependents without regard to the amount of the taxpayer's earnings. In the case of working wives, the $600 deduction is presently available only if the combined adjusted gross income of the wife and husband (who must file a joint return) does not exceed $4,500. If their income exceeds this amount, the deduction available is decreased $1 for each dollar of income above $4,500, thus disappearing entirely at an income level of $5,100. An exception to this rule provides that this income limitation is not to apply if the husband is incapable of self-support because mentally or physically defective.

A dependent of the taxpayer for whom this $600 may be claimed must be a son or daughter (or stepson or stepdaughter) of the taxpayer who is under age 12 or a dependent who is physically or mentally incapable of caring for himself.

(*b*) *General reasons for provision.*—Your committee, while agreeing with the changes made by the House bill in the child-care provision, found them too narrow. As a result, it has liberalized the changes made by the House bill to also include the principal changes recommended by the administration with respect to this provision which were omitted in the House bill. These changes have also been recommended by the President's Commission on the Status of Women. The most important change made by your committee in the House provision is to raise from $4,500 to $7,000 the income limitation applicable with respect to working wives. In 1954, when provision was first made for the deduction of child-care expenses with respect to working wives, your committee in its report then stated:

> * * * [I]t is recognized that in many low-income families, the earnings of the mother are essential for the maintenance of minimum living standards even where the father is also employed, and that in such situations, the requirement for providing child care may be just as pressing as in the case of a widowed or divorced mother.

Thus, Congress provided for the deduction of child-care expenses in the case of working wives because it was recognized that the maintenance of a minimum standard of living in these cases required the wife to work. However, the present maximum joint income level of $4,500 is so low that relatively few working wives presently can claim this deduction. Of the 244,000 taxable returns claiming the deduction in 1960, only 117,000 were joint returns filed by married couples. In 1961, according to Department of Labor statistics, the median income of husband-wife families in which the wife worked at any time during the year was $7,050. Thus, the $4,500 limitation falls far short of covering the average case where the wife has found it necessary to supplement the husband's income by working. To carry out the original intention of Congress with respect to this provision, your committee's bill raises the joint income limitation for husbands and wives who may claim the child-care expense deduction from $4,500 to $7,000.

Under present law, the maximum amount which may be deducted for child care is $600 per year per taxpayer. As the House report indicates a flat limitation of this type fails to take into account the fact that the costs of caring for dependents, particularly where they must be cared for outside of the home, increases as the number of dependents increases. Because of this, the House bill raised the maximum deduction which may be claimed for child-care expenses to $900 where the taxpayer has two or more dependents. Your committee's bill carries this one step further and provides a maximum deduction of $1,000 where there are three or more qualifying dependents. It also makes this graduated maximum available in the case of working wives as well as where there is only one parent. These expenses are as likely to increase on a per-child basis in the case of a married couple as in those cases where there is only one parent.

In other respects, your committee's amendments, with minor technical exceptions, follow the House bill. Thus, as under the House bill, relief is provided where the wife is either in an institution or is physically or mentally incapable of caring for herself. Under present law, if the husband is incapable of self-support because of mental or physical deficiencies, the wife is fully eligible for the deduction without regard to the family income level. Your committee agrees with the House that a family where the wife is in an institution is at least as likely to incur expenses for child care as a family where the husband is incapable of self-support. Similarly, it also agrees that child-care expenses are likely to be required, where the wife is in the home but not capable of caring for herself. As under the House bill, your committee's amendments extend present law to permit child-care expenses in these cases, subject to limitations, to be deducted. Your committee in this regard modified the House provision only in that in the case of incapacitated wives, the deduction is to be fully available where the adjusted gross income of the taxpayer and his spouse does not exceed $7,000 rather than $4,500. This is in conformity with its change in the income level generally applicable in the case of working wives.

Both the House and your committee's bill also raise the maximum age limit generally available from 12 to 13 years for children with respect to whom the child-care deduction generally may be taken.

(c) General explanation: Raising income limitation from $4,500 to $7,000.—Your committee's amendments, as distinct from the House bill, increase from $4,500 to $7,000 the amount of income that families with working wives can earn and still qualify for the full amount of the deduction for expenses incurred for the care of children or dependents. The House bill made no change in this area. This raising of the income limitation to $7,000 is in accordance with the recommendation of the administration.

Under present law, for every dollar of income a husband and working wife have above $4,500, the maximum limit on their deduction for child-care expenses is reduced by a similar dollar below the $600 level. Thus, under present law with the $600 limitation, it is possible for a husband and working wife to receive some child-care expense deduction in the case of those with incomes up to $5,100. Under your committee's bill, since the maximum child-care expense deduction (where there are three or more children) is raised to $1,000, it will be possible for husbands and wives who are both working to claim some child-care expense deductions in cases where their joint incomes are up to $8,000. In 1960, the child-care expense deduction was claimed on 244,000 taxable returns. It is anticipated that the liberalizing amendments, primarily raising the income level for working wives to $7,000, will make this deduction available to an additional 200,000 returns or 444,000 taxable returns in all.

(*c*)(*i*) *General explanation: Raising the deduction to $900 or $1,000 in certain cases.*—Under present law, as previously indicated, the maximum annual deduction which may be claimed by a taxpayer is $600. The House bill, where there are two or more qualified dependents, would raise this maximun deduction which may be taken, for expenses incurred by the taxpayer, to $900. Your committee's amendments provide that the $600 limitation, as under the House bill, is still to be applicable where the taxpayer has only one dependent and that the $900 limitation is to be applicable where the taxpayer has two dependents. However, it provides that where there are three or more qualifying dependents, the maximum deduction which may be taken is to be $1,000, in lieu of the $900 provided by the House bill. The $900 and $1,000 limitations are also to be available in the case of working wives who are eligible for the child-care deduction (under the House bill, the $600 limitation would continue to apply in such cases).

(*c*)(*ii*) *General explanation: Incapacitated and institutionalized wives.*—The House bill adds to the list of situations where the child-care deduction may be claimed those cases where a wife is incapacitated or institutionalized. Your committee's amendments accord substantially the same treatment. For the husband to be eligible for this deduction, the wife must be institutionalized or incapacitated for 90 consecutive days (or a shorter period if she dies). In the case of incapacitated wives, under the House bill the deduction would be fully available only where the adjusted gross income of the taxpayer and his spouse does not exceed $4,500 (for incomes above that level, the deduction would decrease $1 for each dollar of income above $4,500). Under your committee's amendments, the $4,500 limitation in this case is replaced by the $7,000 limitation. The income limitation under both the House bill and your committee's amendments does not apply if the taxpayer's wife is institutionalized for a period of 90 days or more. A wife is considered as being incapacitated if she is incapable of caring for herself because she is mentally or physically defective (including any time she is institutionalized). A wife is considered institutionalized while she is receiving medical care or treatment as an inpatient, resident, or inmate of a public or private hospital, sanitarium, or similar institution.

(*c*)(*iv*) *General explanation: Raising the age limit for children to 13.*—Present law provides that a dependent, for purposes of the child-care deduction (if not physically or mentally incapable of caring for himself), must be a son or daughter (or stepson or stepdaughter) of the taxpayer and must not have attained the age of 12. The House bill raises this age limit to 13 and your committee's amendments make no change in the House bill in this respect.

(*c*)(*v*) *Effective date.*—The amendment made by this provision apply to taxable years beginning after December 31, 1963.

(*d*) *Revenue effect.*—Changes made by the House bill with respect to the child-care provision in a full year of operation would have resulted in a revenue loss of $5 million. The changes made by your committee increase this loss by $15 million or to a total of $20 million when compared with present law.

17. Moving expenses (sec. 213 of the bill and sec. 217 of the code)

(*a*) *Present law.*—Under present law, certain moving expenses of existing employees if reimbursed by the employer are held to be excludable from the employee's income. They have been ruled excludable on the ground that they are incurred "in the interest of the employer" (Rev. Rul. 54–429, C.B. 1954–2, 53).

Under present law, the moving expenses (for moving from one official station to another for permanent duty) which the Internal Revenue Service has agreed are excludable for existing employees where they are reimbursed are:

1. Transportation expenses for moving the employee and his family;
2. Transportation and certain related costs of moving the personal and household effects of the employee and his family; and
3. Expenses incurred for meals and lodging for the employee and his family while they are en route to their new location.

In addition, in two court cases, taxpayers have been permitted to exclude other types of moving expenses, although the Internal Revenue Service has not acquiesced in the exclusion of these other types of moving expenses.[1]

On the other hand, reimbursements for moving expenses received by new employees from their employers are includible in gross income. Moreover, no deduction is allowed for moving expenses of any employee with respect to expenses for which no reimbursement is received.

(*b*) *General reasons for provisions.*—Your committee agrees with the House that the existing tax treatment of moving expenses needs modification because the present treatment discriminates against both new employees and employees who are not reimbursed for their moving expenses by their employers. There is no reason why new employees should include in their income amounts representing moving expenses which, if received by an existing employee who is moved by his employer from one location to another, would be excludable from income. Neither is there any reason for discriminating against those employees who are not reimbursed for their moving expenses, but who incur such expenses in seeking job opportunities. Moreover, it is important to remove deterrents to the mobility of labor. Any thing which can be done in this respect should aid in reducing local structural unemployment.

Both the House and your committee's bill limit the categories of expense for which a deduction is available to new employees or those who are not reimbursed for moving expenses to the three categories specified above, which, by ruling, the Internal Revenue Service recognizes the reimbursements of which are as excludable for existing employees. No inference should be drawn from this, however, that moving expense exclusions under existing law are necessarily limited

[1] In *John E. Cavanagh* (36 T.C. 300; 1961) it was held that living costs incurred by the employee in excess of ordinary living expenses of his family were excludable where they were reimbursed while his household effects were in transit. In *Otto Sorg Schairer* (9 T.C. 549; 1947) it was held that where an employee was reimbursed for a loss incurred in selling his home this reimbursement was an addition to the sales price. More recently, however, the Tax Court held that reimbursements of similar expenses were additional compensation and not excludable from the employee's income in the case of *Harris W. Bradley* (39 T. C. 652; 1963 aff'd, 324 F. 2d 610 (4th Cir. 1963). A reimbursement on sale of a house was also held to be compensation in *Arthur V. Kobacker* (37 T.C. 882; 1962).

to these three categories of expenses. However, since by administrative ruling, these categories are clearly excludable in the case of existing employees who are reimbursed, it is believed that deductions for such expenses should also be made available to new employees and nonreimbursed employees as well. The question of whether the exclusion for existing employees extends beyond these three categories is left for judicial interpretation.

(c) *General explanation of provisions.*—The deductions allowed by the House and your committee's bill with respect to moving expenses are to be deductible in computing "adjusted gross income." These expenses, therefore, are deductible whether the individual involved itemizes his personal deductions or takes the standard deduction. This treatment is provided not only because these expenses are substantially similar to business expenses, but also because when they are incurred, they are likely to be relatively large. In such cases, it was thought that it would be undesirable to, in effect, make taxpayers choose between taking this deduction and the standard deduction in lieu of itemized personal deductions.

No deduction is provided under this provision for moving expenses for which the taxpayer receives reimbursements which are not included in his gross income. Thus, existing employees may continue to exclude reimbursed moving expenses from their gross income in the same manner as under present law. Their status, in this regard, is left entirely unchanged.

The types of moving expenses which may be deducted under this provision are reasonable expenses for—

1. Moving household goods and personal effects from the former residence to the new residence;
2. Transportation expenses of the employee and his family from the former residence to the new place of residence; and
3. Expenses for meals and lodging while in transit from the former residence to the new place of residence.

The moving expenses referred to are available not only with respect to the taxpayer, but also to any other members of the taxpayer's household who had as their permanent place of abode the taxpayer's former residence and moved to his new residence. (For amendment added by your committee with respect to sales of residences of employees who are moved see sec. 232 of the bill, item 39 below.)

(c)(i) *Limitations.*—To prevent the deduction of moving expenses for short moves, the bill provides that, for a deduction to be available, the taxpayer's new place of work must be at least 20 miles farther from his former residence than was his former place of work. In other words, his commuting distance must have increased by at least 20 miles to be eligible for this deduction. If the individual involved previously had no place of work, his new work location must be at least 20 miles from his former residence.

To prevent individuals from taking temporary jobs in order to obtain the deduction of moving expenses, it is provided that during the 12-month period immediately after the individual's arrival at his new principal place of work, he must be a full-time employee in that general location for three-fourths of the time (39 weeks). This limitation, however, is not applied to the extent where the individual is reimbursed for his moving expenses by his employer since, presumably, an employer would not reimburse such expenses even for a new employee unless it was his intention that the individual remain employed for an extended period of time.

This requirement that an employee be a full-time employee in a general location for three-quarters of a year after moving means that where he has moved after the first half of the year, he cannot be sure when he files his return in the following April that he will meet this 9 months' requirement. For that reason, the employee in such a case is permitted to claim the moving expense deduction (assuming he has not already disqualified himself by that time, such as by moving out of the general location). Then, if after filing his return he fails to qualify for the moving expense deduction by not remaining employed full time for 39 weeks in the new location he is to include in his gross income for the following year the amount of moving expense deduction claimed in the prior year.

(c) (ii) *Effective date.*—The new treatment provided by this provision applies to expenses incurred after December 31, 1963.

(d) *Revenue effect.*—It is anticipated that this provision in a full year of operation will result in an annual revenue loss of $60 million a year.

18. Deduction for political contributions (sec. 214 of the bill and sec. 218 of the code)

(a) *Present law.*—Up to the present no deduction or credit has been allowed for political contributions of any type. In fact, charitable and educational contributions presently may be denied if the organizations involved spends any substantial part of its activities in attempting to influence legislation.

(b) *General reasons for provisions.*—Your committee's bill departs with the precedent in this respect primarily because of the report of the late President Kennedy's Commission on Campaign Costs and because of his recommendation to Congress with respect to this report. This section, while not identical to the proposal of the late President, nevertheless is substantially similar to it, and in your committee's opinion carries out the objectives of that request. The purpose of allowing a limited deduction for campaign contributions is, as indicated by the late President, to broaden the base of contributions: "to reduce dependence on large contributions of those with special interests." As he indicated, this section "is designed to give party solicitors an additional tool to help stimulate individuals to contribute money, in * * * election years."

(c) *General explanation of provision.*—The new section added by the bill allows a deduction for political contributions up to a maximum of $50 a year in the case of a single person (or a married person filing a separate return) and up to $100 a year in the case of a married couple filing a joint return. The amounts for which deductions are permitted are limited in order to achieve the objective of the late President Kennedy in "broadening the base of political contributions."

These deductions are available only to those who itemize their deductions, rather than taking a standard deduction. Therefore, this places these limited deductions for political contributions in the same category as charitable contributions, deductible taxes, interest, certain medical expenses, etc.

The bill provides that this deduction for political contributions is to be allowed only if the fact of the political contribution is verified in such manner as the Secretary of the Treasury or his delegate prescribe by regulation. It is anticipated that under this grant of authority the Secretary of the Treasury will provide that the deduction will be available only where the taxpayer, if his return is audited, presents adequate records to show that he has actually made the political contributions to a qualified candidate or committee. This will give assurance against the claiming of deductions for fictitious political contributions.

A political contribution which as a result of the new section added by the bill will be deductible must be a contribution or gift to a "political candidate" or "political committee." However, in addition, it is required that the contribution be made only for the purpose of furthering the candidacy of one or more individuals in a general, special, or primary election or a convention of a political party. Thus, contributions or gifts to further the cause of a referendum or other issue on a ballot will not be deductible. The candidate with respect to which the deduction of a contribution or gift may be claimed may be a candidate for National, State, or local office and may be either a partisan or nonpartisan candidate. Thus, for example, where judges are elected officials, contributions for their candidacy may be deducted. The candidacy of the individual may be either for a primary election or for a convention of a political party nominating candidates for office or for a general election. Included also are special elections to fill vacancies.

The deduction for political contributions under the bill is limited to contributions made by individuals. It is not available with respect to contributions from corporations or from estates or trusts.

(*c*)(*i*) *Effective date.*—The bill provides that contributions or gifts made after the date of enactment of this bill are to be deductible.

(*d*) *Revenue effect.*—It is anticipated that this provision will result in a revenue loss of approximately $25 million a year for Presidential election years; 50 percent of that amount for congressional election years; 25 percent for off years; and average about $15 million per year.

19. One hundred-percent dividends received deduction for members of electing affiliated groups (sec. 215 of the bill and sec. 243 of the code)

(*a*) *Present law.*—Present law in general provides a deduction equal to 85 percent of the dividends received by one corporation from another domestic corporation. This has the effect of taxing 15 percent of intercorporate dividends received. With the present 52-percent tax rate, this is a tax of 7.8 percent on the entire dividend (15 percent times 52 percent), or in the case of the 48-percent rate effective under this bill for corporations in 1965 and subsequent years, a tax on the entire dividend of 7.2 percent.

(*b*) *General reasons for provision.*—The administration in its initial recommendation to Congress proposed that the 2-percent penalty tax on consolidated returns be repealed that controlled groups be limited to a single surtax exemption, and also, that the intercorporate dividends received deduction be increased to 100 percent in the case of amounts received as a dividend from a corporation which is a member of the same parent-subsidiary affiliated group. In this regard, the Secretary of the Treasury in his explanation of this provision to the Ways and Means Committee stated:

> The elimination of the intercorporate dividend tax in this type of parent-subsidiary relationship would extend to such

groups one of the tax advantages generally now available only to affiliated groups which file consolidated returns. This amendment is designed to facilitate the adjustment to the elimination of multiple surtax exemptions in cases where the affiliated group does not, or cannot, file consolidated returns, but would recognize that the earnings of an 80-percent-owned operating subsidiary are more directly the earnings of the parent than is the case where one corporation merely derives investment income from an unrelated corporation.

Your committee is in accord with this recommendation of the administration. Your committee concluded that it would be inequitable to repeal the consolidated return 2-percent tax without also providing a 100-percent intercorporate dividends received deduction for corporations meeting the same tests of common ownership, but which for one reason or another cannot, or do not want to, file a consolidated return and are willing to forgo multiple surtax exemptions. Among the principal reasons for not being eligible to file a consolidated return in the case of an affiliated group is the need for different members of a group to maintain different fiscal years due to variations in the natural business years of the different companies involved. Still another factor accounting for some corporations in an affiliated group not filing consolidated returns is the necessity to use the same accounting method (unless the Internal Revenue Service specifically permits a variance) although there may be valid business reasons for the different accounting methods in the case of the different businesses. Another reason which applies in the case of life insurance companies is that under present law such companies may not file a consolidated return with other domestic corporations which are not life insurance companies. Moreover, still other corporations are hesitant to file consolidated returns because of the sheer complexity of the consolidated return regulations.

For these reasons, your committee has added a provision granting a 100-percent dividends-received deduction in those cases where corporations are affiliated but they do not file a consolidated return. To be sure that no special advantage was given these corporations over those corporations which do file consolidated returns, your committee has reviewed the various provisions of the code and denied tax benefits in those cases where the separate corporations received significant advantages over a consolidated group. Thus, where this 100-percent dividends-received deduction is elected, the group is to have only one $25,000 surtax exemption for the group, the election with respect to foreign tax credits or deductions must be the same for all members of the group, only one $100,000 minimum accumulated earnings credit is to be allowed in determining exemptions from the tax on unreasonable accumulations, only one $100,000 exemption in computing estimated tax subject to accelerated payments is to be allowed, and limitations generally applicable to a single corporation are provided in the case of exploration expenditures.

(c) *General explanation of provision.*—A 100-percent dividends-received deduction is allowed by your committee's amendment when dividends are paid by a domestic corporation but only where the dividends are "qualifying dividends." To be qualifying dividends they must be received from a corporation which is a member of the same affiliated group of corporations. "Affiliated group" for this purpose is defined in the same manner as an affiliated group for purposes of the requirement for filing a consolidated return except that a domestic insurance company (taxable under section 802 or 821) is treated as an includible corporation. For the dividends to be qualifying, the receiving and distributing corporation must be members of the same affiliated group at the time of the distribution and also the dividends must be distributed out of earnings and profits of a year ending after December 31, 1963, when on each day of which the two corporations were members of the same affiliated group and were not claiming multiple surtax exemptions.

The determination as to what earnings and profits a dividend is considered as being distributed out of will be made under the rules applicable elsewhere in the code for this purpose; i.e., they will be considered as paid first out of the current year's earnings and profits and then, to the extent of any excess, out of the prior year's earnings and profits, then, to the extent of any excess, out of the second prior year's earnings and profits, etc. In addition, the dividends must be paid at a time when the distributing and receiving corporations are members of an affiliated group which has elected to qualify for the 100-percent dividend-received treatment provided by the new section.

An election must be made by the parent corporation and consented to by each of the subsidiary corporations. The election is effective for the taxable year of the subsidiaries which includes the last day of the year of the parent with respect to which the election was initially made. In addition, the election applies automatically for each succeeding year unless the election is specifically terminated. A special rule provides that with respect to fiscal years beginning in 1963 and ending in 1964, the election would be effective as long as the last day of the corporation's year is included in a year of the parent for which an election is effective.

An election may be terminated by an affiliated group if the affiliated group files a termination of the election and each member of the group consents to this termination. In addition, the election may be terminated where a new member is added to the affiliated group and this member files a statement to the effect that it does not consent to the election.

Where an affiliated group elects the 100-percent dividend paid treatment, the members of the group must forego certain advantages which they otherwise would have as separate corporations. These rights are withdrawn since they are not available to a group filing a consolidated return, where the tax advantages are substantially similar to those provided in the case of the 100-percent dividends received deduction. The advantages of separate treatment which the affiliated group must forego if this election is made are as follows:

1. The group may not elect to receive more than one surtax exemption.

2. All members of the group must all make the same elections with respect to foreign taxes; i.e., they must all elect either to claim deductions for these foreign taxes or foreign tax credit; and, if they claim foreign tax credit, they must all either elect the "per country limitation" or the "overall limitation" in computing the size of the credits available. They will each, however, continue to compute their own

foreign tax deduction or credit in the same manner as separate corporations.

3. In determining whether or not the various corporations in the affiliated group are subject to the accumulated earnings tax (imposed by section 531), only one $100,000 minimum accumulated earnings credit would be available for the entire group.

4. In determining the tax liability of the group which will be subject to estimated tax (i.e., acceleration of corporate payments so that the tax is paid in the year of liability rather than in the succeeding year), only one exemption of $100,000 of tax liability is to be available to the entire group rather than to each member of the group.

5. In determining the maximum amount of exploration expenditures with respect to mineral deposits which may be written off in any one year or treated as a deferred expense the group of affiliated corporations making this election is to be eligible to write off one $100,000 in any one year with a total of $400,000 over any number of years.

Except for the $100,000 minimum accumulated earnings credit, it is anticipated that the members of the affiliated group will be permitted to apportion the $100,000 exemptions, limitations, or the $400,000 limitation in any manner that they see fit.

Life insurance companies and mutual casualty insurance companies may not file a consolidated return with any other companies except other life insurance companies of the same type. Under your committee's amendment, however, dividends from, or to, such insurance companies are eligible for the 100-percent dividends received deduction if the entire affiliated group of which the insurance company is a member consents to the tax treatment provided by this section.

(*c*)(*i*) *Effective date.*—This 100-percent dividend deduction treatment is to apply with respect to dividends received in taxable years ending after December 31, 1963.

(*d*) *Revenue effect.*—It is anticipated that this provision will result in a revenue loss of approximately $5 million a year.

20. Interest on loans on certain insurance and annuity contracts (sec. 216 of the bill and sec. 264 of the code)

(*a*) *Present law.*—Under existing law, no interest deduction is allowed in the case of indebtedness incurred or continued to purchase, or carry, a single-premium life insurance, endowment, or annuity contract. In addition, if substantially all the premiums on a contract are paid within 4 years of the date on which the contract was purchased, the contract is treated as if it were a single-premium contract for purposes of this provision. Similarly, where a purchaser borrows an amount equal to a substantial portion of the premium payments on a contract, but, instead of purchasing the policy outright, deposits the borrowed funds with the insurance company for future payments on a policy, this also is treated as if it were a single-premium contract and the interest deduction on the indebtedness relating to the contract is denied. However, under present law, no interest deductions are denied where the taxpayer purchases an insurance contract with the intention of borrowing the maximum amount on the contract each year, unless the contract falls in one of the categories described above.

(*b*) *General reasons for provision.*—It is understood that life, or other insurance policies are being sold to individuals on the basis that they cost the individual little or nothing, and in some cases on the grounds that they actually result in a net profit for him. In such cases, the taxpayer each year borrows all, or a substantial part, of the funds necessary to pay the premium on the policy. If he is in a 50-percent (or higher) tax bracket, since the interest payments on such loans are presently deductible, the net interest cost to him is one-half or less of the interest payments he makes. The annual increase in the cash value of the insurance policy to reflect interest earnings, which generally is not taxable to the taxpayer either currently or otherwise, is likely to equal or exceed the net interest charges the taxpayer pays. Thus, for taxpayers in higher brackets, where the annual increment in the value of the policy, apart from the premiums, exceeds the net interest cost of the borrowing, such policies can actually result in a net profit for those insured. Because of this, some insurance companies have sold insurance policies under plans which provide for the taxpayer borrowing the premiums either directly from the insurer, or from a bank or otherwise, primarily on the grounds that the policies are tax-saving devices. Both the House and your committee doubt that the sale of insurance on such a basis is either desirable or fair to taxpayers generally.

However, the importance of being able to borrow on insurance policies is recognized; and, therefore, while adopting a provision designed at minimizing the sale of insurance as a tax-saving device, the House and your committee have been careful in this provision to provide for the retention of rights to borrow on insurance for other than tax-saving purposes without the loss of the interest deduction.

One of the Treasury's proposals on which neither the House nor your committee took any action involves the tax treatment of split-dollar life insurance arrangements, which are closely related to this bank loan insurance provision. These are arrangements entered into jointly by an employer and employee under which part of the premiums on a life insurance policy are paid by each. It is believed that the issues involved in this problem, and the proper solution, including the possibility of administrative action, are in need of further study by the Treasury Department.

(c) *General explanation of provision.*—Both the House and your committee's bill provide that interest paid on indebtedness incurred or continued to pay premiums on life insurance contracts, endowment contracts, or an annuity is not to be deductible if the individual is following a plan of systematically borrowing amounts equal to the increase in the cash value of the insurance contract to pay part or all of the premiums. The interest deduction is to be denied whether the borrowing is direct or indirect; that is, whether it is from the insurance carrier, from a bank, or from any other person. It also is intended to cover cases where the individual borrows on other property or on his general line of credit to pay the premiums. This provision is not to apply to a single-premium contract or to a contract treated like a single-premium contract, since present law already denies a deduction in these cases.

In effect, where the taxpayer systematically borrows the increase in the cash value of his policy he is converting what generally is a permanent form of life insurance into substantially the equivalent of renewable term insurance. In this case, however, he retains the right to restore the contract to permanent insurance as of the original age at which he took out the contract by repaying the amount borrowed from the insurance company, bank, or other person.

The House bill would apply only to insurance or annuity contracts purchased after August 6, 1963, the date the House Committee on Ways and Means first announced its action on this matter. Your committee has amended the provision so that it will apply only to contracts purchased after December 31, 1963, to bring this provision into line with the general effective dates provided in this bill for structural changes. In any event, both the House provision and the provision as amended by your committee will only affect contracts entered into after the specified date and will have no effect on contracts entered into before that date even in the case of borrowings on such a contract in the future.

(*c*)(*i*) *Exceptions.*—Both the House and your committee desire to be sure that the value of insurance generally would not be decreased by reducing the rights of the individual to borrow on the insurance, as he can in the case of other forms of assets. For this reason, a number of exceptions to the general rule are added where, even though the borrowing may take the form of a systematic plan, nevertheless this provision is not to apply. These exceptions are as follows:

1. The interest deduction is to be allowed if there is no borrowing with respect to any four of the annual premiums payable on the insurance or annuity contract in the first 7 years of the contract. However, to prevent avoidance of this provision by taking out a contract with very low premiums for the first 4 years, with the premiums being substantially greater thereafter, the bill contains a rule relating to situations of this type. It is provided that the 7-year period referred to above is to commence again at any time there is a substantial increase in the premiums payable under the insurance or annuity contract.

2. A de minimis rule is to apply. Thus, if the otherwise nondeductible interest of an individual with respect to an entire taxable year does not exceed $100, no interest deduction will be denied.

3. In any event, no interest deduction will be denied if the debt was incurred because of an unforeseen substantial loss of income or unforeseen substantial increase in financial obligations. Thus, for example, the interest deduction would not be denied where the individual systematically borrowed on a policy previously purchased because he, or his family, incurred large unforeseen medical bills or because he unexpectedly lost a substantial income source.

4. The interest deduction is not to be denied where the indebtedness actually is to finance business obligations, rather than to carry insurance. For example, an individual with an insurance policy would not have his interest deductions denied where it can be shown that the amounts borrowed by him were actually used to finance the expansion of inventory or for other similar business needs.

(*c*)(*ii*) *Effective date.*—This provision as amended by your committee applies to amounts paid in taxable years beginning after December 31, 1963, but with respect to policies purchased after December 31, 1963.

(*d*) *Revenue effect.*—It is estimated that this provision will result in an annual revenue gain of $5 million in 1964 and 1965 and $10 million when the provision is fully effective.

21. Interest on indebtedness incurred or continued to purchase or carry tax-exempt bonds (sec. 217 of the bill and sec. 265(2) of the code)

(*a*) *Present law.*—Under present law, no deduction is allowed for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is exempt from Federal income taxes. It has been held that interest paid on indebtedness represented by deposits in banks engaged in the general banking business is not subject to this provision since this indebtedness is not considered to be "incurred or continued to purchase or carry" tax-exempt obligations. This position which has been a long-standing administrative practice was specified by ruling in 1961 (Rev. Rul. 61-222, 1961-2 CB58).

(*b*) *General reasons for provision.*—A witness before your committee called attention to the fact that financial institutions which are subject to the banking laws of a State, although not actually banks themselves, pay interest on face amount certificates—a way by which thousands of individuals throughout the country systematically invest their savings. In the example cited to your committee, a certificate holder pays to the financial institution equal monthly payments for 20 years and at the end of that time, the financial institution pays back the amount of the investment plus interest in accordance with the provisions of the certificate. The funds of the financial institution in this case are subject to regulation by the Investment Company Act which permits investment of the funds received from the certificate holder in "qualified investments."

Qualified investments for this purpose include real estate mortgages, certain property improvement loans, U.S. Government and municipal bonds, and other securities meeting certain performance standards. As a result, part of the financial institution's funds are invested in State and municipal bonds, the interest on which is exempt from Federal income tax.

Your committee concluded that in cases of this type the relationship of the financial institution to the certificate holder is sufficiently close to the relationship of a bank to its depositors as to permit the investment of a substantial portion of the funds of such an institution in tax-exempt State and municipal bonds without this resulting in the possible denial of the interest deduction with respect to amounts paid out to the certificate holders. Your committee therefore has amended the House bill to provide that interest deductions are not to be denied in the case of these types of financial institutions to the extent they invest not more than 25 percent of their assets in tax-exempt obligations.

Your committee intends that no inference be drawn from the fact that it has provided this treatment for the future as to the proper interpretation of the applicable law with respect to interest deductions for any prior year.

(*c*) *General explanation of provision.*—Your committee's amendment adds a sentence to the provision of existing law which denies a deduction for interest on indebtedness incurred or continued to purchase or carry obligations, the interest on which is wholly exempt from Federal income tax. The sentence added provides that financial institutions which are subject to the banking laws of the State in which they are incorporated are not to be denied interest deductions on face amount certificates (as defined in the Investment Company Act of 1940), or on amounts received for the purchase of these certificates, on the grounds that this interest is on indebtedness incurred or continued to purchase or carry tax-exempt obligations. However, interest on these face-amount certificates is to be so treated only to the extent that the average amount of tax investments of the institution in the tax-exempt obligations do not comprise more than 25 percent of the average of the total assets of the institution. "Total assets" for this purpose means gross assets (taken at cost) less all of the liabilities other than the liability on the face-amount certificates.

(c)(i) *Effective date.*—This provision applies with respect to taxable years ending after the date of enactment of this bill.

(d) *Revenue effect.*—It is expected that this provision will result in a negligible revenue loss.

22. Repeal of requirement of allocation of certain traveling expenses (sec. 218 of the bill and sec. 274(c) of the code)

(a) *Present law.*—In the Revenue Act of 1962, Congress provided that where a person takes a business trip and this is combined with recreational or other personal activities, the cost of this trip in certain cases must be allocated between the business and personal activity, the former, but not the latter, being deductible for income tax purposes.

Exceptions in the statute provide that this allocation is not to be required where the trip does not take more than a week or where the time spent on the personal activities represents less than a quarter of the time away from home on the trip. In these cases, the entire expenses of travel, and meals and lodging while in travel status, are deductible as under prior law, where the taxpayer can establish that the trip is related primarily to business. Under the authority provided for prescribing, under regulation by the Secretary or his delegate, the amount of activity allocable to the trade or business, the Treasury Department has held that if the travel expense qualifies as an ordinary and necessary business expense, none of it will be disallowed (1) if the taxpayer does not have substantial control over arranging the business trip or (2) if he does not have the obtaining of a personal vacation as a major consideration in determining whether to make the trip.[1] The Internal Revenue Service has held that an employee who is reimbursed by his employer for his travel expenses is considered not to have substantial control over arranging the business trip providing he is not a managing executive of, or closely related to, his employer. Even a managing executive, or an individual who is closely related to his employer, is not affected if he can establish that he did not have substantial control over arranging the particular trip.[2] It is also indicated that mere control over the timing of a business trip will not itself represent substantial control.[3] Even where the person has substantial control over arranging the business-vacation trip, the Service has indicated that it will not be held to be partially allocable to nonbusiness activity unless obtaining a personal vacation or holiday was a major consideration in making the trip.[4] The Service has also indicated that if a major consideration in making the business trip is to visit a hospitalized relative, this will not result in any allocation of the travel expense for personal reasons. On the other hand, of course, if the primary purpose of the trip is to visit an ill relative

[1] U.S. Treasury Department, Internal Revenue Service, "Questions and Answers for the Businessman Travel, Entertainment and Gift Expenses," Document No. 5495 (7-30-63), question No. 69.
[2] Op. cit., question No. 71.
[3] Op. cit., question No. 73.
[4] Op. cit., question No. 75.

for personal reasons, no deduction would be allowable for travel expense as under prior law.[5]

(*b*) *General reasons for the provision.*—There is at the present time a great deal of confusion as to the area of application of this provision and the rules developed by the Internal Revenue Service with respect to this provision are little understood by the general public. It is recognized that the Internal Revenue Service in its interpretation of this provision has attempted to remove the harsher aspects in its application. However, this also has had the unfortunate effect of complicating the provision to such a degree that it is not generally understood by the traveling public. Moreover, the area of application of the provision is so restricted, since it applies only to self-employed persons and to employees who are managing executives or related to employer, and in many cases not to them, that your committee concluded that the provision in its present form served little purpose. In view of these considerations your committee has added a section to the bill repealing this travel allocation rule retroactively to the date of its enactment in the Revenue Act of 1962.

(*c*) *General explanation of provision.*—The section added by your committee repeals the subsection adopted in 1962 which required a person taking a business trip, which was also combined with recreational or other personal activities, to allocate the cost of the trip between the business and personal activities, deducting the former and not the latter. This allocation was not required where the trip does not take more than a week or where the time spent on personal activity represents less than a quarter of the time away from home on the trip.

(*c*)(*i*) *Effective date.*—This provision is repealed as of the date of its enactment; namely, for periods after December 31, 1962.

(*d*) *Revenue effect.*—It is estimated that the repeal of this provision will result in a revenue loss of $5 million a year.

23. Acquisition of stock in exchange for stock of corporation which is in control of acquiring corporation (sec. 219 of the bill and sec. 368 of the code)

(*a*) *Present law.*—Under present law, a subsidiary corporation can acquire the assets of another corporation in exchange for its parent company's stock. This is a tax-free reorganization (under sec. 368(a)(1)(C)). In addition, following this tax-free reorganization the acquired assets can be transferred to a subsidiary corporation without affecting the tax-free nature of the reorganization.

Under present law, it is not possible, however, for a subsidiary corporation to acquire tax free the stock of another corporation in exchange for the stock of its parent corporation. In such a case, for the reorganization to be tax free, present law requires that the subsidiary corporation transfer its own stock in exchange for the stock of the other corporation, rather than the stock of its parent.

(*b*) *General reasons for provision.*—The Supreme Court in *Groman* v. *Helvering* (302 U.S. 82) and *Helvering* v. *Bashford* (302 U.S. 454), found that exchanges in which the parent corporation transferred stock while its subsidiary corporation received stock or the assets of another corporation did not qualify as tax-free reorganizations because the required "continuity of interest" was lacking.

[5] Op. cit., question No. 76.

In the 1954 code, in order to avoid the results of the *Groman* and *Bashford* decisions, the law was amended to provide that the subsidiary corporation could acquire the assets of another corporation in exchange for its parent corporation's stock (in tax-free reorganization under sec. 368(a)(1)(C)). The 1954 code also provided that following this reorganization, the acquired assets could be transferred to a subsidiary corporation without destroying the tax-free status of the reorganization.

Thus, the 1954 code permits tax-free reorganizations in the case of the exchange of the parent's stock for the assets of a corporation acquired by the subsidiary. However, a similar result is denied where the subsidiary acquires the stock of the other corporation in exchange for the stock of its parent corporation. Since Congress has considered the "continuity of interest" rule satisfied in the case of asset acquisitions, there seems to be no reason for not applying the same rule to stock acquisitions, since there is little in substance to distinguish an asset acquisition from a stock acquisition.

As a result, your committee has concluded that it is desirable to treat these two types of acquisitions in the same manner. For that reason, it has provided tax-free status for the stock-for-stock reorganization in the same manner that present law provides a tax-free status for stock-for-assets reorganizations.

(*c*) *General explanation of provision.*—This provision amends the definition of a stock-for-stock reorganization (known as a (B) reorganization) to qualify as a tax-free reorganization a transaction in which a subsidiary corporation acquires the stock of another corporation (and after that is in control of the corporation) in exchange solely for the voting stock of its parent corporation. Present law is also amended to permit the subsidiary corporation acquiring the stock of another corporation in the "(B) reorganization" to transfer all or part of this stock to another corporation which it controls. In addition, conforming changes have been made to the definition of the term "party to the reorganization".

(*c*)(*i*) *Effective date.*—The amendment made by this provision applies with respect to transactions after December 31, 1963.

(*d*) *Revenue effect.*—This amendment is expected to result in a negligible loss in revenue.

24. Retroactive qualification of certain union negotiated multiemployer pension plans (sec. 220 of the bill and sec. 401(i) of the code)

(*a*) *Present law.*—Under present law, a pension trust is qualified for income tax exemption only if it meets certain requirements relating to coverage of employees and nondiscrimination of contributions or benefits. Where the pension trust is properly qualified, not only is it exempt from Federal taxation with respect to its income, but contributions paid to it by an employer on behalf of his employees are deductible for Federal income tax purposes. Thus, it is of great importance for a pension trust to meet the requirements of the Internal Revenue Code and thereby become a qualified trust.

(*b*) *General reasons for provision.*—On several occasions in recent years bills have been presented to Congress and enacted into law providing for the retroactive qualification of specific pension trusts which could not initially qualify for exemption but after a period of time were able to do so. An example of this is the pension plan of local union No. 435, International Hod Carriers Building and Common Laborers' Union of America which was retroactively made a qualified trust by Congress in section 25 of the Revenue Act of 1962.

These plans are multiemployer pension plans established under collective bargaining agreements between a union and several employers. The regulations under present law (Regulations sec. 1.401–1(a)(2)) require that a "definite written program and arrangement" be communicated to the employees. This requirement cannot be met without delay in many cases of these multiemployer pension funds. However, the employers are required by the collective bargaining agreement entered into to begin making contributions under a general formula when the agreement is signed. However, to determine a schedule of benefits under one of these plans, frequently a complex actuarial study must be made, including a census of the employees of all of the participating employers. This requires a substantial period of time and during this period there can be no "definite written program." Therefore, there cannot be a qualified plan during this period and the contributions required under the union agreement, where they are not vested, cannot be deducted by the employers.

Because of the severe consequences of the failure to qualify for deductions during this period, Congress has from time to time provided retroactive qualification of plans where they subsequently become qualified and where the pension trust in the meanwhile was not operated in a manner which jeopardized the interests of its beneficiaries. To make it unnecessary to consider each one of these plans separately for retroactive qualification, the Treasury Department has recommended to Congress that it be given general authority to qualify these plans retroactively to the date of their creation where certain tests are met: The plans subsequently must become qualified and in the interval the trust must have been operated in a manner which substantially meets the tests under which the plan subsequently qualifies and the interests of the beneficiaries during this period must not in any way have been jeopardized. Your committee is in accord with the Treasury Department's recommendation and, therefore, has added a new section to this bill to provide retroactive qualification for these plans in such cases.

(c) *General explanation of provision.*—Your committee's amendments provide that a trust which is a part of a pension plan which the Secretary has found to be a "qualified trust" and one which is itself exempt from taxation is to be considered as a trust which was a "qualified trust" and as one which was exempt from taxation from the period beginning with the date when contributions were first made to the trust rather than beginning with the date that the trust otherwise first constituted a "qualified trust".

For this retroactive qualification to be made available to a pension trust, it must be established to the satisfaction of the Secretary of the Treasury or his delegate that three conditions have been met. First, he must be satisfied that the trust was created under a collective bargaining agreement with two or more employers who are not related. This provision is made available only in the case of multiemployer plans because it is believed that only these plans involve the substantial delay after the bargaining agreement before it is possible to determine the schedule of benefits for the employees. Moreover, present law already provides that single employer plans may be retroactively qualified to the beginning of a year if the qualifications are fully met by the 15th day of the third month following the close of a year.

Second, it must be shown to the satisfaction of the Secretary or his delegate that the disbursements made from the trust prior to actual qualification substantially meet the tests under which the pension plan subsequently qualifies. Minor variations, not basically discriminatory in character, for this purpose may be ignored.

Third, the Secretary or his delegate must be satisfied that prior to the time the trust constituted a qualified plan the contributions made to this trust were not used in a manner which would jeopardize the interests of the beneficiaries.

These are essentially the same conditions which previously, when plans were considered on an individual basis, Congress has required to be met before retroactive approval was accorded these plans.

(c)(i) *Effective date.*—This provision is to apply retroactively back to what was the general effective date of the Internal Revenue Code of 1954; namely, taxable years beginning after December 31, 1953, and ending after August 16, 1954, but only with respect to contributions made after December 31, 1954.

(d) *Revenue effect.*—It is believed that this provision will result in a negligible loss of revenue.

25. Qualified pension, etc., plan coverage for employees of foreign subsidiaries and domestic subsidiaries operating abroad (sec. 221 of the bill and secs. 406 and 407 of the code)

(a) *Present law.*—Under present law, a domestic corporation may extend old-age and survivors insurance coverage to U.S. citizens employed by its foreign subsidiaries. This social security coverage can be provided by agreements between the parent company and the Secretary of the Treasury or his delegate. This coverage is available only to U.S. citizens employed by foreign subsidiaries in which the domestic corporation has at least a 20-percent voting stock interest or a foreign subsidiary of such a foreign subsidiary if the first subsidiary has at least a 50-percent voting stock interest in the second. Of course, U.S. citizens in a domestic corporation, even though that domestic corporation is operating abroad, also are covered under present law for social security purposes.

There is no method comparable to the social security agreement referred to above for covering under a domestic corporation's qualified pension profit-sharing stock bonus, annuity, or bond purchase plan the U.S. citizens who are employees of its foreign subsidiaries. If a U.S. citizen becomes an employee of the foreign subsidiary, he is no longer eligible to participate in the pension or profit-sharing plan of the domestic parent corporation. Moreover, the foreign subsidiary corporation cannot establish a similar pension, etc., plan and obtain qualifications from the Internal Revenue Service unless it includes in this plan the foreign nationals on its payroll on a nondiscriminatory basis. Where the plan is not qualified, the U.S. citizens of such a foreign subsidiary under present law would be currently taxable on any contributions made by the foreign subsidiary to a pension or profit-sharing plan to which they had nonforfeitable rights.

Similarly, it has been held by some Internal Revenue offices that a domestic corporation operating abroad through branches cannot obtain qualified status plans which provide coverage for U.S. citizens who are employees of the domestic corporation, unless it also provides nondiscriminatory coverage for the foreign employees on its payroll.

(*b*) *General reasons for provision.*—Your committee believes that it should be possible to cover under qualified plans U.S. citizens who are employees of foreign subsidiaries in substantially the same manner as it is possible to cover them by agreement under present law for social security purposes. It is believed that it should be possible to cover the U.S. citizens under a qualified plan for U.S. tax purposes without also covering the foreign nationals of the foreign subsidiary under such a plan. The foreign nationals usually are interested in different patterns of retirement benefits depending upon their own local custom; on the other hand, the U.S. citizen employed by the foreign subsidiary has close economic and personal ties with the United States, expects to return home, and may well wish to continue coverage under a qualified plan of the domestic parent corporation under which he was covered before becoming an employee of the foreign subsidiary.

The problem is substantially similar in the case of U.S. citizens employed abroad by foreign branches of domestic subsidiaries. They are covered for social security purposes and should in your committee's view have an opportunity to be covered under qualified plans in the same way as is proposed in the case of employees of foreign subsidiaries of domestic corporations.

(*c*) *General explanation.*—For the reasons given above, your committee has added an amendment to the House bill providing that U.S. citizens who are employees of foreign subsidiaries of a domestic corporation may under certain circumstances be included for coverage under a qualified pension or annuity plan or profit-sharing or stock bonus or bond-purchase plan or stock bonus plan of the domestic corporation. Thus, contributions made to such a plan for the U.S. citizens employed abroad by the domestic corporation will not be taxable to the employee at the time of contribution even though his rights in the contribution are nonforfeitable and the qualified status of the plan will not be disturbed.

To qualify for this treatment, the individual involved must be a citizen of the United States and an employee of a foreign subsidiary of a domestic corporation. The domestic corporation in this case must have entered into an agreement with the Treasury Department to cover for social security purposes the U.S. citizens who are employees of the foreign corporation involved, and the pension, profit-sharing or stock bonus plan of the domestic corporation must provide coverage for employees of all of its foreign subsidiaries with which it has entered into an agreement to provide social security coverage. In addition the individual involved must not be covered under any other employer's funded plan of deferred compensation such as a pension or profit-sharing or stock bonus plan (qualified or not) with respect to the compensation he receives from the foreign subsidiary. A foreign subsidiary for this purpose is defined in the same manner as is provided for in the case of social security coverage of U.S. citizens who are employees of a foreign subsidiary. Thus, the parent corporation must have a 20-percent voting stock interest in the foreign subsidiary. Also covered are subsidiaries of such a foreign subsidiary where the first foreign subsidiary has at least a 50-percent voting stock interest in the second.

Your committee's amendment also provides that employees of a domestic subsidiary of a domestic parent corporation may be covered under the domestic parent corporation's pension or annuity plan, profit-sharing plan, stock bonus or bond-purchase plan where the individual involved is a U.S. citizen and the domestic subsidiary's operation is largely through foreign branches. Here, of course, coverage for social security purposes is automatically provided since the subsidiary corporation involved is a domestic corporation. In other respects, however, the conditions which must be met are substantially the same as those specified above in the case of the foreign subsidiary. Thus, the pension or profit-sharing plan of the domestic parent corporation must provide for coverage for employees of all domestic subsidiaries (meeting the definition specified below) who are citizens of the United States. Also the compensation paid by the domestic subsidiary operating abroad to the employee must not be covered under any other funded pension, profit-sharing or other type of plan of deferred compensation.

The definition of a domestic subsidiary whose operations are largely foreign approximates the requirements under present law specified with respect to Western Hemisphere trade corporations except that there is no geographical limitation to the Western Hemisphere. Thus, 95 percent or more of its gross income for the taxable year and 2 prior years must be derived from sources without the United States and 90 percent or more of its gross income for this same period must be derived from the active conduct of a trade or business. In addition, its voting stock must be held to the extent of 80 percent or more by the domestic parent corporation (as contrasted to the 20-percent requirement in the case of the foreign subsidiary).

Although the U.S. citizen who is an employee of either the foreign subsidiary or the domestic subsidiaries operating abroad is to receive the benefit of tax postponement with respect to contributions made by the domestic parent corporation to the qualified pension or profit-sharing plan, the domestic parent corporation is not to receive a deduction for its contribution to the plan since this is compensation provided with respect to an employee of its subsidiary. Generally, the domestic parent corporation, to the extent of these contributions, will be treated as having made a contribution of capital to its foreign subsidiary or domestic subsidiary operating abroad. Then this amount will be treated as a deduction to the subsidiary (to the extent it is subject to U.S. tax). In any event, this amount will decrease the earnings and profits account of the subsidiary.

Although the deduction in this case is denied the domestic parent corporation for purposes of all other tests as to the status of the pension or profit-sharing fund, including funding for back years as to which no benefits were provided under any funded plan of deferred compensation, the contribution to the plan with respect to these U.S. citizens employed abroad will be treated in the same manner as other contributions to the fund by the domestic parent corporation. The individual involved will also be treated as if he were an employee of the domestic parent corporation for purposes of the annuity provisions of the code (sec. 72 (d), (f)), the section providing up to $5,000 of tax-free benefits upon an employee's death (sec. 101(b)) and for purposes of the treatment of annuities received under qualified plans for purposes of the estate and gift taxes (secs. 2039 and 2517).

In testing to be sure that a plan is not discriminatory, officers, shareholders, supervisory personnel, etc., of the subsidiary will be treated as if they had the same status with respect to the domestic corporation, and the determination as to whether an individual is highly compensated or not will be made on the basis of what the individual's status would be if he were an employee of the domestic parent corporation. Similarly, what is treated as compensation to the employee for purposes of a qualified plan is to be determined on the basis of his compensation received from the foreign or domestic subsidiary corporation. If part of this compensation is received in foreign currency, this compensation will be valued under existing law for purposes of this provision.

(c)(i) *Effective date.*—The general effective date for these provisions is to be taxable years ending after December 31, 1963.

(d) *Revenue effect.*—It is expected that this provision will result in a negligible loss of revenue.

26. Employee stock options and purchase plans (sec. 222 of the bill and secs. 421–425 of the code)

(a) *Present law.*—Under present law, no income tax is imposed in the case of employee restricted stock options, either when the option is granted or at the time it is exercised. Instead, tax generally is imposed at the time the stock involved is sold by the employee. In the case of those stock options where the option price is at least 95 percent of the market price of the stock at the time the option is granted, the entire amount of any gain realized by the employee at the time he sells the stock is treated as capital gain. Where the stock option price is between 85 and 95 percent of the market price at the time the option is granted, the difference between the option price and the market value of stock at the time of the grant of the option is treated as ordinary income. However, this ordinary income is not realized for tax purposes until the employee sells the stock.[1] Any additional gain at the time the stock is sold in such cases is treated as capital gain. In the case of these restricted stock options, employers are not allowed any deduction for the amount of the gain realized by the employee, whether this gain is treated as capital gain or ordinary income.

For a stock option to be classified as a restricted stock option and be eligible for the treatment outlined above, the option price must be at least 85 percent of the market price of the stock at the time the option was granted, the stock and/or the option must be held by the employee for at least 2 years after the date of the granting of the option and the stock held for at least 6 months after it is transferred to him, the option must not be transferable other than at death, the individual may not be a 10-percent shareholder in the corporation (unless the option price is at least 110 percent of the fair market value) and the option must not be for a period of more than 10 years.

(b) *General reasons for provisions.*—The administration recommended the repeal of the stock option provision altogether. This recommendation was made on the grounds that stock options were compensatory in nature and, therefore, should be treated in the same manner as wages and salaries. It was suggested that with the lower tax rates provided by this bill, compensation received in this manner no longer required special treatment.

[1] If the gain is less than the spread between the option price and the fair market value at the time the option is granted, this lesser amount is taxed as ordinary income.

The House, however, decided to continue the stock option provision because it believed that it is good for the economy for management of various businesses to have a stake in their successful operation. The House believed that this provides important incentives to expand and improve the profit positions of the companies involved. It was suggested that this is not only good for the specific business involved, but also for the economy as a whole. Despite the fact that the House continued the stock option provision, however, it was recognized that there are abuse situations in the present provisions which need correcting. The House bill was directed toward such corrections. Your committee is in accord with this position and has, therefore, with relatively minor changes retained the House bill.

Although the use of stock options generally is thought of in terms of providing incentives for key executives in a business, what are presently called restricted stock options also are used by some companies for an entirely different purpose. Some companies have made stock options available to all, or practically all, of their employees Taking advantage of the fact that the option may be granted at 85 percent of the market price they make discount sales of the stock to their employees generally. These are known as employee stock purchase plans. Where stock options are used in this manner, they are designed primarily as a means of raising capital; and, in such cases, the discounts from market price made available to the employees usually correspond approximately with the costs the company would otherwise incur in floating a new stock issue.

In practice, the House and your committee found that quite different features are required for key employee stock options and the discount purchase plans made available to employees generally. For that reason, the two types of options are placed in separate sections setting forth substantially different requirements for each. In the case of the key employee stock options or "qualified stock options" as they are called by the bill for future years—

1. The period over which the stock must be held has been increased to 3 years. This is designed to give assurance that the key employees actually are acquiring a "stake in the business" and are not merely turning the stock over as fast as the options can be exercised.

2. The maximum period of time over which an option may be outstanding has been reduced from 10 years to 5. It is recognized that stock options historically have a much greater value to the individual if the period of time over which they may be exercised is a long period, since over most 10-year periods stock values have risen. Thus, where the option may be exercised over a very long period of time, such as 10 years, its grant appears more closely associated with compensation and less directed toward the individual efforts of the employee involved. Furthermore, the purpose of the provisions is to encourage the acquisition of a proprietary interest in the business as quickly as possible.

3. The options must be issued at 100 percent of the market price rather than 85 percent (with a special rule where the price inadvertently is set below 100 percent). Closely associated with this also is the removal of the variable price stock option provision. These modifications are made to decrease the compensatory nature of the existing stock option provision and to place

greater emphasis on the employee's efforts to improve his company's business and thereby raise the price level of the stock.

4. Provisions have been added to limit the extent to which new options may be exercised where old options previously were issued, but had become less attractive than a new option because of a decline in the market price of the stock in the interval between the issuance of the two. Existing law already limits the resetting of options below the original price of issue where the stock has declined. This modification achieves the result intended, but not obtained, by existing law. Your committee has adjusted this House provision in two respects to eliminate what it believes were unintended, harsh results under the House bill.

5. Stockholder approval is required for stock option plans to give assurance that the benefits granted management in the case of these options is in accordance with the desires of the stockholders.

6. The bill also provides that stock options generally are not to be made available to employees with stockholdings of more than 5 percent (although to a limited extent, they may be made available in the case of small business to those with holdings up to 10 percent). Under present law, stock options may be granted to employees with stockholdings of more than 10 percent only at a price 10 percent above the market price. It was thought unnecessary to provide employees who are substantial stockholders with any incentive to improve the business since they already have a substantial stake in its successful operation.

In the case of the employee stock purchase plans, existing law is continued (in a separate section) without major modification. In this case, for example, employees will continue to be able to purchase stock through options at a price as low as 85 percent of the market price of the stock at the time the option is issued since these plans, as previously indicated, are in the nature of "discount" purchase plans. However, to qualify for treatment under the employee stock purchase plans, a series of new conditions must be met, designed primarily to establish that the purchase plans are made available without discrimination to most employees of the corporation.

(c) *General explanation of provisions.*—The bill divides the tax treatment of employee stock options and purchase plans into five provisions: First are the general rules applicable to both; second, the special rules applicable to qualified stock options (i.e., those for key employees which are granted after December 31, 1963, under your committee's amendments, or June 11, 1963, under the House bill) third, the special rules applicable to employee stock purchase plans (in general, those granted after the date specified above); fourth, restricted stock options (which cover both of the two categories mentioned immediately above but only for options issued before the specified date); and fifth, certain definitions and special rules applicable to stock option and stock purchase plans in both the past and the future. The material presented below deals first with qualified stock options and then with employee stock purchase plans. The provisions dealing with restricted stock options, which are only those options issued in the past, are covered by a continuation of existing law and are not dealt with here.

(c)(*i*) *Qualified stock options: tax treatment.*—Generally, in the case of qualified stock options, no income tax is imposed either at the time the option is granted or at the time the option is exercised and the stock is transferred to the employee. Similarly, no business expense deduction is allowed to the employer corporation (or a parent or subsidiary of that corporation) at any time with respect to this option.

There is, however, an exception to the general rule that no tax is imposed at the time of the exercise of the option. As is indicated below, one of the requirements of a qualified option is that the price under the option is not to be less than the fair market value of the stock at the time the option is granted. An exception to this, however, is provided where there was an attempt made in good faith to price the option at the market value of the stock but the market value was underestimated. This, of course, would ordinarily occur only in the case of unlisted stock. In such cases the option will not be disqualified, but 1½ times the difference between the option price and what actually is the fair market value of the stock at the time the option is granted (or the difference between the option price and fair market value at the time of exercise, if this is smaller) is to be taxed as ordinary income at the time the option is exercised. This is intended to discourage any attempts at undervaluing the stock, without disqualifying the options where the undervaluation was unintentional.

Another limitation on a qualified stock option (set forth below) is that the stock must be held for at least 3 years. The bill provides that in those cases where it is not held for this 3-year period, the option will still be a qualified option, but the spread between the option price and the value of the stock at the time the option is exercised will be treated as ordinary income at the time the stock is sold. However, in such cases the employee will never be taxed on more than his gain. Thus, if the price of the stock has fallen since the time of the exercise of the option, the amount of the ordinary income will be limited to the difference between the option price and the actual price of the stock on the date of sale. Where the price of the stock at the time of sale is less than the option price, there will be no ordinary income and the difference between the option price and the price at which the stock is sold will be treated as a capital loss. On the other hand, if the stock is sold at a price which is higher than the price on the date the option was exercised, then in addition to the amount treated as ordinary income (the difference between the option price and value on the date of exercise) there will be an amount treated as a capital gain.

The determination of the type of capital gain, i.e., whether short term or long term will depend on the length of time the stock has been held. Thus, any gain where the stock has been held beyond the 3-year period specified with respect to qualified stock options will result in long-term gain with a 50-percent inclusion factor and a 25-percent maximum tax. Where the stock is disposed of in less than 3 years and, in addition to the amount treated as ordinary income, there is an amount treated as capital gain, this capital gain will be either short term (if the stock is held 6 months or less) or long term (if it is held more than 6 months).

As under present law, where the employee dies after having purchased the stock but before holding it for the specified period of time, this holding period is waived since there is no business reason for

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requiring the estate or heir to hold the stock. Similarly, a requirement subsequently referred to that the individual must be in the employ of the corporation involved up to 3 months before the date of exercise of the option also is waived in the case of the death of the employee before exercise.

A transfer to a trustee in bankruptcy (or a similar fiduciary) of shares of stock acquired under a qualified stock option is not considered to be a "disposition" of such share so there will be no ordinary income recognized at that time, although a capital gains tax may be due.

(c)(ii) Qualified stock options: conditions for qualification.—For an individual to receive full qualified stock option treatment, he must not sell (or otherwise dispose of) his stock within 3 years of the date of exercise of the stock option. As indicated previously, where all conditions but this one are met, tax is not imposed until the sale of the stock, but much or all of the tax imposed at that time, if this condition is not met, will be on the basis of ordinary income rather than capital gain. This condition is designed to give assurance that the key executive involved actually maintains a "stake in the business" and is not merely selling the stock shortly after he receives it, thus vitiating the principal purpose of stock options, and converting ordinary compensation into capital gain. This requirement, of course, is not a new idea since present law already requires the individual to hold the option, or stock, for at least 2 years and the stock alone for 6 months in order to receive restricted stock option treatment.

A second condition which must be met for the option to receive qualified stock option treatment is that the individual involved, for the entire time from the date of the granting of the option until 3 months before the date of the exercise of the option, must be an employee either of the company granting the option, a parent or subsidiary of that corporation, or a corporation (or parent or subsidiary of a corporation) which has assumed the option of another corporation as the result of a corporate reorganization, liquidation, etc. This provision differs only slightly from existing law, which requires that the individual be in the employment specified at the time of the granting of the option and on the day ending 3 months before the exercise of the option but does not require that he be in the specified employment in the intervening time. Of course, for this purpose, military leave or sick leave would not disqualify an individual.

In addition to the requirements referred to above, the terms of the option itself must also meet certain specified conditions in order to be eligible for qualified stock option treatment. They are as follows:

1. The option must be granted under a plan which specifies the number of shares of stock to be issued and the employees or class of employees to receive the options. This plan must be approved by the stockholders of the corporation within 12 months before or after the plan is adopted. If the plan permits stock options to be granted to a class of employees, the class of employees must be described with sufficient particularity to allow the shareholders to make a meaningful decision concerning the plan. The use of a general term such as "key employees" is not a sufficient description of those eligible to receive options. Ordinarily any change in the aggregate number of shares which may be issued under the plan or the employees or class of employees eligible to receive such options will be treated as the adoption

of a new plan. No other change in the terms of a stock option plan will, however, be considered to be the adoption of a new plan.

2. The option must be granted within 10 years of the time the plan is adopted or approved by the stockholders, whichever is the earlier.

3. The option must by its terms be exercisable only within 5 years of the time it is granted.

4. The option price must equal or exceed the fair market value of the stock at the time the option is granted. An exception to this provides that where the option price was less than the market price, but this was unintentional, then this condition is to be considered as met (although as previously indicated, a maximum of 1½ times any difference in price is taxed as ordinary income at the time of the exercise).

5. Generally the option by its terms is not to be exercisable while there is outstanding any qualified stock option or restricted stock option which was granted to the employee at an earlier time. The purpose of this provision is to prevent an individual from indirectly gaining an advantage by the employer in effect resetting the price at which an earlier option was issued by issuing a second option at the lower price. To prevent this a second option may not be exercised during the period the first option under its initial terms could have been exercised unless the first option itself is exercised. Thus, generally a cancellation of the first option will not enable the second option to be exercised any sooner. However, the bill as passed by the House provides that restricted stock options may be canceled any time before January 1, 1965, without affecting adversely the exercise of a qualified stock option subsequently issued. In addition, in the case of a restricted stock option which under its terms is made available to the employee only in installments over an extended period of time, the House bill provides that the installments which cannot yet be exercised at the time of the granting of a new qualified option are not to prevent the exercise of this second option so long as these installments cannot be exercised. Your committee has accepted this general rule of the House bill preventing the "resetting" of option prices and also has accepted the modifications in the general rule provided by the House bill. However, your committee has added two new modifications to provide for situations which it believes were overlooked by the House. First, where the option price for the new option is at least as high as the price of each of the outstanding, previously issued options to purchase the same stock (whether these prior options were qualified options or restricted options), this "reset" rule is not to apply; i.e., the new stock option in such a case can be exercised before the outstanding options. Second, your committee has provided that where an option under the terms under which it was granted is not immediately exercisable in full, the employer can permit the exercise date for any or all of the remaining installments of the options to be accelerated without this change being considered a "modification" which would require a new option price for the option for it to continue to constitute a qualified (or restricted) option. Both of these modifications made by your committee continue the intent of the House provision, in that neither permits the taxpayer to exercise a new option at a lower price than his old option until the old option has been exercised or lapsed. It was thought, however, that there was no need to deny the right to exercise the second option in those

cases where the taxpayer could gain no price advantage from this. Similarly, it was thought that there was no reason why the installments on the first option should not be accelerated where the inability to exercise these installments was preventing the exercise of the new option.[1]

6. The option by its terms must be nontransferable other than at death and must be exercisable during the employee's lifetime only by him. This provision is the same as under present law.

7. The employee, immediately after the option is granted, must not own stock representing more than 5 percent of the voting power or value of all classes of stock of the employer corporation or its parent or subsidiary. In the case of small businesses, however, the employee may own up to 10 percent of the voting power or value of the stock before being disqualified. For a corporation with equity capital of less than $1 million, this percentage is to be 10 percent and for one with equity capital of $2 million it is to be 5 percent. Between these two levels of equity capital the allowable percentage decreases gradually from the 10-percent level for a company with $1 million of equity capital down to the 5-percent level for a corporation with equity capital of $2 million or more. Equity capital for this purpose is the assets of the corporation, adjusted for any change in their basis, less any indebtedness of the corporation. Where a parent or subsidiary also are involved, adjustments are made to delete intercorporate ownership. For this purpose, the individual is considered to own stock owned directly or indirectly by brothers and sisters, wife, ancestors, and lineal descendants. Stock owned directly or indirectly by a corporation, partnership, estate, or trust for this purpose is considered as being owned proportionately by shareholders, partners, or beneficiaries.

(c)(*iii*) *Employee stock purchase plans; tax treatment.*—As indicated previously, except for the addition of the nondiscrimination requirement (and the requiring of stockholder approval) the tax treatment of employee stock purchase plans continues to be substantially similar to the tax treatment of restricted stock options under present law. Thus, as under present law, no income is to be reported by the employee either at the time the option is granted or at the time it is exercised. Similarly, no deduction is available to the employer corporation with respect to the employee stock purchase plan.

As under present law, under these purchase plans the option may be issued at a price as low as 85 percent of the market value of the stock at the time of the grant. Where this is done, this spread between the option price and the market value at the time the option is granted, upon the subsequent sale of the stock by the employee or upon the employee's death is treated as ordinary income. However, in no event is the amount to be taxed to the individual as ordinary income to exceed the gain realized on the stock at the time of its disposition.

In addition, ordinary income in the case of employee stock purchase plans may arise where the stock is disposed of before the expiration of the applicable holding period. As under present law, the option and/or stock must be held for a period of at least 2 years and the stock itself held for a period of at least 6 months. Where this holding

[1] This latter rule, of course, applies whether or not a second option is issued; but it is believed that it will have a primary impact in cases of this type.

period is not complied with, then any spread between the option price and the price of the stock at the time the option is exercised will be treated as ordinary income when the stock is sold or otherwise disposed of. As under present law, the specified amount is ordinary income without regard to whether this is greater or less than the gain realized on the stock at the time of the sale. Where the gain otherwise realized is less than this amount treated as ordinary income, the specified amount is still treated as ordinary income but a capital loss is recognized equal to the difference between the market value of the stock at the time of exercise and the sales price of the stock. Apart from these two cases where ordinary income may be realized any other gain recognized on the sale of purchase plan stock results in capital gain.

(c)(iv) *Employee stock purchase plans; conditions for qualifications.*— As indicated above, to qualify for purchase plan treatment, the stock in these cases must not be disposed of within 2 years of the date of the granting of the option nor within 6 months after the transfer of the stock to the individual. This is a continuation of existing law.

In addition, the individual must at all times during the period beginning with the date of the granting of the option and ending 3 months prior to the date of exercise, be an employee of the corporation granting the option, a parent or subsidiary of the corporation, or a corporation (or parent or subsidiary of a corporation) which assumed this stock option as a result of a corporate reorganization, liquidation, etc. This provision is the same as that previously described in the case of qualified stock options. As indicated in the case of qualified stock options, this differs only slightly from existing law.

To qualify as an employee stock purchase plan, nine requirements must be met by the plan itself. Alternatively, all but the first two of these may, however, be met in the stock offering rather than the plan. These conditions are as follows:

1. As under present law, the plan must provide that the options are to be granted only to employees of the granted corporation or a parent or subsidiary.

2. The plan must be approved by the stockholders of the corporation granting the option within 12 months before or after the date the plan is adopted. This provision is a new requirement which is the same as that provided in the case of qualified stock options.

3. No employee can be granted an option if he owns 5 percent or more of the voting power or value of all classes of stock of the employer corporation or its parent or subsidiary. Present law provides that employees having more than a 10-percent interest in a corporation may not obtain a restricted stock option at less than 110 percent of the market price of the stock.

4. A new provision designed to prevent discrimination provides that the options must be granted to all employees of the corporation except that there may be excluded one or more of the following four categories:

(*a*) Employees who have been employed less than 2 years;

(*b*) Employees who are part time and employed 20 hours or less per week;

(*c*) Employees whose customary employment is not for more than 5 months a year; and

(*d*) Officers, supervisory personnel, or highly compensated employees.

5. Another new provision designed to give assurance that these stock purchase plans are nondiscriminatory requires that all employees granted options have the same rights and privileges except that the amount of stock which may be purchased by any employee may be a uniform percentage of total compensation or regular or basic compensation and the plan may provide a maximum number or value of shares to be purchased.

6. Under the plan, the option price may not be less than 85 percent of the market value of the stock at the time the option is granted or not less than 85 percent of the market value of the stock at the time the option is exercised, whichever is the lesser. This restriction is similar to the limitations of present law although slightly more restrictive in some cases.

7. The period over which the option may be exercised cannot exceed 5 years where the option price is not less than 85 percent of the value of the stock at the time of the exercise or 27 months from the date of the grant of the option if the option price is at least in part determined on the basis of the price of the stock at the time the option is granted. Present law provides a 10-year period over which restricted stock options may be exercised but in practice it is understood that options issued under purchase plans generally have a much shorter period over which they may be exercised.

8. A new ceiling is provided to the effect that an employee may not purchase stock at an annual rate in excess of $25,000 a year. This restriction is provided since these plans are designed primarily for broad employee participation.

9. As under present law and in the case of the qualified stock options, the option must not be transferable by the individual other than at death and must be exercisable during the employee's life only by him.

(c)(v) *Reporting requirements.*—The bill provides that corporate employers are to report on the transfer of stock to an employee in the case of the newly established category of qualified stock options or present law restricted stock options. They also are to report on the sale of stock by the employee where stock is acquired under a stock purchase plan at a price less than the full value of the stock and where, under a restricted stock option, stock is purchased at a price between 85 and 95 percent of the value of the stock. In these latter two cases, the report of the sale of the stock by the employee is required since generally in these cases ordinary income tax will be payable by him. A copy of the form of the report going to the Government also is to be sent to the employee or former employee on or before January 31 after the year involved. In those cases where the employer is required to report on the sale of stock by the employee, he will not be expected to follow the ownership of the stock beyond the first transfer; e.g., if an employee transfers stock to a street name and then subsequently sells the stock, the employer will report the first transfer of the stock to the street name but will not be required to report the subsequent sale. Moreover, the reporting in these cases is merely to indicate the name, address, and account number of the individual employee involved and the stock sold by him.

(c)(vi) *Effective date.*—In the case of qualified options, the House bill generally provided that the new provisions were to apply to options granted to an individual after June 11, 1963. Your committee has amended this to provide that the new provisions with respect to qualified options are to apply to options granted after December 31, 1963. A binding, written contract entered into before January 1, 1964, will not be considered as giving rise to options which must meet the "qualified option" test. Your committee has provided this new effective date to conform the effective date in this case with the general effective date provided under the bill for structural changes. In addition, it thought that it would be unfair to require taxpayers to conform to a new set of rules during an extended interval of time when the status of the proposals was still uncertain.

Of course, in a transaction which qualified as a tax-free reorganization, where a corporation entered into a binding obligation to assume outstanding restricted stock options previously granted by a corporation, any option which the acquiring corporation issues in assuming the outstanding options already granted by the acquired corporation, to the extent provided by present law, are considered as continuations of the old options and therefore will be considered as granted prior to January 1, 1964, and treated as restricted stock options rather than qualified stock options.

In the case of qualified options, your committee has also added a transition rule. This rule provides that an option which is issued after December 31, 1963, and before January 1, 1965, which does not meet the terms of a "qualified option", can be modified to meet these terms any time before January 1, 1965, without this modification being considered as giving rise to a new option requiring a new option price. This rule is intended to give taxpayers who have their plans already established, or who initially are not aware of the new provision, time to modify their stock options so that the new conditions are met without the options being disqualified as a result.

In the case of employee stock purchase plans, the new provisions under the House bill would apply to options granted after June 11, 1963. Your committee's bill has changed the effective date of the employee stock purchase provision so that it applies to options granted after December 31, 1963, in the same manner as in the case of the qualified options. These same reasons account for this change. Thus, the new employee stock purchase plan provision will apply generally to options granted after December 31, 1963. Existing law, however, will apply to options granted pursuant to a written plan adopted and approved before January 1, 1963, which at that time met the nondiscrimination requirements specified for employee stock purchase plans. A plan which was being administered in a way which did not discriminate in favor of officers, supervisory personnel, or highly compensated employees would continue to qualify as adopted and approved before January 1, 1964. Except for the date, this modification is the same as provided by the House bill. Thus, a plan (not otherwise being discriminatory) would be considered nondiscriminatory even though only full-time employees were covered (rather than those working 20 hours a week or more) or those with less than 6 months a year employment were omitted (rather than those with less than 5 months employment).

(*d*) *Revenue effect.*—The changes made by this provision are not expected to have any appreciable revenue effect. To the extent that the changes made above result in a reduction in stock options issued, this will increase deductions taken by corporations as they make deductible payments to employees in other forms.

27. Installment sales by dealers in personal property (sec. 223 of the bill and sec. 453(a) of the code)

(*a*) *Present law.*—A taxpayer using installment sale reporting can defer income for tax purposes until payments are received under the contract (rather than treating the entire amount as income as of the time the sale is made). This provides the seller with funds with which to pay the tax, while at the same time giving him the immediate advantage of deductions attributable to the sale.

Prior to October 15, 1963, sales under revolving credit plans were not recognized by the Treasury Department as installment sales for tax purposes because of certain differences between revolving credit plans and traditional installment sales. For instance, installment sales ordinarily involve a separate contract for each item of property purchased, providing for a series of payments specifically applicable to the purchase price of that piece of property. Usually the seller also retains some type of security interest in the property, until the property is paid for.

Revolving credit plans, on the other hand, do not involve separate sales contracts; under these plans any item in the store may be charged to the same account, and the seller does not retain any security interest in the property sold. The buyer has an option to pay his account in full within 30 days with no interest or finance charges. Alternatively, he may pay the account in installments and in this case a finance or service charge related to the unpaid balance of the account is added to the account each month. The buyer's regular payments are not specifically attributable to the purchase price of any single item but only go to reduce the unpaid balance on what may be the total purchase price of several items purchased at different times.

Despite these differences the U.S. district court in Massachusetts held revolving credit sales did qualify for installment sale treatment because, like installment sales they did retain the essential feature of an arrangement for the payment by the purchaser for the merchandise sold to him in a series of periodic payments of an agreed part or installment of the debt due (*Consolidated Dry Goods* v. *U.S.*, 180 F. Supp. 878; 1960). Shortly after this case was decided, the Internal Revenue Service announced that it would not follow the decision but was studying whether workable standards could be formulated for determining what part of revolving credit sales qualify as "sales on the installment plan" under existing law (Rev. Rul. 60-293, 1960-2 CB 163).

New regulations were issued by the Treasury Department on October 15, 1963 (TD 6682) as the result of this study. They specifically provide for installment sale treatment of some amounts received under revolving credit plans, and include rules for determining the extent to which revolving credit plans qualify as installment sales. Broadly speaking, under these rules, a sample of revolving credit sales is taken from balances in customer accounts as of the billing dates for the last month of the seller's taxable year, and the percentage of sales in the sample accounts determined which (1) are of the type the revolving credit plan contemplates will be paid for in two or more installments and (2) actually are paid for in two or more installments. This percentage is then applied to total revolving sales accounts (after adjusting for sales of nonpersonal property) and the resulting amount is considered to be sales under the installment plan. This new regulation provides installment sale treatment for about 80 percent of revolving credit sales.

(*b*) *General reasons for provision.*—Your committee believes that although the new revolving credit regulations are commendable, they are difficult to apply. By providing in the statute that revolving credit sales are to qualify for income spreading, your committee's bill fully conforms the tax treatment of income under revolving credit plans and installment sales contracts. It also replaces the complex sampling procedure required by the regulations with a simple rule which will forestall compliance and administrative problems likely to arise under the regulations. It, of course, is not intended in making this change to exclude from installment sales treatment any sales or existing charges which are covered by existing law or regulations.

(*c*) *General explanation of provisions.*—This amendment adds definitions of two terms of the provision of present law which allows dealers in personal property to spread income from installment sales over the payout period under the installment contract. These terms are "installment plan" and "total contract price."

(*c*)(*i*) *Installment plan.*—The definition of "installment plan" would extend installment sale treatment to income received under any plan which provides for the payment by the purchaser for personal property sold to him in a series of periodic installments of an agreed part or installment of the debt due the seller. This definition would extend installment sale treatment to revolving credit sales of personal property which do not qualify under the new Treasury regulations. These include, principally, sales which are paid for in full on the first billing for the month of purchase, and sales for a month which in total amount to less than the monthly payment agreed to be paid by the purchaser under the revolving credit contract.

(*c*)(*ii*) *Total contract price.*—The proposed definition of "total contract price" would include finance and service charges with respect to revolving credit sales in the amount subject to installment sale treatment, thereby conforming to the treatment which is permitted in the case of the "time price differential" under traditional installment sale arrangements. Time price differentials are treated as part of the contract price and are not required to be included in income for tax purposes until the installments are received under the contract. Finance charges under revolving credit plans on the other hand, under the new regulation, may not be deferred until payments are received but must be accrued currently in the month to which they relate. The amendment does not change present law with respect to the treatment of amounts charged for service contracts or warranties.

(*c*)(*iii*) *Effective date.*—The amendments made by this provision are to apply with respect to taxable years beginning after December 31, 1963.

(*d*) *Revenue effect.*—These amendments are expected to result in a revenue loss of $140 million in the first full year of operation. However, this is a nonrecurring loss which is not repeated in subsequent years. The loss thereafter is expected to be about $10 million a year.

28. Timing of deductions and credits in certain cases where asserted liabilities are contested (sec. 224 of the bill and sec. 461 of the code)

(*a*) *Present law.*—Prior to the decision in the *Consolidated Edison* case [1] the Internal Revenue Service generally held that the payment of a contested tax liability resulted in the tax being considered as deductible even though the tax was still being vigorously denied and contested.[2] In the *Consolidated Edison* case decided in 1961 the Supreme Court held that a contested tax even when paid does not accrue as a deduction for income tax purposes until the contest is terminated. It was held that the tax was not deductible until after the contest was settled because all of the events which would determine whether or not the amount would ultimately have to be paid would not be determined until that time.

(*b*) *General reasons for provision.*—Although your committee does not question the legal doctrine laid down by the Supreme Court in the *Consolidated Edison* case, it believes that it is unfortunate to deny taxpayers a deduction with respect to an item where the payment has actually been made, even though the liability is still being contested either as to amount or as to the item itself. The objective of the reporting of items of income and deduction under the internal revenue laws generally is to realistically and practically match receipts and disbursements attributable to specific taxable years. The internal revenue laws contain a number of adjustments designed to accomplish this result. Your committee believes that allowing the deduction of items in the year paid, even though they are still being contested in the courts or otherwise, more realistically matches these deductions up with the income to which they relate than would the postponement of the deduction, perhaps for several years, until the contest is settled. To the extent that deductions are allowed under this rule and then subsequently as a result of the contest the items were found not to be payable, adjustment can be made for this overstatement of the deduction by the inclusion of the overstatement in income in the year in which the amount of the liability is finally determined.

(*c*) *General explanation of provision.*—In view of the above considerations, your committee has amended the provision of existing law which specifies the year for the taking of deductions or credits generally. The amendment provides that if a taxpayer contests an asserted liability, such as a tax assessment, but makes a payment in satisfaction of this liability and the contest with respect to the liability exists after the payment, then the item involved is to be allowed as a deduction or credit in the year of the payment. This is based upon the assumption that the deduction or credit in this case would have been allowed in the year of payment, or perhaps in an earlier year when it would have been accrued, had there been no contest.

The treatment provided here can be illustrated by an example. Assume that in 1965 a $100 liability is asserted against a business which it pays at that time but contests the liability in a court action. Assume further that in 1967 the court action is settled for $80. Under present law, before the enactment of this provision, the deduction of $80 would be allowed in 1967. Under your committee's action, the taxpayer could claim a $100 deduction in 1965 but then in 1967 would

[1] *The United States* v. *Consolidated Edison Co. of New York Inc.*, 366 U.S. 380 (1961).

[2] This is the general rule laid down in *Chestnut Securities Co.* v. *United States* (62 F. Supp. 574 (1945)) which the Internal Revenue Service accepted in GCM 25298 (1947-2 CB 39).

have to take $20 into income except as provided in section 111 of the code, relating to recovery of bad debts, prior taxes, and delinquency amounts.

In those cases where payment is not made until after the contest is settled, this does not prevent an accrual basis taxpayer from accruing the deduction or credit in an earlier year in which the contest is settled.

A similar amendment to that described above is also made to the Internal Revenue Code of 1939.

(c)(i) *Effective date.*—Generally, your committee's amendment to the 1954 code is to apply to payments made in taxable years beginning after December 31, 1953, and ending after August 16, 1954, the general effective date of the 1954 code. The amendment to the 1939 code applies to payments in taxable years to which that code applies.

The bill provides two exceptions to the general effective date rule specified above. First, if the taxpayer elects, he may continue to apply the old law with respect to taxable years beginning before January 1, 1964; i.e., he may claim the deduction or credit in the year in which the contest is settled rather than in the year in which the payment is made. If the taxpayer makes this election, he must do so within 1 year after the date of enactment of this bill and may not change this election after the expiration of this 1-year period. Moreover, to make this election the taxpayer must follow the rule of old law with respect to all payments made in a year beginning before January 1, 1964. This election may not be made with respect to a payment if the assessment of any deficiency arising as a result of this election would be barred with respect to any year. If this election is made with respect to a year which is not barred, the period for assessment of any deficiency arising from this election is to be kept open at least until 2 years after the date of enactment of this bill.

The second general exception to the general effective date is designed to keep a taxpayer from losing a deduction as a result of the enactment of this new provision. Thus, where for a past year no deduction or credit was allowed for a payment in a year before the contest with respect to it was settled and the refund or credit which would result from the deduction in the earlier year is barred, then the deduction is to be allowed in the year in which the contest is settled.

(d) *Revenue effect.*—This provision is expected to result in a negligible decrease in revenues.

29. Interest on certain deferred payments (sec. 225 of the bill and sec. 483 of the code)

(a) *Present law.*—Under present law, an individual may sell a capital asset on the installment basis without making any specific provisions for interest payments on installments. In such cases the full difference between the cost or other basis for the property and the sales price usually is treated as capital gain to the seller. The buyer takes as a basis for the property the total sales price paid. For example, an individual taxpayer might sell a capital asset worth $1,000 for $1,300 payable over 10 years. In this case, if no mention is made that part of this payment is to be treated as interest, and the seller elects to report any gain on the installment basis, then each payment might be treated partly as a return of capital and partly as a capital gain. Over the 10-year period, the taxpayer would report $300 of capital gain (assuming he had the full fair market value of $1,000 as his basis for the property). However, had $300 of this $1,300 payment been specified as an interest payment, this amount would have been ordinary income to the seller rather than capital gain. From the buyer's standpoint, the $300, if treated as part of the price of the property would be added to the basis of the property and, in the case of depreciable property be recoverable over the life of the property. He might also, if the property qualified, be eligible for an investment credit with respect to this $300. On the other hand, if this $300 were treated as interest, he could receive an interest deduction for this amount.

(*b*) *General reasons for provision.*—Your committee agrees with the House that there is no reason for not reporting amounts as interest income merely because the seller and purchaser did not specifically provide for interest payments. This treats taxpayers differently in what are essentially the same circumstances merely on the grounds of the names assigned to the payments. In the case of depreciable property this may convert what is in reality ordinary interest income into capital gain to the seller. At the same time the purchaser can still recoup the amount as a deduction against ordinary income through depreciation deductions. Even where the property involved is a nondepreciable capital asset, the difference in tax bracket of the seller and buyer may make a distortion of the treatment of the payments advantageous from a tax standpoint. The House and your committee believe that manipulation of the tax laws in such a manner is undesirable and that corrective action is needed.

(*c*) *General explanation of provision.*—The bill solves the problem referred to above by providing that where property is sold on an installment basis and part or all of the payments are due more than 1 year after the date of the sale or exchange—if no interest payments are specified or if "too low" interest payments are specified then part of each payment due after 6 months is to be treated as interest rather than as part of the sales price.

The interest rate to be used for purposes of this provision is to be a rate provided by regulations prescribed by the Secretary of the Treasury or his delegate. It is anticipated that any rate specified by the Secretary of the Treasury or his delegate will reflect the going rate of interest and will not be higher than the rate at which a person, in reasonably sound financial circumstances and with adequate security could be expected to borrow money from a bank. A rate of 5 percent, for example, would appear appropriate under existing circumstances.

With this interest rate specified by the Secretary, the proportion of each payment which would be considered an interest payment would be determined in the following manner: First, the present value of each installment payment would be determined, based upon the specified interest rate. Second, the deduction of the total of these present values from the total actual payments provided for under the contract then would give the total "unstated" interest payments under the contract.[1] Third, the total unstated interest then is assumed

[1] Where an interest rate was provided on the installments but at "too low" a rate, the present value of these interest payments would be determined along with the present value of the remainder of the payments as well. The unstated interest then would represent the present values, including the present values of such interest payments, deducted from total payments to be received under the contract excluding the interest payments.

to be spread pro rata over the total payments involved. Thus, if a specific payment represents one-tenth of the total payments, it would be assumed to include one-tenth of the total unstated interest.

For ease of administration and compliance, the regulations are to provide for the discounting of payments on a 6-month basis and are to ignore for this purpose any interest payments due within the first 6 months.

Where an installment contract provides for the payment of some interest, no unstated interest is to be computed unless the interest payments specified are at a rate more than 1 percent below the rate of interest payments which would be computed under this provision in the absence of those payments. Thus, if a 5-percent rate is specified by the Secretary, no unstated interest will be computed where the interest actually provided for under the contract is 4 percent or more. This represents a de minimis rule to prevent the application of this provision in those cases where interest variations are relatively minor.

For purposes of this provision, a payment for property in the form of a note, or other evidence of indebtedness of the purchaser, is not to be treated as a payment. To treat such amounts as payments would permit avoidance of this provision merely by exchanging non-interest-bearing forms of indebtedness for property. However, payments made on such indebtedness for purposes of this provision will be treated as if they were payments made on the contract itself.

Where, at the time of the sale or exchange, some or all of the payments are indefinite as to their size; for example where the payments are in part at least dependent upon future income derived from the property, the "unstated" interest for purposes of this provision will be determined separately with respect to each indefinite payment as it is received, taking into account the time interval between the sale or exchange and the receipt of the payment. Also, where there is a change in the amount due under a contract, the "unstated" interest is to be recomputed at the time of each such change.

The bill specifies five situations in which this provision is not to apply: First, a de minimis rule as to price is provided. Thus, the provision will not apply unless the sale price of the property is in excess of $3,000. Second, in the case of the purchaser of the property, if any of the amounts involved are carrying charges which under present law from the standpoint of the purchaser are treated as interest, then, in the case of the purchaser, this provision is not to apply. Third, in the case of the seller, this provision is to apply only if some part of the gain from the sale or exchange of the property would be considered as gain from a capital asset or as gain from depreciable property. If the property is sold at a loss, this provision will nevertheless apply if, had there been a gain, some part of it would have been considered as gain from a capital asset or from depreciable property. Fourth, this provision is not to apply in the case of payments with respect to patents, which are treated as capital gain under present law. Fifth, the provision is not to apply where the property is exchanged for annuity payments which depend in whole or in part on the life expectancy of one or more individuals. In addition, this provision, of course, will not apply to payments such as those for timber, coal and iron ore (sec. 631) where the property is treated as sold as the timber is cut or the coal or iron ore is withdrawn, with the result that this is not treated as an installment contract.

(*c*)(*i*) *Effective date.*—Under the House bill this provision applies to payments made after December 31, 1963, on account of sales or exchanges of property occurring after June 30, 1963. Your committee has accepted the House effective date, but has provided one exception to it. It has provided that the new rule is not to apply to any sale or exchange made pursuant to a binding, written contract (including an irrevocable written option) entered into before July 1, 1963. This is consistent with the treatment provided elsewhere in the bill with respect to binding contracts.

(*d*) *Revenue effect.*—This provision is expected to result in a negligible increase in revenues.

30. Personal holding companies (sec. 226 of the bill and secs. 541–543 of the code)

(*a*) *Present law.*—Under present law, a domestic personal holding company is taxed on its "undistributed personal holding company income" at a rate of 75 percent on the first $2,000 and 85 percent on the balance. This is in addition to the regular corporate income tax. In general terms, a personal holding company is a closely held corporation, most of whose income is derived from certain specified forms of passive income. The tax applies only where 50 percent or more in value of the outstanding stock of the corporation is owned directly or indirectly by five or fewer individuals. In addition, at least 80 percent of the corporation's gross income must be from what is defined as "personal holding company income."

In general terms, personal holding company income consists of income from what are considered to be passive forms of investment. Thus, it includes dividends, interest, and annuities. It also includes most royalties although mineral, oil, or gas royalties are included only where these royalties do not represent 50 percent or more of the company's gross income or where there are not trade or business deductions (other than compensation for personal services rendered by shareholders) equal to 15 percent or more of the company's gross income. Copyright royalties also are classified as personal holding company income if they represent less than 50 percent of the company's gross income or the business deductions (other than compensation for personal services rendered by shareholders) represent less than 50 percent of gross income or if other personal holding company income constitutes more than 10 percent of gross income. Thus, where these mineral, oil, gas, or copyright royalties represent the principal business of the company, this type of income is not classified as personal holding company income, if there also is evidence, in the form of sufficient business deductions, that the company is actively engaged in business. Rents also are classified as personal holding company income unless they represent 50 percent or more of the company's gross income. Other forms of income which are classified as personal holding company income includes income from stock, security, and commodity transactions (except in the case of dealers, producers, etc.), income from estates and trusts, income from personal service contracts where 25 percent or more of the stock of the corporation is owned directly or indirectly by the individual performing the services, and income from the right to use property of the corporation where 25 percent or more of the stock of the corporation is owned directly or indirectly by the person eligible to use the property. This latter category of income, however, is treated as personal holding company income only where 10 percent or more of its income (without regard to this latter category or rents) is personal holding company income.

(*b*) *General reasons for provisions.*—Congress first imposed this tax on personal holding companies in 1934 in order to prevent the avoidance of the individual upper bracket surtax rates, by leaving what is essentially investment-type income in a corporate organization, subject to the lower corporate income tax. As indicated by the Administration, ways around the present personal holding company provisions have been found in several arrangements which permit the use of holding companies to avoid the individual income tax with respect to what is essentially investment-type income without the company involved being classified as a "personal holding company."

The principal avoidance devices involve the use of rental income, income from mineral operations, and certain capital gains which are not classified as personal holding company income as means of sheltering other investment income in such a manner that 80 percent or more of the company's gross income does not come within the technical definition of personal holding company income. In view of this, a number of modifications are made in the personal holding company provisions designed primarily to minimize the extent to which these special categories of income can be used to shelter clearly passive income. More detailed reasons for each of the various modifications provided by the bill are set forth in the explanation given below with respect to each of the modifications.

(*c*) *General explanation of provisions.*—The bill makes a series of modifications in the application of the personal holding company tax in the case of domestic corporations. However, except in the case of the dividends paid deduction in a liquidation, no change is made in the case of foreign personal holding companies. Most of the modifications described below are designed to eliminate various means by which holding companies have been avoiding classification as personal holding companies, although other problems are also dealt with.

(*c*)(*i*) *Tax rate of 70 percent.*—In view of the fact that this bill decreases the maximum tax rate applicable to individuals from 91 to 70 percent, your committee agrees with the House that the rates applicable to personal holding companies also should be lowered from the present rates of 75 percent on the first $2,000, and 85 percent on the excess, to what will be the new top individual income tax rate. Moreover, there appears to be no particular purpose for continuing the graduation in the personal holding company tax rate from 75 percent on the first $2,000 to 85 percent on the balance. In view of this, the bill provides that the personal holding company tax is to be 70 percent of the undistributed personal holding company income.

(*c*)(*ii*) *Decrease in 80-percent test.*—As previously indicated, one of the tests under present law provides that a company, to be a personal holding company, must derive 80 percent or more of its gross income from certain specified types of passive income, called personal holding company income. The bill decreases this 80-percent test to 60 percent. The decrease in this percentage is made because too many holding companies which are essentially holding companies of passive income have avoided the classification as such by holding their "personal holding company income" just slightly below the 80-percent limit. The more realistic 60-percent limit together with other modifications described below will make the avoidance of this classification much more difficult for holding companies generally.

(c)(iii) *Adjusted ordinary gross income requirement.*—Under present law the 80-percent requirement referred to above is applied to the gross income of the corporation; i.e., if the gross income derived from certain specified passive sources equals 80 percent of the total gross income of the corporation, the corporation is classed as a personal holding company. This has made it possible for corporations to avoid personal holding company classification by seeking out types of income not characterized as passive, or of a personal holding company type, which give rise to a proportionately large amount of gross income even though leaving little, if any, income after the deductions attributable to this income. In this manner, various types of income have been used to shelter investment income and remove the company from the classification of a personal holding company. Rents, where they constitute more than 50 percent of the gross income of the corporation, are an example of a type of income used to shelter passive income, such as dividends. Mineral, oil, and gas income are the other principal examples of income which have been so used.

To overcome this problem, the bill adjusts downward the income from certain sources to the extent of certain specified deductions attributable to these types of income. Thus, the corporation will be a personal holding company if 60 percent of "adjusted" gross income consists of certain passive income. The adjustments are as follows:

1. In the case of gross income from rents, the deductions for depreciation and amortization, property taxes, interest, and rents paid to the extent attributable to the rental income received, are to be deducted from gross income.

2. In the case of mineral oil, and gas royalties and also in the case of working interests in oil or gas wells, the deductions attributable to these royalties or working interests for depreciation, amortization and depletion, property and severance taxes, interests and rents paid are to be deducted in computing this adjusted gross income. It should be clearly understood that although income from working interests in an oil and gas well for purposes of the 60-percent limitation are reduced by the deductions referred to above such income is itself never classified as personal holding company income.

3. Interest from U.S. Government bonds held for sale by a dealer who is making a primary market for these obligations and interest on condemnation awards, judgments and tax refunds also are to be excluded in arriving at adjusted gross income for this purpose. This adjustment serves a different purpose from the first two deductions in that it merely excludes from the base on which personal holding company income is computed this particular type of interest income which in reality is not passive in nature.

In applying the 60-percent test, not only is the total gross income adjusted downward by the amount of the deductions (or interest) referred to in the cases specified above, but also in determining the rental income and mineral, oil and gas income for purposes of this test, this income also is reduced by the specified reductions.

(c)(iv) *Capital gains.*—Under present law capital gains (other than capital gains attributable to stock, securities, or commodities) are not treated as personal holding company income. All capital gains, however, are included in the gross income of the company for purposes of the 80-percent test. As in the case of the deductions referred to above, some companies have timed the realization of their capital gains income in such a manner as to keep their personal holding company income below the 80 percent. The bill avoids this problem by excluding all capital gains from the gross income in determining whether the 60-percent test is met. Thus, the test under the bill is based on adjusted ordinary gross income.

(c)(v) *Rental income.*—Under present law rental income is classified as personal holding company income only if it represents less than 50 percent of total gross income. This is based on the concept that where rental income represents the major activity, the activity involved is more likely to be of an active rather than passive character. The House bill retains this 50-percent test (applying it, however, to adjusted income from rents and to adjusted ordinary gross income) but adds a second test providing that rental income may be characterized as passive, or personal holding company income even where it represents 50 percent or more of the adjusted ordinary gross income if, apart from the rental income, more than 10 percent of the ordinary gross income (gross income excluding capital gains) of the company is personal holding company income. For this purpose, income derived from the use of corporate property by shareholders is not viewed as personal holding company income, but income from copyright royalties and the adjusted income from mineral, oil, and gas royalties is included for this purpose as personal holding company income.

Your committee has accepted the House changes in the 50-percent test with one modification. Your committee has made an amendment to this test with regard to rentals of tangible personal property retained by the lessee for three years or less. Under the amendment, in the case of such property, the income is not to be reduced by depreciation attributable to it for purposes of the 50-percent test and also for purposes of computing ordinary gross income. However, in the case of the provision in the House bill that the personal holding company income (apart from rent) may not exceed 10 percent of the ordinary gross income, your committee's amendments provide that the personal holding company income for this purpose may be reduced by dividends paid during the year, by dividends paid in the next year which are treated as if paid in the year in question, and by consent dividends. Your committee believes that this prevents the 10-percent rule from working harshly where the personal holding company income other than rents may exceed 10 percent of ordinary gross income, perhaps by only a small amount but under the House bill, nevertheless, result in the entire amount of rental income being classified as personal holding company income. Your committee's amendment in effect permits taxpayers to meet the 10-percent test after dividend payments (or amounts treated as paid in dividends). At the same time it gives assurance that the personal holding company income (apart from rent) sheltered in the company may not exceed 10 percent of its ordinary gross income.

The fact that rental income, both in applying the 60-percent test and also in applying the 50-percent provision to the rental income itself, is determined on the basis of reducing rental income by depreciation, amortization, property taxes, interest, and rents paid has already been noted above. However, as previously indicated, tangible personal property rented for three years or less is not reduced by depreciation attributable to it for purposes of these tests, under your committee's amendments.

(c)(vi) *Mineral, oil, and gas royalties.*—Under present law mineral, oil, and gas royalties are considered to be personal holding company income unless they represent 50 percent or more of the gross income of the company and unless the trade or business expense deductions (other than compensation for personal services rendered by shareholders) represent 15 percent or more of the gross income of the company. Thus, under present law, as in the case of rental income, mineral, oil, or gas royalties are treated as personal holding company income unless they represent the bulk of the company's income. However, in this case there also must be business expenses—indicating the active character of the business—constituting 15 percent or more of the gross income.

The bill retains these two tests but applies them on the basis of the adjusted ordinary gross income, thereby reducing, for this purpose, the income considered to be in these categories by depreciation, depletion, property and severance taxes, interest, and rent paid.

In addition, the bill adds another test which must be met in such cases for the mineral, oil, or gas royalty income to escape characterization as personal holding company income. The personal holding company income of the company, apart from this category of income (but including as such income that from copyright royalties and from rents), must not represent more than 10 percent of the ordinary gross income of the company. Thus, the personal holding company type income which mineral, oil, or gas royalty income may shelter even where this income represents the bulk of the income of the company must be relatively small; namely, less than 10 percent of ordinary gross income. Your committee has also added an amendment making it clear that income from mineral, oil, and gas royalties includes production payments and overriding royalties.

(c)(vii) *Copyright royalties.*—Under present law, copyright royalties also are considered to be personal holding company income unless they represent 50 percent or more of the total gross income. An additional test which must be met in order to escape such classification is that the personal holding company income, apart from the copyright royalty income, must not exceed 10 percent of the company's gross income and the trade or business expense deductions (other than those for compensation for personal services rendered by shareholders or for royalties paid to shareholders) must represent 50 percent or more of the company's gross income. This provision is modified by the bill in that the requirement that deductions equal at least 50 percent of gross income is changed to provide that they must equal 25 percent of ordinary gross income reduced by royalties paid and by depreciation deductions with respect to the copyrights.

(c)(viii) *Produced film rents.*—Under present law payments received from the distribution and exhibition of motion picture films are treated as rentals. As a result, under present law, a corporation may be formed by an individual who owns a motion picture negative and have its earnings treated as rents for purposes of the personal holding company tax. Since in such a case more than 50 percent of its gross income would be considered to be from rents, there would be no personal holding company tax payable in this case.

To meet this problem, the bill provides that payments received from the use of, or the right to use, films generally will be characterized as copyright royalty income. Thus, such income will be classified as personal holding company income unless 50 percent or more of the company's ordinary income is from this source, not more than 10 percent of the company's ordinary gross income is personal holding company income, and the deductions properly allocable to this film income represent 25 percent or more of the gross income from this source reduced by royalties paid and depreciation taken.

The bill, however, retains what is essentially the treatment of present law for "produced film rents." Produced film rents are rents arising from an interest in a film acquired before the production of the film was substantially complete. It was thought that less severe tests should be applied in such cases because the participation in the production of the film in itself indicates an active business enterprise in this case. For produced film rent to escape characterization as personal holding company income, as under present law, these rents need constitute only 50 percent or more of the ordinary gross income of the company.

(*c*)(*ix*) *Other types of income characterized as personal holding company income.*—Compensation for the use of property by a shareholder, amounts received under a personal service contract, and income from estates and trusts continue to be classified as personal holding company income essentially to the same extent as under present law, except for the fact that capital gain income is not classified as part of gross income in applying the 10-percent test in the case of the use of corporate property by shareholders.

(*c*)(*x*) *Personal finance companies.*—Present law provides that certain types of companies are not to be classified as personal holding companies. These include, for example, banks, life insurance companies, and surety companies. Also excluded from such classification are certain types of personal finance companies. Under present law, there are four different types of personal finance companies which are excluded from the personal holding company category. These categories in general terms are as follows:

1. Licensed personal finance companies, 80 percent of whose gross income is interest from loans if at least 60 percent of their gross income is received from loans classified as "small loans" by State law (or $500 if there is no State law limit) and if the interest is not payable in advance and computed only on unpaid balances. In addition, loans to a person who is a 10-percent shareholder must not exceed $5,000 in principal amount. These frequently are known as "Russell Sage" type personal finance companies.

2. Other lending companies engaged in the small loan or consumer finance business, 80 percent of whose gross income consists of interest or similar charges on loans to individuals and income from 80-percent-owned subsidiaries which in turn themselves meet this test. In addition, at least 60 percent of the company's income must be from interest or similar charges made in accordance with small loan or consumer finance laws to individuals where the loans do not exceed the State specification for small

loans (or if there is no such limit, $1,500) and if the trade or business expenses of the company represent 15 percent or more of the company's gross income. These companies also must not have loans outstanding to shareholders, with a 10-percent interest or more, which exceed $5,000.

3. A loan or investment company (such as a Morris Plan bank), a substantial part of whose business consists of receiving funds not subject to check and evidenced by certificates of indebtedness or investment, and making loans and discounts. Here also loans to a person who is a 10-percent shareholder may not exceed $5,000 in principal amount.

4. A finance company actively engaged in purchasing or discounting accounts or notes receivable, or installment obligations, or in making loans secured by any of these or by tangible personal property, if at least 80 percent of its gross income is derived from such business. In addition, at least 60 percent of such a company's gross income must be derived from certain categories of income. These categories, in general, relate to business or factoring-type loans: such as purchasing or discounting accounts or notes receivable, or installment obligations arising out of the sale of goods or services by the borrower in his business; making loans for not more than 36 months to businesses where the amounts are secured by accounts or notes receivable or installment obligations of the type described above, or secured by warehouse receipts, bills of lading, inventories, chattel mortgages on property used in the borrower's trade or business, etc. In the case of these companies, the trade or business expense deductions must represent at least 15 percent of the gross income of the company, and loans to those who are 10-percent shareholders in such company must not exceed $5,000 in principal amount.

In the interest of simplification, the House substituted one exclusion for the four now provided these categories of lending or finance companies. At the same time, it saw no need for purposes of the personal holding company provision to restrict the type of loans which these companies could make. It was suggested that this was properly a matter of regulation by State law governing these lending or finance businesses and that in any event the personal holding provisions do not apply to widely held corporations. In these latter cases only State law governs the type of loans which can be made.

In view of these considerations the House bill substituted for all four of the categories described above, one definition of a lending or finance company which is to be excluded from personal holding company tax treatment. This definition provided is designed first to assure that 60 percent of the company's income is from the active, regular conduct of a lending or finance business, and second that its personal holding company income [1] plus interest from U.S. obligations as a dealer in these obligations is not more than 20 percent of the company's ordinary income. These two limitations, and the restriction described below relating to business expense deductions, are designed to give assurance that the company is actively engaged in the lending or finance business and that not more than 20 percent of its remaining income is personal holding company income.

[1] For this purpose personal holding company income is computed without regard to income from subsidiaries qualifying under this exemption as lending businesses, but including gross income from rents royalties, produced film rents, and compensation for use of corporate property by shareholders.

Your committee has modified the requirement that not more than 20 percent of the company's ordinary income may constitute personal holding company income. The House bill permits a company engaged in the small loan business to satisfy the 20-percent test by excluding income which it receives from subsidiaries in the lending or finance business. Your committee's bill would extend this treatment to finance companies. Finally, a technical amendment makes it clear that income received for furnishing services and facilities to a lending or finance company is not to be treated as personal holding company income to members of the same affiliated group which meet the requirement of the exemption for the lending and finance companies, whether they are exempt from the personal holding company tax under the same or another provision.

In addition to 60- and 20-percent tests, the company must have certain business deductions described below, which are directly attributable to its lending or finance business equal to 15 percent of the ordinary gross income up to $500,000 plus 5 percent of the ordinary gross income between $500,000 and $1 million. This provision gives further assurance, as evidenced by the deductions of the company, that it is actively engaged in the lending or finance business. A fourth limitation applicable under present law in the case of all of the categories of lending companies denies the right to make loans to persons who are 10-percent shareholders to the extent of more than $5,000 a year in principal amounts.

The lending or finance business for purposes of this provision is defined as including the business of making loans and purchasing or discounting accounts receivable, notes, or installment obligations receivable, notes or installment obligations. It does not include, however, the making of loans or purchasing or discounting accounts receivable, notes or installment obligations if the remaining period to maturity on the loan or paper exceeds 60 months. It also does not include the making of loans evidenced by indebtedness issued in a series under a trust indenture and in registered form or with interest coupons attached. Your committee has amended the definition of a lending or finance business to make it clear that this includes the income from rendering services or making facilities available to another member of the same affiliated group which is also in the lending or finance business. This is provided because as a matter of economical operations, one company frequently hires the necessary personnel, acquires the appropriate facilities, and in accordance with the requirements of banks, borrows all of the money for the group. Then all of the corporations in the group pay a service charge for these services to the company performing them.

Business deductions for purposes of the 15-percent or 5-percent test include only those trade or business expense deductions which are deductible only by reason of section 162 or section 404 (other than compensation for personal services rendered by shareholders or members of their family), and depreciation deductions and deductions for real property taxes to the extent that the property to which they relate is used in the regular conduct of the lending or finance business. Trade or business expense deductions which are allowable specifically under other sections, such as the deduction for interest expense which is also allowable under section 163, are not included for purposes of the 15-percent or 5-percent test.

(c)(xi) *Liquidating dividends.*—Under present law, the 75- or 85-percent tax (70 percent under the bill) on personal holding companies applies only to the undistributed personal holding company income. Thus, this tax is applied after dividend distributions are taken into account. Included among the amounts treated as dividends eligible for the dividends paid deduction are distributions in liquidation to the extent of the accumulated earnings and profits. As a result, in the year of the liquidation of a personal holding company there is no income subject to personal holding company tax for that year. Despite the fact that the distributions are treated as dividends to the personal holding company, its stockholders in that year receive this income and report it at capital gains rates.

Thus, under present law, a company which is a personal holding company may nevertheless avoid both the personal holding company tax and the ordinary income treatment to its shareholders with respect to the personal holding company income the year in which it liquidates.

A problem is also presented in the case of corporations where a subsidiary is liquidated and both the parent and the subsidiary corporation are personal holding companies. In such a case, if the earnings and profits of the subsidiary exceed its undistributable personal holding company income in the year of the liquidating distribution, the parent corporation may use the excess dividend paid deduction in computing its own dividend paid deduction, thereby reducing its own undistributed personal holding company income in the taxable year and also in the 2 succeeding taxable years.

The bill meets these problems by limiting the application of section 562(b) to companies other than personal holding companies or foreign personal holding companies. However, it is provided in section 316(b) that in the case of a complete liquidation of a personal holding company within a 24-month period after the adoption of the plan of liquidation, that the term "dividend" is to include any amounts distributed in this liquidation to other than corporate shareholders to the extent of its undistributed income (before any deductions for this amount) only if the corporation involved designates amounts as dividends (and so notifies the distributee). If the corporation does so designate the distributions as dividends the individuals receiving a liquidating distribution from the personal holding company must report the amount so distributed as a dividend in the year of receipt. The bill also provides that in the case of a foreign personal holding company, the amount included in a United States shareholder's income is not to be diminished by any liquidating distributions made during the year.

An amendment is also made to the code which provides in the case of corporate distributees that where a complete liquidation of a personal holding company occurs within 24 months after the adoption of the plan of liquidation, the distribution is to be treated as a dividend for purposes of the personal holding company tax only to the extent of the corporate distributee's share of the undistributed personal holding company income for the taxable year of the distribution. Thus, the dividends paid deduction is allowed to a personal holding company only to the extent of the undistributed income for the taxable year and with respect to noncorporate distributees, only if such distributees treat such distribution as a dividend.

(c)(xii) *One-month liquidations.*—Your committee agrees with the House that while the tightening of the personal holding company provisions as indicated in the prior discussion is desirable, nevertheless, it would be unfortunate to apply these provisions without any alternatives being available, to companies which in the past have not been classified as personal holding companies but which as a result of the new provision will for the first time find themselves subject to personal holding company tax. Your committee agrees that it would be unfair to require such companies to pay personal holding company tax if they are willing to liquidate. Although it is understood that some of these companies are willing to liquidate, nevertheless, it would represent a hardship under existing law for them to do so. The hardship arises from the fact that if they liquidate under the provisions of section 331 of the code, not only would the earnings and profits of such corporations be taxed to the shareholders at capital gains rates but also any other appreciation which has occurred in the value of the assets would be so taxed to them. Such companies in the absence of the new personal holding company provisions would face no necessity of liquidating and therefore under these circumstances no tax would now be paid with respect to these unrealized increases in value. The House and your committee believed it was appropriate therefore to forego the tax at this time on unrealized appreciations in value but to collect the capital gains tax on the earnings and profits distributed.

The bill, to facilitate the liquidation of these companies, provides a special provision (in sec. 333) applicable in the case of companies which, for one of the two most recent taxable years ending before December 31, 1963, were not personal holding companies under existing law, but would have been in that year if the new law provided by this bill had been in effect at that time. In such cases, the bill provides that any distribution in liquidation made by the corporation to the extent of the earnings and profits accumulated prior to the time of the liquidation is to be taxed at capital gains rates and that any remaining gain is to be recognized only to the extent of assets which consist of money or of stock or securities acquired by the corporation after December 31, 1962.

To be eligible for the treatment described above, the liquidation of one of these corporations must occur before January 1, 1967, under your committee's amendments (or January 1, 1966, under the House bill). The treatment described above providing capital gains treatment with respect to earnings and profits is not to apply with respect to any earnings and profits to which the corporation involved succeeds after December 31, 1963, under your committee's amendments (August 1, 1963, under the House bill) as a result of any corporate reorganization or as a result of a liquidation of a subsidiary of that corporation (except earnings and profits which on December 31, 1963 (August 1, 1963, under the House bill) constituted the earnings and profits of one of the companies described above or which were earned by such a company).

In addition to liquidations occurring before January 1, 1967, the capital gains treatment for earnings and profits accumulated before 1967 and nonrecognition of gain with respect to any other gains to the extent with respect to assets acquired before 1963 (and assets other than stock and securities acquired thereafter) the bill also makes this special liquidation treatment apply to certain corporations which liquidate after 1966 (1965 under the House bill). To qualify for this post-1966 liquidation treatment, as in the prior case the corporation involved must be one which in at least one of the two most recent taxable years ending before December 31, 1963, was not a personal holding company under present law but would have been had the provisions of this bill been in effect with respect to that year. To qualify for this special post-1966 liquidation treatment, the corporation involved must also have incurred indebtedness in the period from December 31, 1933, to December 31, 1963 (August 1, 1963, under House bill), which is still outstanding, or incurred indebtedness after December 31, 1963 (August 1, 1963, under the House bill), which merely replaced indebtedness incurred before that time. So that the necessary records will be kept, the corporation must notify the Secretary that it may wish to liquidate under these provisions. This notice must be given before January 1, 1968 (January 1, 1967, under the House bill).

Cases have been called to the attention of your committee where corporations have entered into commitments to use their incomes to pay off such debts and where as a result it is difficult, if not impossible, for them to liquidate before this indebtedness is paid off. For that reason, the bill makes the liquidation treatment described above (but only with respect to earnings and profits accumulated before 1967) apply if the corporation liquidates in the year in which it either does pay off the pre-December 31, 1963, indebtedness or could have, if it had devoted all of its earnings or profits after 1963 to this purpose. In addition, it must also devote to this purpose any deductions for depreciation, amortization, or depletion since the funds in this case remain in the corporation and can be used to retire indebtedness. Thus, the special liquidation treatment described here with respect to liquidations occurring after 1966 is available only during the period of time necessary for the corporation to retire outstanding indebtedness out of earnings and profits and depreciation allowances.

Your committee has added an amendment providing that where a corporation believes that it is one of these "would have been" corporations eligible for the special liquidation treatment under section 333, if it subsequently is determined that it did not qualify for this treatment, the liquidation will, nevertheless, be treated as occurring under section 333 unless in the election it was indicated that it was made under section 333 only on the assumption that the new treatment would be available. Where the shareholders indicate that they made the election on this assumption, section 331 will apply if other requirements for the use of this liquidation section had been complied with.

(c)(xiii) *Postponement of new personal holding company provisions for certain corporations.*—To encourage the liquidation of companies which are not now personal holding companies but would become so as a result of the new provisions, a provision is added by the bill to the effect that such companies, if they liquidate before January 1, 1966, will not be subjected to the new personal holding company provisions provided by this bill. They will, however, have available to them the special liquidation provisions described immediately above and will be subject to the rules specified in the prior heading with respect to the dividends paid deduction. In addition, this provision will not apply in the case of the liquidation of a subsidiary corporation under section 332 unless before the 91st day after the last distribution by the subsidiary the parent corporation also is liquidated and both of these events occur before January 1, 1966.

(*c*)(*xiv*) *Deduction for amortization of indebtedness.*—In 1934, when the personal holding company provision was first adopted, Congress provided that indebtedness incurred before 1934 by a company which subsequently became a personal holding company would receive a special debt amortization deduction in computing its personal holding company tax. It was provided that to the extent that this debt was paid off, or amounts were set aside to pay off this debt, the tax base for purposes of the personal holding company tax was to be reduced by the amount of the amortization payments. Thus, these amortization payments were treated for purposes of the personal holding tax as deductions in the same manner as dividend distributions to shareholders.

The bill adds a similar provision for indebtedness incurred after December 31, 1933, and before January 1, 1964 (August 1, 1963, under the House bill), in the case of corporations which were not personal holding companies in one of the 2 most recent taxable years ending before December 31, 1963, but would have been had the new personal holding company provision been in effect at that time.

Qualified indebtedness for purposes of this provision includes not only the debt outstanding before January 1, 1964 (August 1, 1963, under the House bill), but also debt which has replaced that outstanding before January 1, 1964 (if the special amortization deduction has not already been taken for the repayment of the old debt). Thus, short-term bank loans, for example, which are renewed at intervals will not be disqualified for purposes of this amortization deduction if the taxpayer elects not to deduct the payment of the prior loan. In addition to deductions for actual payments, deductions are also permitted for amounts (if reasonable) which are irrevocably set aside to pay off a debt which may be payable at some future date.

The deduction for indebtedness under this provision is to be reduced by any deduction which the company receives for depreciation, amortization, or depletion, and for any deduction (in computing undistributed personal holding company income) for net long-term capital gains. These deductions are disallowed since the funds represented by them can be used by the corporation to pay off indebtedness in the same manner as the earnings and profits of the corporation. Any of these deductions not used in 1 year are carried forward for this purpose and used in a subsequent year. A special provision provides that where depreciable or depletable property which would give rise to this cutback in the indebtedness provision is disposed of after December 31, 1963, then to the extent the basis of the property disposed of exceeds the indebtedness which was transferred at the time of the same disposition the qualified indebtedness for which a deduction may subsequently be taken is reduced.

(*c*)(*xv*) *Effective dates.*—Generally the personal holding company provisions are made effective with respect to taxable years beginning after December 31, 1963. The dividends paid deduction modification and the liquidation provision, however, are to apply to distributions made in taxable years of the distributing corporation beginning after December 31, 1963.

(*d*) *Revenue effect.*—It is estimated that the personal holding company provision will result in a revenue increase of $15 million a year in a full year of operation.

31. Treatment of property in the case of oil and gas wells (sec. 227 of the bill and sec. 614 of the code)

(*a*) *Present law.*—The percentage depletion deduction, in the case of oil and gas, is either 27½ percent, multiplied by the gross income from the "property" or, if less, 50 percent of the net income from the "property." As a result, what constitutes "property" is of considerable significance in determining the percentage depletion deduction available. To avoid any reduction in the 27½-percent deduction on gross income from the property, it frequently is desirable to combine wells having a high ratio of net income to gross income with those having a low ratio so that the 50 percent net income limitation will have little, or no, effect.

At one time each separate mineral deposit in a lease or fee acquisition was treated as a separate property. Subsequently, the administrative practice arose of permitting, at the taxpayer's option, the aggregation or combination of deposits in a single lease or acquisition (sometimes referred to as a single tract or parcel of land). In 1954, Congress permitted the aggregation of properties across lease lines so long as all the properties were in one "operating unit." This change was prompted by circumstances of the hard mineral industry but it also applied to the oil and gas industries as well. In 1958, Congress adopted detailed rules in the case of the hard minerals. In general these rules provided that operating mineral interests may be aggregated mine by mine and any number of mines may be aggregated so long as they are in a single operating unit. These rules, to the extent applicable to hard minerals remain in force. In the case of oil and gas, Congress in 1958 gave operators an option to use either the 1939 code "lease" rule or the 1954 code "operating unit" rule.

The law and the regulations in the case of the "operating unit" rule provide that it is not necessary for purposes of the aggregation that the separate operating mineral interests be included in a single tract or parcel of land, or in contiguous tracts or parcels of land, so long as the interests are a part of the same "operating unit." In defining the "operating unit," the regulations refer to operating mineral interests which are operated together for the purpose of producing minerals. With respect to each taxpayer what constitutes an "operating unit" must be determined on the basis of his own operations. The operating units may not be uniform in the various natural resources industries or in any one of the natural resource industries. Moreover, in the case of a particular taxpayer, business reasons may require the formation of operating units that vary in size and content. The term "operating unit" refers, however, to a producing unit and not an administrative or sales organization. Among the factors which indicate that mineral interests are operated together as a unit are—

(1) Common field or operating personnel;
(2) Common supply and maintenance facilities;
(3) Common processing or treatment plants; and
(4) Common storage facilities.

It is made clear that operating mineral interests which are geographically widespread may not be treated as parts of the same operating unit merely because a single set of accounting records, a single executive organization, or a single sales force is maintained by the taxpayer with respect to such interests or merely because the products of the interests are processed at the same treatment plant. Generally, however, the determination of the taxpayer as to what constitutes an operating unit is to be accepted unless there is a clear and convincing basis for a change in such determination.

(*b*) *General reasons for provision.*—There have been two major objections to the operating unit rule adopted in 1954 as applied to oil and gas. First, it has been difficult to determine what an operating unit is and this is a continuous source of controversy between taxpayers and the Government. The problem arises from the fact that the term "operating unit" apparently has no generally understood meaning within the oil and gas industries. Basically, it is a tax concept having no real business substance.

Second, the operating unit rule has proved objectionable because it gives taxpayers an opportunity to increase their percentage depletion deduction merely by choosing the best combination of high and low cost properties for purposes of this aggregation rule. This opportunity, of course, is available only to those large enough to have many diverse property interests. It is possible under this rule to include some leases or tracts of land within a large area and to omit others even though the latter may be contiguous to some of the property included, while other property included in the aggregation may be many miles away. Taxpayers, in fact, are contending that the term "operating unit" covers operations over widespread geographical areas, including substantial portions of several States.

To remove this controversy and also to delete this opportunity for larger companies to maximize their percentage depletion deductions by unrealistic grouping of properties, the bill for the future eliminates the operating unit aggregation rule in the case of oil and gas properties. No inferences are to be drawn from this, however, as to what constitutes an operating unit or as to what could properly be aggregated with respect to the period of time before this change is made. In place of the operating unit rule taxpayers, as was true before 1954, will be able to maintain separate deposits as separate properties or can combine some or all deposits falling within a single lease or acquisition. They will not, however, be able to combine different leases or acquisitions, except in the case of properties which are in a unitization agreement. In these latter cases the owners of the property have in effect exchanged their separate interests in their leases for undivided interests in the whole, with the result that all interests of a taxpayer in the unit become one property.

(*c*) *General explanation of provision.*—The operating unit rule of existing law provides that if a taxpayer owns two or more separate operating mineral interests which constitute all or a part of an operating unit, he may form one aggregation and treat as one property any two or more of these interests, treating as separate properties any interests which he does not include in this one aggregation. Separate operating mineral interests may be aggregated for this purpose whether or not they are in a single tract or parcel of land, or contiguous tracts or parcels. A taxpayer may not, however, form more than one aggregation within a single operating unit.

The bill repeals the rule described above for taxable years beginning after December 31, 1963, with respect to oil and gas. It substitutes in its place a rule which, in effect, restores the pre-1954 administrative practice. No longer will the aggregation of properties be permitted at the "operating unit" level. Except in the case of unitization agreements discussed below, taxpayers may not aggregate oil and gas properties above the level of a separate lease or acquisition, or "separate tract or parcel of land" as referred to in the bill.

The general rule which will apply in the future is that all of the taxpayer's operating mineral interests in a separate lease or acquisition will be combined and treated as one property. However, the taxpayer may elect to treat separately operating mineral interests within a single lease or acquisition. Where he does this he may have either no combination, or one combination of mineral interests in that tract or parcel of land. If he has one combination, all other mineral interests not in that combination are treated as separate properties.

Where the taxpayer has elected to treat separately some or all of the operating mineral interests in a single lease or acquisition, and subsequently finds or acquires new interests in that property, the new interests, unless he elects otherwise, are to be treated as a part of the combination, if there is a combination, or as separate properties if there is no such combination.

The election to treat part or all of the operating mineral interests in a lease or acquisition as separate properties must be made at the time of the filing of the return for the first taxable year beginning after December 31, 1963, or if later, the first taxable year in which an expenditure for the development or operation of the operating mineral interest is made by the taxpayer after acquisition.

(c)(i) *Unitization or pooling arrangements.*—As previously indicated, a unitization or pooling agreement is to be an exception to the rule stated above. A unitization agreement arises where two or more taxpayers holding interests in separate tracts or parcels of land exchange their interests for an undivided interest in a larger area (either by formal conveyances or contractual arrangement). Such an agreement also arises where a taxpayer holding operating mineral interests in several leases enters into an arrangement to pay the lessors royalties based on an undivided share of the oil and gas from all the leases. The bill provides that in these cases all of the operating mineral interests of a taxpayer which participate in one of these unitization agreements are to be treated as a single property without regard to the rules specified above. This treatment applies to all compulsory unitization agreements required by State law and also to voluntary agreements which meet both of the following two tests:

(1) The operating mineral interests must be in the same deposit or two or more deposits, the joint development or production of which is logical from the standpoint of geology, convenience, economy, or conservation; and

(2) The operating mineral interests covered by the agreement must be in tracts or parcels of land which are either contiguous or in close proximity.

In making this determination under No. (1), tax benefits are not to be taken into account.

A special rule is provided in the case of unitization agreements entered into in taxable years beginning before January 1, 1964. In these cases, where for the last taxable year beginning before 1964 the taxpayer treated each interest as a separate property and if it is determined by law that this was the proper treatment, then the taxpayer may, if he so desires, continue to treat these interests as separate properties despite the fact that they are in a unitization agreement.

(*c*)(*ii*) *"Unscrambling" of basis.*—In the past, because of the "operating unit" rule, taxpayers have aggregated two or more separate leases or acquisitions which under the new rules provided by this bill, they must treat separately. This means that any basis for these properties must be segregated or "unscrambled." In the great majority of the cases, it is understood that this will present no problem because of the fact that the entire basis of the property involved has already been written off by percentage depletion deductions. However, for those where some basis still remains, the bill provides two rules, either of which may be followed in "unscrambling" the basis of the operating mineral interests which for the future must be treated as separate properties. The first of these rules provides that any basis may be divided among the separate properties in accordance with the fair market value of each property. The second rule provides that taxpayers may take the adjusted basis of each property at the time it was first included in an aggregation and adjust this basis downward for adjustments reasonably attributable to the property so that the total of these adjusted bases equals the adjusted basis of the former aggregation.

(*c*)(*iii*) *Effective date.*—The amendments made by this provision apply to taxable years beginning after December 31, 1963. This does not involve any change in elections for those already covered under the 1939 code rules (sec. 614(d)).

(*d*) *Revenue effect.*—It is expected that this provision will result in an annual increase of revenue of $40 million.

32. Treatment of iron ore royalties (sec. 228 of the bill and secs. 631(c), 1231(b), and 272 of the code)

(*a*) *Present law.*—Under present law, iron ore royalties give rise to ordinary income; against this, however, a depletion deduction of 15 percent may be taken.

In the case of coal royalties, however, where the property has been held over 6 months, present law provides that the excess of the amount realized from the disposal of the coal, over the adjusted depletion basis and the expenditures attributable to making and administering the contract and in preserving the economic interest retained in the contract, is to be treated as a capital gain. Where capital gain is realized from coal royalties, no deduction is allowed for percentage depletion or generally for the making and administering of the contract or the preservation of the economic interest in the contract.[1]

(*b*) *General reasons for provision.*—Your committee agrees with the House that the tax treatment now available with respect to coal royalties also should be extended to iron ore royalties as well. The capital gains treatment was made available in the case of coal royalties in part at least to encourage leasing, and therefore production, at a time when the coal industry was facing strong competition from other forms of fuel energy. Today, domestic iron ore production also

[1] Where the expenditures referred to above plus the adjusted depletion basis of the coal disposed of exceed the amount realized under the contract and are not used to offset other gains, a loss is allowed (if some income is realized under the contract).

generally is decreasing. In recent years, for example, iron ore production in the United States has been as follows:

	Thousands of long tons
1950	98, 045
1955	103, 003
1958	67, 709
1959	60, 276
1960	88, 784
1961	71, 329

Source: Department of Interior, Bureau of Mines, Minerals Yearbook.

The capital gains treatment provided by this bill should encourage domestic leasing of iron ore properties to operators, and therefore should improve the position of domestic iron ore production relative to foreign production.

Your committee has modified the House bill, however, to limit the capital gains treatment for iron ore royalties to domestic iron ore. In addition, it has denied capital gains treatment for these royalties where the person receiving the royalty and the person acquiring the iron ore are related persons or are owned or controlled directly or indirectly by the same interests.

(c) *General explanation of provision.*—The bill provides that, as in the case of the disposal of coal, where iron ore is disposed of after being held for more than 6 months by the owner under a contract in which the owner retains an economic interest in the iron ore, the difference beween the amount realized from the sale of the iron ore and certain costs is to be treated as a capital gain. An amendment made by your committee limits this treatment in the case of iron ore to that mined in the United States.

The costs taken into account for purposes of determining the gain are the cost of the property itself (adjusted downward for any depletion deduction taken) plus expenditures in the taxable year for making and administering the contract and the preservation of the economic interest retained under the contract. However, where these expenditures together with the adjusted basis of the property exceed the amount realized under the contract and are not used to offset other gains from the sale or exchange of "property used in the trade or business," a loss is to be recognized. Thus, the costs and expenses incurred by the taxpayer are to decrease the amount received in determining the amount treated as a capital gain.

The bill treats these iron ore royalties like coal royalties as "property used in the trade or business." As a result, if the gains from iron ore royalties plus the gains from other "property used in the trade or business" exceed the losses from the same type of property, the gain is to be treated as capital gain.

In obtaining this capital gains treatment for the iron ore royalty the lessor must forgo any depletion deduction with respect to his property (although his adjusted depletion basis is taken into account in computing his gain). In addition, he must generally forgo any deductions for expenditures attributable to the making and administering of the royalty contract and any expenditures attributable to the preservation of his economic interest in this contract. The primary exception to the denial of the deductions in this case is where these expenses plus the adjusted depletion basis for the iron ore disposed of exceed the royalty payments received and are not offset against other gains. With respect to this excess, a loss is allowed.

The House bill provided in the case of iron ore, as in the case of coal under present law, that the capital gains treatment is not to apply to income realized by any owner as a coadventurer, partner, or principal in the mining of the coal or iron. The word "owner" here means any person who owns an economic interest in the coal or iron ore in place including a sublessor. Your committee has added an amendment which in the case of iron ore further restricts the availability of the capital gains treatment. Under your committee's amendment, the capital gains treatment will not be available where the owner of the interest in the iron ore and the operator are related, or where the two parties are owned or controlled directly or indirectly by the same interests. "Relationship" here is the same as the relationship which would result in the denial of a deduction for losses in the case of the sale of property under section 267 or 707(b).

The iron ore for this purpose is considered as being sold on the date the iron ore is mined.

(c)(i) *Effective date.*—As amended by your committee, the capital gains treatment provided by this provision is to apply to amounts received or accrued in taxable years beginning after December 31, 1963, attributable to iron ore mined in taxable years beginning after December 31, 1963. In the House bill, the capital gains treatment would have applied to all iron ore mined in taxable years beginning after December 31, 1963, even though amounts were received with respect to such iron ore in prior taxable years.

(d) *Revenue effect.*—This provision is expected to result in an annual loss of revenue of $5 million.

33. Insurance companies; mutualization distributions made in 1962 (sec. 229(a) of the bill and secs. 809(d)(11) and 809(g)(3) of the code)

(a) *Present law.*—The Life Insurance Company Income Tax Act of 1959 provided a special rule where a stock life insurance company is "mutualized," or converted into a mutual life insurance company, with a liquidating distribution being made to the shareholders and the remainder of the surplus and reserves being held for the benefit of policyholders in what then becomes a mutual company.

The 1959 act provided a special deduction for these liquidating payments to shareholders. To the extent of the excess of any gain from operations for the year in question over the taxable investment income, a deduction is allowed in computing the phase 2 tax of the insurance company for amounts paid out in one of these liquidating distributions to the shareholders. The distribution has to be under a mutualization plan adopted before January 1, 1958. This deduction in computing the phase 2 tax cannot result in any lower tax than if the 1957 law had applied in the year in question. In addition, this amount is treated as paid first out of capital and paid-in surplus, to the extent of this capital and paid-in surplus, with the result that no tax is likely to arise under phase 3 of the life insurance company tax in the case of these distributions.

The treatment described here was initially made available with respect to distributions in 1958 and 1959 but was subsequently (in Public Law 87-59) extended to cover distributions in 1960 and 1961.

(b) *General reasons for the provision.*—The attention of your committee has been called to a case where a mutualization agreement was entered into before January 1, 1958, and the final distribution payment was authorized in 1961 but the distribution of these payments could not actually be made until 1962 because of the requirements of the State law involved. Your committee believes that liquidation payments made under these circumstances should be treated in the same manner as in the case of the mutualization liquidating payments made in prior years.

(c) *General explanation of provision.*—For the reasons given above, your committee has added an amendment to the bill providing that the special liquidating distributions rules provided by present law for the years 1958-61 under a mutualization agreement entered into before 1958 are also to apply to distributions in 1962. This will enable the company to receive a deduction for this amount (subject to applicable limitations) in computing its phase 2 tax and also to treat this amount for purposes of phase 3 as being made first out of capital and paid in surplus, to the extent of such amounts, and only after that, is a part of this amount to be treated as a payment first out of the already tax-paid shareholders surplus account, to the extent of the balance of this account, and only then from the policyholders surplus account, withdrawals from which are subject to tax.

(c)(i) *Effective date.*—The amendment made by this provision is to apply to taxable years beginning after December 31, 1961.

(d) *Revenue effect.*—It is estimated that this provision will result in a negligible loss of revenue for 1 year.

34. Accrual of bond discount by certain insurance companies (sec. 229(b) of the bill and sec. 818(b) and sec. 822(d)(2) of the code)

(a) *Present law.*—Under existing law, prior to Rev. Rul. 60-210 (1960-1 CB 38), mutual fire and casualty insurance companies and life insurance companies amortized premiums and accrued discount on bonds purchased by them. In the case of State and local government bonds, these companies increased the amount of their deduction for tax-exempt interest by the amount of discount accrued by them. This had the effect of treating discount in the same manner as tax-exempt interest, without regard to whether the discount was on the original issue of the bond or whether it grew out of subsequent fluctuations in the market value of the bond.

Revenue ruling 60-210, issued May 31, 1960, draws a sharp distinction in tax treatment between "issue" discount and so-called "market" discount on State and local government bonds. Under this revenue ruling, in the case of issue discount, such discount continues to be treated as in the nature of tax-exempt interest, and the deduction for such interest continues to be increased by the amount of issue discount accrued each year. Market discount, on the other hand, although required to be accrued by these companies, no longer is allowed by the Internal Revenue Service to increase the deduction for tax-exempt interest. Thus market discount accrued by life insurance companies and by mutual fire and casualty insurance companies is taxed as ordinary income.

Stock fire and casualty insurance companies on the other hand, and corporations generally, are not required to accrue discount (either that arising at the time of issue or market) on bonds purchased at a discount by them. Rather these corporations treat market discount on both taxable and nontaxable bonds as capital gain (or loss) when the bond is sold or disposed of by them and treat original issue discount on taxable bonds as ordinary income when it is realized.

The Revenue Act of 1962 further affected the tax treatment of discount on bonds purchased by mutual fire and casualty insurance companies (but not life insurance companies). Broadly speaking, it was the purpose of that act to treat mutual fire and casualty insurance companies more nearly like stock fire and casualty insurance companies for Federal income tax purposes. To accomplish this objective, mutual companies were taxed under a modified total income formula, which in effect converts accrued discount on bonds into an underwriting deduction. This effectively takes market discount out of the ordinary income tax base of these mutual companies and provides capital gain (or loss) treatment for market discount on both taxable and nontaxable bonds when the bonds are sold or disposed of by the mutual companies and treats original issue discount on taxable bonds as ordinary income as it is realized upon disposition. This treatment is identical to the treatment of discount by stock fire and casualty companies and other corporations. However, this treatment under the 1962 Revenue Act does not apply to all mutual fire and casualty insurance companies. Actually, it applies only to those companies which are subject to the modified total income tax.

Therefore, small mutual companies (those whose gross investment income, plus premiums, is between $150,000 and $500,000) which are taxed only on their investment profits must continue to treat accrued discount currently as ordinary income. In addition, life insurance companies must treat this discount currently as ordinary income.

(*b*) *General reasons for provisions.*—Your committee sees no reason for treating market discount on bonds owned by life insurance companies and by small mutual fire and casualty insurance companies as ordinary income when all other corporations, including all other insurance companies, are allowed capital gain treatment for such discount. Moreover, when the tax treatment of bond discount varies depending upon the type of business the bondholder may be engaged in, it is difficult for the bond market (particularly in the case of State or local government securities) to function normally, since the after-tax earnings on the bond will not be uniform.

Moreover, your committee desires to bring stability to an area of the tax law that has been unsettled since 1960. From 1942 until 1960 there was little question but that discount on tax-exempt bonds held by life insurance and mutual fire and casualty insurance companies, regardless of the source of the discount, was tax exempt. In 1960, however, the market portion of discount on such bonds was held by the Internal Revenue Service to be taxable as ordinary income. In 1962 larger mutual fire and casualty insurance companies (but not the smaller mutual fire and casualty companies and not life insurance companies) were provided capital gains treatment on their market discount. Under your committee's bill in the future, market discount on bonds held by insurance companies and other corporations will be taxed alike; that is, as capital gain when the bond is sold or redeemed.

(*c*) *General explanation of provision.*—This amendment provides that for taxable years beginning after December 31, 1962, market discount received by any insurance company will be taxed as a capital gain. This conforms the treatment of this discount in the case of life insurance companies and small mutual fire and casualty companies with that presently accorded stock fire and casualty companies, and the larger mutual fire and casualty companies (under the Revenue Act of 1962) and corporations generally.

In the case of original issue discount, the amendment conforms the treatment by small mutual fire and casualty companies with the treatment of original issue discount received by stock fire and casualty, and larger mutual fire and casualty companies (under the Revenue Act of 1962). Under the amendment, this discount will be reported as ordinary income when it is realized upon disposition.

Life insurance companies, however, would continue (as under present law) to accrue original issue discount currently on both taxable and tax-exempt bonds.

(c)(i) *Effective date.*—The amendments made by this provision are to apply to taxable years beginning after December 31, 1962.

(d) *Revenue effect.*—This provision is expected to result in a negligible loss in revenue.

35. Contributions by certain insurance companies to qualified pension, etc., plans (sec. 229(c) of the bill and sec. 832(c)(10) of the code)

Under the Internal Revenue Code of 1939, deductions for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan were allowed under the same section (sec. 23(p)) as most other deductions from gross income. In the rearrangement made in the 1954 Code, however, the deduction for these contributions was transferred over to the subchapter relating to deferred compensation and pension, profit sharing, stock bonus plans, etc. However, the 1954 Code in the case of casualty insurance companies in providing for trade or business deductions, refers to deductions in part VI of subchapter B, relating to itemized deductions for individuals and corporations, unintentionally omitting the reference to section 404 wherein the deductions for contributions to qualified pension, etc., plans is provided under the 1954 Code.

To remove this clerical error in the 1954 Code, and to make it clear that deductions are allowed for contributions to a qualified pension, etc., trust in the case of these casualty insurance companies, your committee has added a provision to the bill containing an appropriate cross-reference to obtain this result. Thus, section 832(c)(10) of the code is amended by making specific reference to section 404 and following, which are the provisions relating to pension, profit sharing, stock bonus plans, etc.

The amendment made by this provision is to apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

36. Regulated investment companies: Time for mailing certain notices to shareholders (sec. 230(a) of the bill and secs. 852–855 of the code)

(a) *Present law.*—Under present law, companies may qualify as "regulated investment companies" if they meet certain tests set forth in the statute. In general, to qualify for this status, the bulk of a company's income must be derived from dividends, interest, and gains on the sale of stock or securities. In addition, to receive this treatment, a substantial portion of the company's assets must be in diversified stock investments rather than being concentrated in the stock of a single or a few companies. Where a company qualifies as a regulated investment company, if it distributes at least 90 percent of its investment company income (excluding net long-term capital gains), then the company is taxed only on its undistributed income.

In addition, certain features of the tax law which generally would be applicable only to the company receiving the income, in the case of a "regulated investment company" may be passed through to its shareholders. In each of these cases, the present provisions of the Internal Revenue Code provide that the shareholder must be given notice with respect to these special tax features within 30 days after the close of the regulated investment company's taxable year.

(b) *General reasons for provision.*—This provision increases from 30 to 45 days after the close of a regulated investment company's taxable year the time accorded it for giving notices to its shareholders with respect to these special tax features. Your committee believes that the allowance of this additional 15-day period is desirable because the regulated investment companies have had difficulties in getting out their notices within the 30-day period. Moreover, since individuals generally are not required to file their individual income tax returns until the 15th day of the 4th month (rather than the 15th day of the 3d month of the year as at one time was the case) provision of this additional time for the regulated investment companies to submit these reports to their shareholders still leaves the shareholders with 2 months after the receipt of the notices before their tax returns need to be filed.

(c) *General explanation of provision.*—The various tax features with respect to which the regulated investment company under this bill is to be given 45 rather than 30 days after the end of the year for notice to its shareholders are as follows:

1. Under present law, dividends paid to shareholders of a regulated investment company may be designated as capital gain dividends to the extent of the excess of the net long-term capital gain of the regulated investment company over its net short-term capital loss (but only to the extent these amounts are paid out). In the case of these dividends, the company pays no tax but the shareholder includes the dividend in his income as a long-term capital gain. In this case, the company is to have until 45 days after the end of its taxable year to notify its shareholders as to the amount of the dividend (sec. 852(b)(3)(C)).

2. As an alternative to actually distributing net long term capital gains, a regulated investment company can report such capital gains and pay a 25-percent tax on this income. Then the shareholder may include his share of these capital gains in his income as long term capital gain and claim a tax credit for the tax paid by the regulated investment company. For this treatment to be available, the company must designate within 30 days after the close of the taxable year the amount to be so treated by each shareholder. This provision increases this period of time to 45 days (sec. 852(b)(3)(D)(i)).

3. Present law provides that where more than 50 percent of the value of a regulated investment company's assets consist of stock or securities in foreign corporations and certain other tests are met, then the regulated investment company may elect to treat as distributed to its shareholders any income, war profits, and excess profits taxes paid by it to a foreign country (or a possession of the United States). Where the company so elects, the shareholders of the company include the amount of these foreign (or possession) taxes in their income and

then either claim a deduction or foreign tax credit for these amounts. For this treatment to be available, notice must be mailed to the shareholders not later than 30 days after the close of the company's taxable year. The provision changes this 30-day period to a 45-day period (sec. 853(c)).

4. Existing law provides that where less than 75 percent of a regulated investment company's gross income represents dividend income, then the shareholder receiving a dividend from the regulated investment company is to treat the amount he receives as a dividend only in the ratio which the company's dividend income represents of its total gross income. Present law provides that a regulated investment company must supply its shareholders with written notices indicating how much of its income in these cases is to be treated as dividends. This written notice must be supplied the shareholder within 30 days of the close of the company's taxable year. This provision changes the 30-day period to a 45-day period (sec. 854(b)(2)).

5. Existing law provides that income may be treated as paid out in the year earned if a regulated investment company declares a dividend before the time specified by law for filing of its return for the year in question and distributes this dividend to its shareholders not later than at the time of the first regular dividend payment after the declaration. (The shareholder in such cases may take the income into account in the taxable year in which he receives the distribution.) For the dividends to be considered as paid out in the earlier year, notice under existing law with respect to such dividends must be made to the shareholders not later than 30 days after the close of the taxable year in which the distribution of the dividends is made. This provision changes the 30-day period to a 45-day period (sec. 855(c)).

(*c*)(*i*) *Effective date.*—The changes in the filing dates referred to above are to apply to taxable years of regulated investment companies ending on or after the date of enactment of this bill.

(*d*) *Revenue effect.*—It is expected that this provision will have no effect on revenues.

37. Regulated investment companies: Redemptions by unit investment trusts (sec. 230(b) of the bill and sec. 852(d) of the code)

(*a*) *Present law.*—Present law provides that mutual funds are to be treated for Federal income tax purposes as "regulated investment companies." To qualify for this treatment the corporations involved must have widely diversified investments largely consisting of stocks or bonds. Ninety percent or more of their ordinary income must also be paid out to their shareholders. Such corporations, however, pay tax on their net long term capital gain to the extent such capital gain is not distributed to the shareholders.

In some cases what are sometimes called unit investment trusts are also associated with a mutual fund. These unit investment trusts receive periodic payments from individuals and invest these funds usually in the stock of a single mutual fund. Under present law these unit investment trusts are themselves also classified as regulated investment companies.

(*b*) *General reasons for provision.*—A problem has arisen under present law where one investor liquidates his interest in one of these unit investment trusts. In such a case if the trust sells stock which it holds to make the liquidating distribution and the proceeds from the sale are distributed to one investor it is possible to argue that the distribution is a "preferential dividend" (as defined in sec. 562(c)) and that for this reason it does not result in a dividends-paid deduction for this amount to the trust (but only to the extent of the investor's allocable share of the gain). This would therefore result in a tax on the capital gain to the trust although it retained none of the capital gain in its possession.

(c) *General explanation of provision.*—To meet the problem described the bill provides that in the case of a redemption by the trust of the investor's stock (in whole or in part) the redemption will not be considered as preferential dividend. This amendment is not intended to have any effect on the law prior to the effective date of this provision.

(c)(i) *Effective date.*—This amendment applies to taxable years of regulated investment companies ending after December 31, 1963.

(d) *Revenue effect.*—It is expected that this provision will have a negligible effect on revenues.

38. Foreign tax credit with respect to certain foreign mineral income (sec. 231 of the bill and sec. 901(d) of the code)

(a) *Present law.*—Under present law, citizens of the United States and domestic corporations may treat foreign income, war profits, and excess profits taxes paid or accrued to a foreign country as a credit against their U.S. income tax otherwise payable. In addition to taxes paid directly by a U.S. taxpayer, domestic corporations are allowed a credit for foreign taxes paid by 10-percent-owned first tier foreign subsidiaries and by second tier foreign subsidiaries if 50 percent of their voting stock is owned by a 10-percent-owned first tier foreign subsidiary. Similar tax credits are allowed if so-called "tax haven" income is included in the gross income of a domestic corporate shareholder (under sec. 951).

Foreign taxes which may be allowed as a credit against U.S. tax are limited to the same proportion of the U.S. tax against which the credit is taken as the income from sources within each foreign country (the "per country" limitation), or alternatively all foreign countries (the "overall" limitation), bears to the entire taxable income of the taxpayer. Thus, if foreign tax on foreign source income of the taxpayer on a per-country or overall basis is equal to, or less than, the U.S. tax resulting from including the foreign source income in taxable income, the entire foreign tax is allowed as a credit. Except in the case of interest income which is not related to the taxpayer's foreign operations, computations of foreign and U.S. taxes on foreign source income, for purposes of the limitation on the foreign tax credit, are made without regard to the type of activity from which the income is derived. To the extent the foreign taxes on foreign source income exceed the U.S. income tax applicable to the same income, the excess foreign tax may be carried back 2 years and forward 5 years and be used as a credit against U.S. tax in those years to the extent the foreign tax credit limitation for these years exceeds the foreign tax credit otherwise allowable.

(b) *General reasons for provision.*—Under present law, U.S. taxpayers who extract minerals in foreign countries are allowed a deduction for percentage depletion in computing their U.S. income tax. Because of the allowance by the United States of percentage depletion to the mineral-producing industries, the U.S. tax payable on these operations is often lower than the foreign tax payable on the income from the same operations. Although the rates of tax generally in the foreign country in which the mineral is extracted are not likely to be higher than ours, the fact is that they frequently do not allow a deduction for percentage depletion or grant it at a lesser rate than does the United States. To the extent foreign tax paid or accrued on foreign income derived from the extraction of minerals from mines, wells, or other natural deposits exceeds the U.S. tax on the same income, the excess foreign tax, under present provisions relating to the allowance of foreign tax credits, is available as a credit against U.S. tax otherwise payable on foreign source income from unrelated activities of the taxpayer in the same or other foreign countries.

To prevent continuance of this benefit, which is available only to U.S. taxpayers who are engaged in the business of operating foreign mines, wells, and other natural deposits, your committee has provided that excess foreign tax credits which are attributable to the allowance of percentage, rather than cost, depletion by the United States shall not be allowed as a tax credit against U.S. tax otherwise payable on the income from taxpayer's nonmineral foreign activities. For this purpose, however, the taxpayer's mineral income is to include income from refining, distribution, and retail sales of the mineral products as well as their extraction. This is set forth in more detail below. Treating these related activities in this manner is necessary to enable these companies to maintain their present competitive position with others engaged in mineral extraction abroad. On the other hand, however, since the foreign tax credit cannot offset income from domestic sources, this will have no effect on domestic production.

(c) *General explanation of provision.*—For purposes of computing foreign tax credits available to a U.S. citizen or domestic corporation who claims a deduction for percentage depletion, your committee's bill requires a taxpayer to divide his income into two parts: first, "mineral income" from sources without the United States, and second, income from all other sources.

For purposes of this provision, the bill defines "mineral income" as income derived from the extraction of minerals from mines, wells, or other natural deposits, income from the processing of such minerals into their primary products, and income from the transportation, distribution, and sale of the primary products derived from the mineral or of the mineral itself. Thus, for example, an integrated oil company would treat its entire income from the production of oil, income attributable to the refining of crude oil into gasoline, income from the distribution of gasoline to marketing outlets, and its income from retail sales of gasoline as mineral income. Similarly, income from the refining, distribution, and marketing of fuel oil by the taxpayer would also be treated as mineral income for this purpose, whether or not the oil sold was extracted by the taxpayer. However, income attributable to the manufacture, distribution, and marketing of petrochemicals is not to be treated as mineral income since your committee does not consider them to be primary products of oil. In addition to treating certain operating income as mineral income, taxpayers are permitted to treat dividends from corporations in which they own 5 percent or more of the voting stock as mineral income to the extent the dividend is attributable to mineral activities of the payor corporation. However, this rule only applies if the dividend is treated as income from sources without the United States for income tax purposes. Thus, for example, if a domestic oil company receives a dividend from a foreign oil pipeline company in which it owns more than 5 percent of the voting stock at the time of the distribution, the domestic company may treat the dividend as "mineral income." The bill also provides that a taxpayer may treat the portion of his distributable share of income of a partnership as mineral income to the extent it is derived from foreign mineral activities of the partnership.

Once the income of a taxpayer is divided into the mineral and nonmineral categories, your committee's bill results in a disallowance of foreign taxes as a credit against U.S. tax to the extent the excess of foreign tax over U.S. tax on the mineral portion of the taxpayer's income is attributable to the allowance of percentage, rather than cost, depletion for U.S. income tax purposes. Under this rule, foreign and U.S. taxes may be compared on the foreign mineral income of the taxpayer as a whole under the overall limitation, or they may be compared on a per country basis. However, if a foreign tax is disallowed under this provision in the year paid or accrued, it is not permitted to be treated as a carry back or a carry forward to another taxable year.

This provision does not affect taxpayers who do not claim percentage depletion on income from extraction of foreign minerals. Moreover, it does not affect taxpayers who claim percentage depletion on such income for Federal income tax purposes if the foreign tax allocable to their foreign mineral income is equal to or less than the U.S. tax applicable to the same income assuming the taxpayer used cost, rather than percentage, depletion for U.S. tax purposes.

(*c*)(*i*) *Effective date.*—This provision applies with respect to the computation of foreign tax credits for taxable years beginning after December 31, 1963.

(*d*) *Revenue effect.*—This provision is expected to result in a negligible increase in revenues.

39. Sale of residence by employee (sec. 232 of the bill and sec. 1003 of the code)

(*a*) *Present law.*—Under present law, amounts received by transferred employees from their employers in reimbursement of "losses," selling commissions, and legal fees incident to the sale of a principal residence have been held to be as ordinary income. *Harris W. Bradley*, 39 T.C. 652 aff'd 324 F. 2d 610 (4th Cir. 1963).

Prior to the *Bradley* opinion the treatment of these reimbursements was governed by a 1947 opinion of the Tax Court which treated the reimbursed amount as part of the selling price of the old residence (*Schairer*, 9 T.C. 549). This had the effect of providing capital gains treatment on the reimbursed amount if there was an overall gain on the sale and if the proceeds were not reinvested in a new residence. If, on the other hand, there was a loss on the sale of the old residence, the reimbursement received from the employer was not taxed.

(*b*) *General reasons for provisions.*—Your committee believes that treating reimbursements for selling expenses and "market value losses" as part of the proceeds from the sale of the old residence if the sale occurs because of an employee's transfer to a new place of work recognizes the practical effects of the transaction and treats the employee much as if he had not been required to sell his home under forced circumstances.

These transfers may be for the convenience of the employer, not the employee, and they often occur unexpectedly. In these cases the employee may be unable to sell his residence on a normal market but must dispose of it promptly, often when market conditions are most unfavorable. In many cases an employer may transfer a great many of his employees at one time. This may have a depressing effect on the home market for which the employer is largely responsible, and his reimbursements of his employees' selling expenses is only equitable.

Your committee believes that in a case of this type the employees are likely to derive no economic advantage from the reimbursements from their employers and that as a result it is unfortunate to treat these reimbursements as compensation.

(c) *General explanation of provisions.*—For these reasons, your committee's bill treats reimbursements received by employees from their employers for selling expenses and market value losses arising from the "forced" sale of their residence (within a limited period from the employee's transfer to a new place of work) as an additional amount realized on the sale of the old residence. The provision limits the amount of reimbursement which may receive this treatment to the lesser of (A) the sales differential, or (B) 15 percent of the gross sales price of the old residence. "Sales differential" for this purpose means the amount by which (A) the appraised value of the old residence exceeds (B) the gross sales price of the old residence, reduced by the selling commissions, legal fees, and other expenses incident to the transfer of ownership of the old residence. In no event, however, is the appraised value, for purposes of (1) above, to exceed the fair market value of the old residence.

The bill further provides that this treatment is to apply only where the employee sells his house during the "forced sale" period; that is, the period beginning 90 days before and ending 180 days after the date on which he commences work as an employee at his new principal place of work. In addition, for the new rule to apply, the employee's commuting distance must, as in the case of the deduction for moving expenses under section 213 of the bill, be increased by at least 20 miles. This prevents the provision from applying to purely local moves. Finally, the individual receiving the reimbursement must have been an employee of the reimbursing employer for at least 6 months prior to the transfer.

(c)(i) *Illustrations.*—The following illustrations indicate the operation of this new provision in cases where the proceeds from the sale are not reinvested in a new residence and compares the result under the new provisions with the tax consequences under the Bradley decision.

Illustrations of provision

	Case A	Case B	Case C
Gross sales price of old residence	$30,000	$30,000	$30,000
Real estate commission	1,800	1,800	1,800
Legal fees incident to closing	200	200	200
Amount of reimbursement by employer	2,000	5,000	3,000
Average of appraisals of old residence	30,000	33,000	31,000
Fair market value of old residence	30,000	33,000	30,000
Cost of old residence	20,000	33,000	30,000
Tax consequences:			
1. Sec. 232:			
(a) Ordinary income	0	500	1,000
(b) Capital gain	10,000	0	0
2. Existing law, *Bradley* decision:			
(a) Ordinary income	2,000	5,000	3,000
(b) Capital gain	8,000	0	0

Case A indicates that where a residence is sold for its full value (which exceeds its cost), reimbursements received by the transferred employee for selling commissions and closing costs serve to increase the amount of capital gain otherwise realized on the sale.

Case B shows the application of the 15-percent limitation in a situation involving a loss based upon both fair market value and the employee's cost. In this case $500 of the reimbursed amount (the portion of the $5,000 reimbursement in excess of 15 percent of gross selling price) is not considered part of the amount realized on the sale.

Case C shows the fair market value limitation. Here, the old residence was sold for its value (which equaled its cost), but the employee was reimbursed $1,000 for a "loss" he did not incur. Under the provision, this $1,000 is not considered part of the amount realized on the sale.

(c)(ii) *Effective date.*—The amendment made by this provision shall apply to reimbursements received with respect to sales contracts entered into after December 31, 1960, in taxable years ending after such date.

(d) *Revenue effect.*—This amendment is expected to result in a revenue loss of $45 million in a full year of operation.

40. Dispositions of depreciable real estate (sec. 233 of the bill and sec. 1250 of the code)

(a) *Present law.*—Under present law, taxpayers may take depreciation on real property (other than land) used in a trade or business or held for the production of income. The depreciation methods available are the same as those applying to tangible personal property. They include (1) straight-line depreciation; (2) 150 percent declining balance depreciation; (3) double-declining balance depreciation; (4) sum-of-the-years-digits depreciation; and (5) any other consistent method of depreciation which does not during the first two-thirds of the useful life of the property result in greater depreciation than under the double-declining balance method. The 150-percent declining balance method is available with respect to used real property only under certain circumstances. The last three methods of depreciation referred to are available only for property with a useful life of 3 years or more and only if the property was new property in the hands of the taxpayer.

The depreciation is allowed as a deduction against ordinary income. As the depreciation deduction is taken the cost or other basis of the real property is reduced by a like amount. If the property subsequently is sold, any gain realized on the difference between the sales price (adjusted downward for selling expenses) and the adjusted basis of the property is taxed as a capital gain if the total transactions in depreciable property and certain other property (referred to in sec. 1231) result in a gain for the year involved. On the other hand, where the aggregate of these transactions results in a loss, the net loss is an ordinary loss.

(b) *General reasons for provisions.*—Since the depreciation deductions are taken against ordinary income while any gain on the sale of the property is treated as a capital gain, there is an opportunity under present law in effect to convert ordinary income into capital gain. This occurs whenever the depreciation deductions allowed reduce the basis of the property faster than the actual decline in its value.

Congress in the Revenue Act of 1962 recognized the existence of this same problem in the case of gains from the disposition of depreciable machinery and other personal property. In that act, the Congress provided that any gain realized on the sale of these assets in the future would be ordinary income to the extent of any depreciation deductions taken in 1962 and subsequent years with respect to the property.

In the case of real estate, this problem is magnified by the fact that real estate is usually acquired through debt financing and the depreciation deductions allowed relate not only to the taxpayer's equity investment but to the indebtedness as well. Since the depreciation deductions relate to the indebtedness as well as the equity in the property, this may permit the tax-free amortization of any mortgage on the property. As a result in such cases there is a tax-free cash return of a part of the investment which may in fact enable the taxpayer to show a loss for several years which he may offset against income for tax purposes.

In 1962, Congress did not include real property in the recapture provision applicable to depreciable personal property because it recognized the problem in doing so where there is an appreciable rise in the value of real property attributable to a rise in the general price level over a long period of time. The bill this year takes this factor into account. It makes sure that the ordinary income treatment is applied upon the sale of the asset only to what may truly be called excess depreciation deductions. It does this first by providing that in no event is there to be a recapture of depreciation as ordinary income where the property is sold at a gain except to the extent the depreciation deductions taken exceed the deduction which would have been allowable had the taxpayer limited his deductions to those available under the straight-line method of depreciation. Secondly, a provision has been added which in any event tapers off the proportion of any gain which will be treated as ordinary income so that it disappears gradually over a 10-year holding period for the real estate. As a result, under the bill, no ordinary income will be realized on the sale of real estate held for more than 10 years.

(c) *General explanation of provisions.*—In view of the considerations set forth above, the House and your committee have amended present law to provide that when depreciable real estate is sold after December 31, 1963, in certain cases a proportion of any gain realized upon the sale of the property is to be treated as ordinary income; that is, previous depreciation deductions against ordinary income are to be "recaptured" from the capital gains category.

The bill accomplishes this result by treating as ordinary income a certain percentage of what is called "additional" depreciation or the amount of gain realized on the sale of the property, whichever is smaller.[1] Generally, the "additional" depreciation referred to here is that part of the depreciation deductions which exceeds the depreciation deductions allowable under the straight-line method. The depreciation deductions taken into account, however, are only those taken after December 31, 1963. Thus, they are the excess of any depreciation deductions taken under the double-declining balance method,

[1] This provision also applies to certain dispositions where there is not a sale or exchange. Therefore, the bill refers not only to the excess of the amount realized over the adjusted basis of the property but also, so that the provision will apply to these dispositions which are not sales or exchanges, it refers to the excess of the fair market value of the property over its adjusted basis.

sum-of-the-years-digits method, or other method of rapid depreciation, over the depreciation which would have been taken under the straight-line method. In the case of property held for 1 year or less, however, the deductions recaptured are to include not only the excess over straight-line depreciation, but rather the entire depreciation deductions taken.

The bill limits the depreciation recapture to the excess over straight line depreciation because it is believes that only to this extent could the depreciation taken appropriately be considered in excess of the decline in the value of the property which occurs over time. If a gain still occurs, it is believed that this is attributable to a rise in price levels generally rather than to an absence of a decline in the value of the property. The portion representing the rise in value is comparable to other forms of gains which quite generally are treated as capital gains. Moreover, it is believed that when the property is held for an extended period of time, gains realized on the sale or other disposition of the property are more likely to be attributable to price rises generally than to an excess of depreciation deductions. For that reason, the bill also tapers off over a 10-year period the proportion of the additional depreciation (or gain where smaller) which is to be treated as ordinary income upon the sale of the property.

This is accomplished by providing that the additional depreciation (or gain if smaller) which otherwise would be treated as ordinary income is to be decreased by 1 percentage point for each full month the property is held in excess of 20 full months. Thus, the amount which will be treated as ordinary income in the case of property held for a full 21 months would be 99 percent (the applicable percentage) of the amount which otherwise would be so treated. This decreases 1 percent for each succeeding month the property is held until the applicable percentage decreases to zero for property held for 10 years or more.

The property which is to be given the type of treatment described above is depreciable real property other than real property which is eligible for the investment credit. Such property is already subject to the recapture rule provided by section 1245 which generally applies to tangible personal property. The types of real property, therefore, which are not subject to this provision are property other than buildings or structural components which are used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services or represent research or storage facilities used in connection with these activities. Examples of the types of real property which, therefore, are not included under this provision are railroad track and bridges and blast furnaces.

This provision applies only to the additional depreciation allowed or allowable. Consequently, the enactment of this provision is not intended to affect the question of whether all or any part of a claimed deduction for depreciation is in fact allowable. For example, since in the year real property is sold the actual value of the property is known, it has been held that depreciation deductions should not be allowed to the extent they reduce the adjusted basis of the property below the actual amount realized. This provision, in providing for ordinary income treatment for certain additional depreciation, is not intended to affect this holding.

(*c*)(*i*) *Substantial improvements.*—Because the percentage of additional depreciation (or gain, if smaller) decreases after the first 20 months by 1 percent a month, it is necessary to determine when property has been acquired. This presents a special problem where real estate already held is substantially improved. To consider the substantial improvement as being held for the same period as the original investment in the property would mean that where property has been held for 10 years or more there would be no ordinary income arising with respect to substantial improvements, even though these improvements might have been made within the last few years. To prevent avoidance of the ordinary income treatment provided by this provision, the bill defines a "separate improvement" which is treated as a separate element for purposes of determining the amount treated as ordinary income upon the sale or exchange of real property. Appreciation which may be treated as ordinary income is divided up among the separate elements in accordance with the additional depreciation deductions with respect to each element.[1]

A separate improvement is intended by the bill to be only an improvement which is of a substantial nature. Lesser improvements are treated as if they were a part of the original structure and do not take a new, or separate holding period for purposes of determining the proportion of the additional depreciation (or gain, if smaller) treated as ordinary income. As a result, separate improvements are defined under the bill as arising only where the cost of the improvements in question is greater than the largest of the following three amounts—

1. 25 percent of the adjusted basis of the property;
2. 10 percent of the original cost of the property plus the cost of any improvements made prior to those being considered here less the cost of retired components; or
3. $5,000.

These tests are applied over a 3-year period. Thus, if improvements made in any 3-year period increase the adjusted basis of the property before that period by 25 percent or more or exceed the amount specified under the other tests if larger, then this entire amount will be treated as a separate improvement. The 25-percent adjusted basis test in this case is expected to be the principal test applied; however, the 10-percent test will prevent a relatively moderate improvement in a fully, or almost fully, depreciated building from being classified as a substantial improvement. The $5,000 limitation is intended as a de minimis rule below which no aggregate amount in a 3-year period would be treated as a substantial improvement.

In applying the above test for determining whether an improvement is to be treated as substantial, improvements in any one of the 3 years are to be omitted entirely if they do not amount to at least $2,000, or 1 percent of the original cost of the property plus the cost of any improvements previously made (less the cost of retired components), whichever is the greater. As in the case of the $5,000 limitation, which applies over the 3-year period, these exceptions are designed as a de minimis rule to make it unnecessary to treat as separate improvements relatively minor improvements made in any one of the 3 years which may be involved in the computation in question.

In the future additional depreciation allowed over straight line depreciation is to be subject to recapture not only in the case of the

[1] In addition to the separate improvements, the bill also treats as separate elements units of real property which were placed in service at different times before initial completion of the building.

double-declining balance and other forms of rapid depreciation available only in the case of new property, but also the excess over straight line depreciation is to be recaptured in the case of depreciation, such as the 150-percent declining balance depreciation which presently is permitted with respect to used real property under certain circumstances.

(c)(ii) *Disposition where ordinary income is recognized.*—Ordinary income under the bill is recognized not only in the case of the sale or exchange of real property but also in the case of all other types of dispositions unless a specific exception is provided. Thus, as in the case of the provision enacted in 1962 in connection with tangible personal property, this provision may result in the recognition of ordinary income even though capital gain might not otherwise have been realized at the time of such a disposition. The bill provides seven general categories of exceptions, however, where dispositions are not to result in the recognition of any ordinary income.

The first exception is for gifts. Thus, the making of a gift for this purpose will not be a taxable event. However, the depreciation deductions of the donor in such a case are carried over to the donee. As a result, if the donee subsequently sells the real property, there may be ordinary income recognized by him as a result of depreciation deductions taken by the donor. The donee in such a case, however, will receive the benefit of the holding period of the donor. The effect, therefore, of this is to treat the donor and donee for purposes of this provision as if they were one person, with the result that upon the subsequent sale by the donee of the property, the same amount (if any) will be treated as ordinary income as if the donor held the property throughout the entire period. Similarly, in determining the percentage decrease in total gain to be taken into account as ordinary income, the holding period of both the donor and the donee is taken into account. This, of course, means that a smaller proportion of the gain will be treated as ordinary income than would be true if only the donee's holding period were used for this purpose.

In the case of real property which is given to a charitable organization, although no income is realized by the donor at the time of the gift, the bill provides that the amount of the charitable contribution deduction he may receive is reduced by the amount which would have been treated as ordinary income had the real property been sold at its fair market value (amendment to sec. 170(e)). This conforms with the treatment provided in 1962 by Congress with respect to tangible personal property contributed to a charity.

A second exception to the recognition of ordinary income upon the disposition of real property is provided in the case of transfers at death (except where the sale has occurred before death, in which case the amount is treated as income with respect to a decedent under sec. 691). In this case, however, there is no carryover of the income potential of the depreciation deductions to the decedent's devisee or heir.

A third category of exceptions to the recognition of ordinary income is provided in the case of a series of transactions which generally are tax free and in which the basis of the real property is carried over from the former to the new owner. However, in these transactions where there is any gain recognized because the exchange is accompanied by "boot" (i.e., money or its equivalent) then to the extent of this gain, ordinary income may be recognized or to the extent of the applicable percentage of the additional depreciation deductions if smaller. The tax free transactions referred to relate to those occurring upon the complete liquidation of a subsidiary (sec. 332); in the case of a transfer for stock or securities to a corporation controlled by the transferor (sec. 351); in the case of a transfer of property by a corporation which is a party to a reorganization in pursuance of a plan of reorganization solely for stock or securities in another corporation also a party to the reorganization (sec. 361); and in the case of reorganizations in certain receivership and bankruptcy proceedings (secs. 371(a) and 374). Also included in the same category are contributions of real property to a partnership in exchange for an interest in the partnership, and distributions by a partnership of real property in partial or complete liquidation of an interest in the partnership (but in this respect, see the special partnership treatment described below). Under the bill, however, there will be a recognition of ordinary income where there is a contribution of depreciable property to a tax exempt organization (other than an exempt farm cooperative) in exchange for stocks or securities in the exempt organization. Recognition of gain in this case, as in the case of tangible personal property in the provision added last year, is provided because a disposition of the property by the exempt organization ordinarily would escape the realization of the ordinary income with respect to these deductions.

A fourth category of exceptions is provided in the case of so-called like-kind exchanges of real property used for production or investment and for involuntary conversions. In exchanges of these types, the ordinary income recognized is in general limited to any appreciation in value attributable to depreciable real property which is not reinvested, after the exchange or involuntary conversion into other depreciable real property. Thus, ordinary income will be recognized to the extent of the additional depreciation, decreased according to the holding period involved, or by the following amount of appreciation, whichever is the smaller. First, to the extent that the exchange or conversion results in actual gain being recognized, this will be treated as ordinary income under the general rule. Second, this gain will be increased by stock purchased in a corporation even though under the involuntary conversion provision this generally would not result in the recognition of gain. This amount is treated as potential ordinary income since any subsequent sale of the stock does not represent the sale of a depreciable asset and, therefore, it would not be possible in this event to recapture the depreciation. Third, to the extent of any remaining appreciation represented by real property, ordinary income is recognized to the extent this unrealized appreciation cannot be included in the basis of the newly acquired real property. Under this provision, the newly acquired real property will, upon its sale or other disposition, give rise to the same ordinary income, decreased according to the holding period for the newly acquired property, as would the previously held real property (except to the extent that ordinary income was recognized at the time of the conversion). The holding period for purposes of determining the percentage of the additional depreciation which is to be treated as ordinary income is begun anew with respect to the exchange or converted property, but the new holding period applies only to the percentage of the gain which would have been taken into account had the property held been sold at the time of the exchange or conversion.

A fifth exception is provided in the case of the exchange or sale of property in obedience to Federal Communications Commission orders or orders of the Securities and Exchange Commission (secs. 1071 and 1081). In these cases, also, the ordinary income includes not only the actual gain recognized but also the appropriate percentage of any depreciation charges unrecovered at the time of the sale or exchange which are not reinvested in other depreciable real property.

A sixth exception is provided in the case of distributions of real property by a partnership to a partner. A distribution of real property by a partnership to a partner, to the extent that the distribution represents the partner's share of unrealized appreciation attributable to this property, is not to result in ordinary income to the distributee partner at the time of the distribution. However, the unrealized appreciation representing additional depreciation taken by the partnership will be carried over to the distributee partner. When he disposes of this real property, the unrealized appreciation represented by these partnerships (or by an earlier transferee where the partnership acquired the property without recognizing gain), additional depreciation deductions will be taken into account in a manner substantially the same as that applying where the taxpayer himself took the depreciation deductions. This rule applies only to the extent a partner is considered as receiving his share of the real property to which is attributable potential ordinary income. An amendment made elsewhere to the code (sec. 751(c)) provides that in other cases the ordinary income element in real property is to be considered as "unrealized receivable." Thus, to the extent of applicable percentage of the additional depreciation deductions taken (or potential gain, if smaller) ordinary income will be recognized in the case of the sale of a partnership interest, in the case of a distribution to a retiring or deceased partner, and in the case of distributions to a partner where he receives either more or less than his proportionate share of real property reflecting this ordinary income.

A seventh exception deals with the case where the property being disposed of by the taxpayer is his principal residence. Under present law (sec. 1034) where the taxpayer sells his principal residence and within a year before or after this sale (18 months after in the case of the construction of a new home) purchases or builds another, then any gain realized on the sale of the first residence is not recognized for tax purposes to the extent the total proceeds from the sale of the first residence are invested in the second. The bill provides that in cases of this type, to the extent the full proceeds from the sale of the first residence are reinvested into a second, no ordinary income is to be recognized at that time.

Similarly, the bill provides no recognition of ordinary income potential with respect to the provision incorporated elsewhere in this bill (sec. 206 of the bill) which provides that no gain is recognized by a taxpayer age 65 or over who sells a home which he has used as a personal residence and owned for 5 out of the last 8 years.

As in the case of the provision enacted in 1962 relating to tangible personal property, the House and your committee in this provision found it necessary to recognize ordinary income in cases where capital gain is not recognized under existing law. This was done primarily in those cases where the transferee receives another basis for the property than that of the transferor. This treatment is provided in three types of cases where a distribution is made by a corporation without the payment of a tax at the corporate level on unrealized appreciation in value; namely, where the real property is distributed as a dividend (sec. 311), where the real property is distributed as part of a partial or complete liquidation by a corporation (sec. 336), and where in a plan of complete liquidation a corporation sells the real property (and perhaps other assets) and within a 12-month period completes the liquidation of the corporation (sec. 337). Similarly, if the real property is first sold by a corporation for installment notes and the gain which would be realized on such sale is delayed because of the installment method of reporting, a distribution of these notes to the shareholder in a liquidation under section 337 (12-month liquidation) results under this bill in the recognition of the same amount of ordinary income of the corporation as would have been realized on a cash sale of these notes. The same rule is applied whenever similar installment notes are distributed by a corporation in a liquidation in which the basis of the real property to the receiving shareholder is determined under section 334(b)(2) (purchase of 80 percent of the stock of one corporation by another corporation followed by immediate liquidation of the corporation acquiring). The other situations where ordinary income may be realized under this provision although capital gain would not otherwise occur, include the case where distribution is made by a partnership and the partner gives up, or acquires, more than his proportionate share of this real property. Other cases include the provision relating to the exchange of like-kind property, involuntary conversions, sales or exchanges to effectuate FCC policy, and exchanges in obedience to orders of the SEC. In all of these cases where the property received in exchange for depreciable real property is not itself depreciable real property, then ordinary income is recognized.

(c)(*iii*) *Leasehold improvements.*—Improvements made to property held under a lease by a lessee present a special problem in determining what is the amortization period equivalent to the straight-line depreciation method selected as the norm in the usual case. Present law (sec. 178) in general provides that leasehold renewal periods are to be taken into account in determining amortization or depreciation with respect to any year if the initial lease period remaining is less than 60 percent of the useful life of the building or other improvement, or if less than 75 percent of the cost of the lease is attributable to the remaining portion of the initial lease period, and if it is more probable that the lease will be renewed, extended, or continued than that it will not. Such a test is appropriate when looking forward to amortization deductions in future years. However, it does not represent an adequate norm for the measurement of excess or additional depreciation after the deduction has been taken and the lease is being sold.

As a result, the bill provides that in determining the norm for purposes of specifying additional depreciation which may be treated as ordinary income, periods for which a lease may be renewed, extended, or continued under an option exercisable by the lessee are generally to be taken into account. However, the renewal periods so taken into account are not to extend the amortization period by more than two-thirds of the initial lease period remaining after the improvement was made. Thus, in the case of a 6-year lease with a 6-year renewal period, only 4 additional years are to be taken into account in determining the amortization period of an improvement made at the beginning of the initial lease. Thus, in this case, the amortization payments with respect to the lease would be spread over a 10-year period and payments in excess of such a spreading would be considered additional depreciation adjustments. However, if the useful life of the asset itself in such a case were less than 10 years, then the depreciation deductions would be spread for this purpose in a straight-line method over the useful life of the asset, and this would be used as the measure in determining additional or excess depreciation adjustments.

(c)(iv) *Effective date.*—This provision is to apply with respect to depreciation attributable to periods after December 31, 1963, and to dispositions of property after that date.

(d) *Revenue effect.*—Since this provision relates only to depreciation deductions in 1964 and subsequent years, the initial revenue impact of this bill is expected to be small. In fiscal year 1965, it is expected that this provision will result in a revenue gain of about $5 million. In subsequent years, however, when the provision becomes fully effective, it is anticipated that it will result in a revenue gain of approximately $15 million a year.

41. Income averaging (sec. 234 of the bill and secs. 1301–1305 of the code)

(a) *Present law.*—Present law does not provide any generally available income averaging provision for the persons whose income fluctuates widely from year to year. Instead, present law contains six specific averaging provisions dealing with special types of situations: Certain compensation for personal services, income from inventions or artistic work, certain income from backpay, compensation for damages for patent infringements, breach of contract damages, and damages for injuries under the antitrust laws.

In the case of the provision relating to compensation for personal services and that relating to inventions and artistic works, in order to be eligible for this treatment, the employment involved must have covered 36 months or more in the case of the compensation for personal services, and in the case of the work on the inventions or the artistic works must have covered a period of 24 months or more. In addition, eligibility under these same two provisions required that the receipts of the payments involved with respect to the work be heavily concentrated in 1 year. In the case of compensation for personal services, 80 percent or more of the total compensation for the employment must have been received in the taxable year in question. In the case of the invention or artistic work, the amount received in the year in question must not be less than 80 percent of the gross amount received with respect to the invention or artistic work in the taxable year, all prior years, and the succeeding 12 months. The backpay provision also has a somewhat similar provision. To be eligible for averaging in the case of backpay, the amount of backpay received in the taxable year must exceed 15 percent of the gross income for that year.

In the case of all of the present averaging devices, the averaging is achieved by providing that the tax involved is not to be greater than if this income were spread back, either ratably over the period to which the income relates, or to the specific years to which the income relates. However, in the case of income from inventions, the spread back for this purpose may not exceed 60 months, and in the case of artistic work it may not exceed 36 months. The other averaging provisions are not limited in this respect. The tax in each case, although imposed as of the current year, is determined by making a recomputation with respect to one or more back years.

(b) *General reasons for provisions.*—A general averaging provision is needed to accord those whose incomes fluctuate widely from year to year the same treatment accorded those with relatively stable incomes. Because the individual income tax rates are progressive, over a period of years those whose incomes vary widely from year to year pay substantially more in income taxes than others with a comparable amount of total income but spread evenly over the years involved. This occurs because the progressive rates take a much larger proportion of the income in taxes from those whose incomes in some years are relatively high. The absence of any general averaging device has worked particular hardships on professions or types of work where incomes tend to fluctuate. This is true, for example, in the case of authors, professional artists, actors, and athletes as well as farmers, fishermen, attorneys, architects, and others.

The present averaging provisions have proved unsatisfactory, first because they are limited to a relatively small proportion of the situations where averaging is needed. Thus, while they presumably cover inventors and writers, they do not provide for actors, athletes, and in most cases do not provide for attorneys, architects, and others. Even in the case of inventors and authors, the present provision is inadequate because of the requirement that the income arise over at least a 24-month period and 80 percent or more of the income from the invention or work be concentrated in the current year in question. In practice, many cases involving authors and inventors where averaging is needed do not meet these specific requirements. This was made clear in testimony from authors and others.

The present averaging provisions also have proved unduly complicated in practice because of the requirement that the prior years' incomes and taxes must be recomputed as if the income had actually been received in those prior years.

Your committee agrees with the House that income averaging should be designed to treat everyone as nearly equally for tax purposes as possible, without regard to how their income is spread over a period of years and without regard to the type of income involved. At the same time, it is necessary to have any income averaging device in a form which is workable, both from the standpoint of the taxpayer and the Internal Revenue Service.

Although the bill generally repeals the averaging devices in present law (secs. 1301–1307), it is recognized that cases may arise where a person has entered into long-term contingent employments upon the assumption that the averaging device in present law applicable to compensation from an employment would be available. Since employments in some cases may last for extended periods of time, such as 20 years, the general 5-year averaging device might produce less favorable treatment than the present provision. As a result, the bill provides, in the case of these long-term employments which were already in being before 1963, for the taxpayers involved to continue the form of averaging available under present law if they elect to forgo the general 5-year averaging provided in this bill.

(c) *General explanation of provisions.*—In view of the considerations set forth above, the bill deletes all of the averaging provisions in present law referred to previously and substitutes instead an income averaging device available to individual taxpayers generally, substantially without regard to the source of the income. As indicated subsequently, however, in the case of the averaging device for compensation from an employment, the bill in certain cases permits the continuance of the application of this provision.

Under the averaging rule provided by the bill, once the amount of income to be averaged is determined—called averageable income in the bill—and assuming this amount is more than $3,000, the taxpayer is to compute a tentative tax on one-fifth of this amount. The tax on this one-fifth is determined by adding this one-fifth to 1⅓ times the average income received in the prior 4 years, plus the average capital gains income in this same 4-year period. The tax attributable to this one-fifth is then multiplied by 5 to determine the final tax on this income.

Averaging is available only where the "averageable income" exceeds $3,000 because, with the present progressive rate structure with tax brackets usually of $2,000 to $4,000, smaller amounts achieve little if any benefit from averaging. The device of including one-fifth of the averageable income in the tentative tax base, computing the tax attributable to this amount, and then multiplying this result by 5, achieves a result which is substantially similar (except when there are rate changes during the 5 years) to including one-fifth of the income eligible for averaging in the taxable income base of each of the prior 4 years and of the current year. The advantage of making the computation in this manner is that it is not necessary to recompute the tax for each of the 4 prior years in order to obtain this result.

The "averageable income" referred to here is the excess of the taxable income in the current or computation year—with certain adjustments—over 1⅓ times the average base period income. The average base period income is the average of the taxable income in the 4 prior years with certain adjustments specified below.

Averageable income is limited to that which is in excess of 1⅓ times average income in the base period for two basic reasons. First, in any new provision of this type, it is necessary to limit the number of cases to which the new provision will apply to a manageable level from the administrative standpoint. In other words, it was necessary initially, at least, to limit the volume of cases where averaging will be applied. Moreover, it is clear that the greatest need for averaging occurs where the fluctuation in income levels varies widely. An increase of more than one-third from the prior average income was selected to make the new averaging rule available in those cases where it is needed the most.

As indicated above, in computing the income subject to averaging, it is necessary to make some adjustments in both the income of the current, or computation year, and also in the income of the 4 base period years with which the current year's income is compared. The income of the computation year, referred to in the bill as the "adjusted taxable income" is the taxable income for that year decreased by: (1) Any capital gain net income for that year; (2) any income for that year attributable to gifts, bequests, devises, or inheritances received during that year or any of the four prior base period years; [1]

[1] Income attributable to gifts, bequests, devises, or inheritances between a husband and wife are not taken out of the income for the computation year if they file a joint return for the computation year or one of them makes a return in that year as a surviving spouse. Also not taken into account are amounts of less than $3,000 in computation year.

(3) any excess of wagering gains in the year over wagering losses; and (4) certain amounts of income to which penalties apply with respect to owner-employees who are self-insured for pension plan purposes (sec. 72(m)(5)).

Long-term capital gains are excluded from the income subject to averaging in the computation year on the grounds that such income does not require averaging because of the fact that only 50 percent of the capital gain income is included in the tax base in any event. Moreover, without regard to the averaging provision, such income is subject to a maximum rate of 25 percent.

Averageable income also excludes income from gifts, devises, or inheritances where the gifts, etc., have been received either in the computation year or in any of the four prior base period years, because such income does not arise from any additional efforts on the part of the taxpayer but merely represents a transfer to the taxpayer of income previously received by someone else. In addition, in the case of the transfer by gift of income producing properties between related parties, there would be some opportunity for manipulation if such income were not excluded from that which can be averaged. Income attributable to such property is excluded under the bill only where it is in excess of $3,000 in the computation year. Also, because it may be difficult to trace specific income to specific gifts, bequests, devises, or inheritances, the bill presumes that such property earns a 6-percent rate of return unless the taxpayer establishes to the satisfaction of the Treasury that some other amount of income is earned with respect to the property.

Net wagering gains are excluded from averageable income to prevent such income from receiving a preferred status. For similar reasons, penalty income of owner-employees in the case of self-insured pension plans is excluded.

It is also necessary to make some adjustments in the base period income with which the adjusted taxable income for the computation year is compared. Two of these adjustments are the same as those made in the computation year. Thus, capital gain net income for the base period year is excluded as is any income from gifts, bequests, devises, or inheritances where such property was initially received by the taxpayer in 1 of the 4 base period years.

A third adjustment made to the average base period income is to add back to such income any income excluded from the taxpayer's base in such year on the grounds that it was earned in a foreign country (the exclusion under sec. 911 of present law) or on the grounds that it was income from sources within a possession of the United States (sec. 931 of present law). The inclusion of such amounts in the base period is necessary so that the taxpayer will not become eligible for averaging merely on the grounds that during the 4-year base period, or a part of this period, he was in a foreign country and not subject to U.S. tax on his earned income. If such amounts are not included in the base period income comparable amounts earned in the United States in the computation year would be eligible for averaging.

(*c*)(*i*) *Example.*—For most taxpayers with little or none of the income which gives rise to the special exceptions described above the application of this averaging provision is relatively simple. This can be illustrated by an example of an unmarried taxpayer having an average base period income of $3,000 in the years 1961–64 and an adjusted taxable income of $44,000 in 1965. The taxpayer in this case is eligible for averaging since his "averageable income" exceeds $3,000. His averageable income in this case can be computed as follows:

1. Adjusted taxable income in computation year	$44, 000
2. 133⅓ percent of average base period income ($3,000× 133⅓ percent)	4, 000
3. Averageable income	40, 000

Since the averageable income is in excess of $3,000, the entire amount is subject to averaging.

Computation of tax:

(a) 133⅓ percent of average base income ($3,000× 133⅓ percent)	4, 000
(b) Averageable income included in tentative tax base (⅕ of $40,000)	8, 000
(c) Tentative taxable income	12, 000
(d) Total tentative tax liability (1965 rates under bill)	2, 830
(e) Tax on $4,000 not subject to averaging	690
(f) Tax liability on ⅕ of averageable income	2, 140
(g) Tax on total averageable income ($2,140× 5)	10, 700
(h) Total final tax liability (tax on $4,000 not subject to averaging and $40,000 subject to averaging)	11, 390
(i) Tax on $44,000 under 1965 rates without averaging	18, 990

(c)(ii) *Treatment of capital gains and priority of taxing different types of income.*—As previously indicated, net capital gains—any excess of net long-term gains over capital losses—are excluded from the adjusted taxable income for the computation year in determining how much of this income is to be eligible for averaging and also from the average base period income. Thus, generally, capital gains (other than short-term capital gains) have no effect in determining the income subject to averaging. There is one exception to this general rule, however. If the average capital gain net income in the base period exceeds the capital gain net income in the computation year, then to the extent of this excess the income subject to averaging is reduced. Generally, it was thought that capital gains should be set apart and not taken into account in averaging since they, in effect, have their own specialized form of averaging. However, in those cases where the average capital gains in the base period exceed the capital gains in the computation year, it is believed that averaging should be permitted only when total taxable income of the current year is substantially greater than the average of the base period.

The bill provides that in determining the tax which is attributable to the income subject to averaging, the first income subject to tax is to be the ordinary income not eligible for averaging. In the example previously presented, this meant that the $4,000 of income not subject to averaging was considered to be the income subject to the first income brackets. The income subject to the next higher income rates is the capital gain net income of the computation year but only to the extent [1] this does not exceed the average base period capital gain net income. Following this is the income subject to averaging, with respect to which one-fifth is included, the tax then computed, and the result multiplied by 5. Any remaining capital gains income in the computation year, in excess of average base period capital gain net income, is treated as coming on top of this income subject to averaging along with income from wagering or gifts, bequests, devises, or inheritances, which is not eligible for the averaging treatment.[2]

[1] Actually this amount is preceded by an amount equal to any excess of average base period capital gain over capital gains of the computation year in those infrequent cases where such income exists.

[2] The penalty income with respect to owner-managers in connection with receipt of pension-type income is treated as if the averaging provision did not apply.

The alternative capital gains tax in such a case is determined by applying 25 percent to the long-term capital gains. This tax then is compared with the tax attributable to the capital gains in the computation explained above. The reason for structuring the tax base in the manner indicated is to give assurance that the income subject to averaging is taxed, as nearly as possible, at the same income level as would be the case had such income been earned ratably over the current year and 4 prior years.

(c)(iii) *Eligible individuals.*—To be eligible for averaging, one of the principal concerns is that the individual's income must have been subject to tax by the United States throughout the entire base period as well as the computation year. No one is eligible for averaging who was a nonresident alien in any of the 4 base period years or in the computation year. To be eligible for averaging, the individual must be a citizen or resident in the computation year. In addition, even though a citizen in the computation year, the individual must be claiming no exclusion in that year for income earned abroad. He may have claimed such an exclusion with respect to a base period year, but, for purposes of determining his income in the computation year subject to averaging, this income is added back to his base period income.

A second concern of this provision is that the individual be a member of the labor force in both the computation year and in the 4 base period years. It has been necessary, however, to approximate this result in some cases. The general rule provides that the individual and his spouse must have furnished one-half or more of his own support in each of the base period years. However, it was not intended to exclude from the benefits of the averaging provision an individual who, although in the labor force, was unemployed in part or all of the base period years. For that reason, individuals generally are eligible for averaging if they are 25 years old and there have been at least 4 years since the individual attained age 21 when he was not a full-time student. Thus, generally, individuals age 25 or over will be eligible for averaging so long as they have been out of school for at least 4 years since age 21. A second exception is provided for the individual who, although not self-supporting in the 4-year base period, nevertheless, has income in the current year more than half of which is attributable in substantial part to work he has done in two or more of the base period years. This is designed to make sure that those who have performed some work of a substantial nature which occurred over a period of years will be eligible for averaging even though below the 25-year age limit. A third exception is provided for an individual who was not self-supporting in the base period and who makes a joint return with someone else if not more than 25 percent of the total adjusted gross income of the couple in the computation year is attributable to the individual in question. This means that an individual who has been in the labor force and who marries someone who was a dependent of another will not be deprived of averaging, assuming three-quarters or more of the income in the computation year is attributable to the individual who was in the labor force in the base period. This is designed to assure that a man who marries a woman who was a dependent of her father during part or all of the base period years is not deprived of income averaging as a result of this marriage.

(c)(iv) *Special rule with respect to marital status.*—No problems arise in applying the averaging provision where a husband and wife file a joint return in the computation year and also did so in each of the base period years. However, it is necessary to reconstruct their income where they either filed separately (or with other spouses) in the base period years or are filing separately in the computation year. For example, if a married couple files a joint return in the current year but filed separate returns for one or more base period years, their base period income for purposes of averaging in the current year will be their combined base period incomes for their base period years. In addition, the bill provides that an individual's base period income is to be either his actual base period income in each of the base period years or, if higher, 50 percent of the combined base period income of him and his spouse.[1] In determining actual income for purposes of this provision, community property laws are not to be taken into account with reference to income from personal services. Thus, the actual income attributed to an individual will be the income earned by him without regard to whose income it is considered to be under community property law.

(c)(v) *Continuance of present averaging device in certain cases.*—The bill provides that the averaging device in present law with respect to compensation from an employment is to continue to be available if the taxpayer so elects where he receives or accrues compensation from employment which began before February 6, 1963. If the taxpayer elects this treatment he must forgo for that year the generally available averaging device and the carryover of certain excess charitable contributions.

This provision, which on this elective basis is continued for compensation for the employment begun before the specified date, provides in general that the employment must cover a period of 36 months or more and that the gross compensation from the employment received by the individual (or partnership) in the year in question must not be less than 80 percent of the total compensation for such employment. Where these conditions are met, present law provides that the tax is not to be greater than if the compensation had been included in the gross income of the individual ratably over the period of the employment prior to the date of the receipt or accrual.

(c)(vi) *Effective date.*—The amendments made by this provision apply to taxable years beginning after December 31, 1963. This means that averaging will be available for the first time with respect to taxable years beginning in 1964. This will involve base period years as far back as 1960. However, as indicated previously, the averaging device in present law relating to compensation from employment where the employment began prior to February 6, 1963, may continue to be applicable for taxable years beginning after December 31, 1963, at the election of the taxpayer.

(d) *Revenue effect.*—This provision is expected to result in a reduction of $40 million of tax liabilities in the calendar year 1964 and subsequent years.

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[1] If the individual involved was married to another person in one or more of the base period years, his base period income is to be not less than 50 percent of his income in that year combined with the income of whichever spouse had the higher income.

42. Small business corporations: Ownership of certain stock disregarded (sec. 235(a) of the bill and sec. 1371 of the code)

(*a*) *Present law.*—In 1958 Congress added to the Internal Revenue Code a new subchapter (sec. 1371 and following) which provides that the earnings of certain small business corporations may be taxed to the shareholders of the corporation (rather than taxing the corporate entity as such) in a manner somewhat similar to the way partnership earnings are taxed to the partners rather than to the partnership. Where the tax treatment provided by this subchapter is elected, the shareholders include in their own income for tax purposes the current taxable income of the corporation, both the dividends which have been distributed and the portion of the earnings which are still retained by the corporation. This treatment was provided in order to permit businesses to select the form of business organization desired without the necessity of taking into account major differences in tax consequences.

The right to elect the treatment provided under the new subchapter was limited to small business corporations in part because of the complexity involved in passing the earnings of a corporation through to its shareholders where the stock of the corporation is held by a widely diversified group of shareholders, and in part because it was thought that only the relatively small corporations were essentially comparable to the partnership or proprietorship where the earnings are taxed to the owners rather than to the business organization. As a result, Congress provided that corporations making this election must be domestic corporations which are not eligible to file a consolidated return with any other corporation. Also, they must have not more than 10 shareholders, their shareholders must all be individuals (or estates), no nonresident aliens may be shareholders, and the corporations may not have more than one class of stock.

(*b*) *General reasons for provision.*—Situations have been called to your committee's attention where corporations are denied the privilege of electing to have their income taxed to their shareholders (rather than to the corporation) merely on the grounds that the corporation owns the stock of completely inactive subsidiaries.

The establishment of inactive subsidiaries is a common business practice for corporations planning for future growth. Such corporations often desire to reserve their corporate name in States in which they are not yet doing business by establishing subsidiaries with the same or a similar name to that of the parent corporation. Your committee sees no reason to penalize the parent corporation by denying it the privilege of electing to pass the income through to its shareholders for tax purposes merely because, for business reasons, it has established these inactive subsidiaries which constitute an affiliated group which could file a consolidated return.

(*c*) *General explanation of provision.*—As a result of the considerations set forth above, this provision adds a new subsection to section 1371 of the code providing that a corporation will not be considered a member of an affiliated group for purposes of this election (and, therefore, not be denied the right to elect subch. S status) merely because it owns stock in another corporation which is inactive. An inactive corporation, in this case, is one that has not begun business after the date of its incorporation and before the end of the parent corporation's taxable year in question and that does not have taxable income for this taxable year. If these conditions are met and the parent is not affiliated with any other corporation, an election may be filed under subchapter S by the parent corporation despite the rule that a subchapter S corporation may not be a member of an affiliated group. However, if the subsidiary corporation does not meet the conditions set forth above in a subsequent year, the parent corporation's subchapter S status would be terminated at that time.

(c)(i) *Effective date.*—This bill is effective for taxable years of corporations beginning after December 31, 1962.

(d) *Revenue effect.*—It is estimated that this provision will result in a negligible loss of revenue.

43. Small business corporations: Certain distributions of money after close of taxable year (sec. 235(b) of the bill and sec. 1375 of the code)

(a) *Present law.*—As indicated above, the earnings of small business corporations may be taxed to the shareholders of the corporation in a manner somewhat similar to the way partnership earnings are taxed to the partners rather than to the partnership. The shareholders are taxed each year on the dividend income received from the corporation plus any additional earnings of the corporation which are retained by it rather than distributed. If in a particular year such a corporation does not in fact distribute its earnings, any distributions in a later year are treated as dividend distributions to the extent of the earnings and profits of that later year. In addition, if in that later year the corporation has ceased being an "electing small business corporation" then all distributions are treated as being dividends to the full extent of both current and accumulated earnings and profits.

(b) *General reasons for provision.*—The rule stated above has created a problem where an electing small business corporation sells a capital (or depreciable) asset, adopts a resolution to distribute to its shareholders all or part of the proceeds of such sale, and then actually does distribute such proceeds in the year immediately following the year of sale. In such a case, even though the shareholders pay tax on the full capital gains in the year of the sale, the distribution to them in the later year will be treated as an ordinary dividend at least to the extent of the current earnings and profits of the later year. The result will be even harsher if in the later year the corporation has ceased being an electing small business corporation, because in this case the distribution will be a dividend to the extent of both the current and the accumulated earnings of the corporation.

(c) *General explanation of provision.*—To prevent the result described above, your committee's bill adds a provision to the effect that in the case of an electing small business corporation a distribution of money to the shareholders on or before the 15th day of the third month following the close of a taxable year, may, at the election of the corporation, be treated as a distribution of money made on the last day of the taxable year in question. This election is available whether or not the corporation involved is an electing small business corporation in the second year.

(c)(i) *Effective date.*—This amendment applies to taxable years beginning after December 31, 1957.

(d) *Revenue effect.*—It is anticipated that this provision will result in a negligible loss of revenue.

44. Repeal of additional 2-percent tax for corporations filing consolidated returns (sec. 236 of the bill and sec. 1503 of the code)

(*a*) *Present law.*—Under present law a consolidated income tax return may be filed by a group of parent and subsidiary corporations where there is 80 percent control of each level of the chain of corporations, and there is a common parent corporation; 80 percent control, in this case, means 80 percent of the voting power of all classes of stock and at least 80 percent of each class of nonvoting stock. In the consolidated return, intercompany transactions are washed out, and it is possible to offset losses of one corporation against the gains of other members of the group. These intercompany transactions which are washed out also include intercompany dividends. As a result, dividends may be paid from one company in a consolidated group to another of the same group without the second member including in its income 15 percent of this dividend income.

Under present law, where the election to file a consolidated return is made, a special tax is levied equal to 2 percent of the consolidated taxable income of the group.

(*b*) *General reasons for provision.*—The bill removes the special 2-percent penalty tax on the privilege of filing a consolidated return, in part because the return of commonly controlled corporations as a single economic unit for tax purposes is in accord with the reality of the situation. Moreover, there appears to be no reason why, where a group of commonly controlled corporations are willing to have their operations consolidated for tax purposes, the mere presence of more than one corporate organization in the group should result in any penalty tax. No such penalty, for example, is exacted in the case of other corporate organizations operating through divisions rather than separate corporations.

In addition, the removal of this 2-percent penalty tax should encourage the filing of consolidated returns and serve as a brake on the expansion of the use of multiple surtax exemptions to gain tax advantages.

(*c*) *General explanation of provision.*—In view of the considerations set forth above, both the House and your committee's version of the bill repeals the special 2-percent tax on consolidated returns, effective with respect to taxable years beginning after December 31, 1963. This 2-percent tax presently applies to the consolidated taxable income of the affiliated group of includible corporations.

(*d*) *Revenue effect.*—The repeal of the 2-percent tax on consolidated corporate returns is expected to decrease revenues by $50 million a year.

45. Reduction of surtax exemption in case of certain controlled corporations (sec. 237 of the bill and secs. 1561–1563 of the code)

(*a*) *Present law.*—Under present law, corporations are taxed at a 30-percent rate on the first $25,000 of their taxable income and at a 52-percent rate on all income over that amount. This tax rate differential results from the fact that the first $25,000 of income of a corporation is subject to the 30-percent normal tax but is exempt from the 22-percent surtax, while income in excess of $25,000 is subject to both the 30-percent normal tax and the 22-percent surtax. This tax structure was intended to encourage small businesses which operate in corporate form. However, medium and large enterprises have in some cases taken advantage of the lower rates afforded small business by organizing their corporate structure in multiple corporate form.

As a result, the Internal Revenue Code contains several provisions designed to prevent taxpayers from using the multiple form of corporate organization, to avoid taxes. For example, present law provides (sec. 269) that where an individual or corporation acquires control of a corporation and the principal purpose of the acquisition is the evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance, this deduction, credit, or allowance is not to be allowed. Also, elsewhere (sec. 1551) present law provides that if a corporation transfers part or all of its property (other than money) to another corporation created to acquire the property, or not actively engaged in business at the time of the transfer, and if there is common control of the two corporations, then the transferee corporation is not to be allowed the $25,000 surtax exemption or the $100,000 accumulated earnings credit unless it establishes by the clear preponderance of the evidence that the securing of the exemption or credit is not a major purpose of the transfer. In addition, present law (sec. 482) provides that where two or more corporations are owned or controlled directly or indirectly by the same interest, the Secretary of the Treasury or his delegate may allocate deductions, credits, or allowances between or among these corporations, if he determines that this is necessary to prevent evasion of taxes or clearly to reflect the income of the corporations.

(*b*) *General reasons for provision.*—This bill reduces the tax applicable to the first $25,000 of taxable income from 30 to 22 percent and decreases the tax applicable to income above $25,000 from 52 to 50 percent in 1964 and to 48 percent in subsequent years. One of the effects of this change is to increase the value of a surtax exemption from $5,500 (22 percent tax applicable only above $25,000, multiplied by the first $25,000 of income) per corporation under present law to $6,500 (26 percent tax applicable only above $25,000, multiplied by the first $25,000 of income) per corporation for 1965 and subsequent years.

While the importance to small business of reducing the tax on the first $25,000 of income from 30 to 22 percent is recognized, it is believed that this substantial tax reduction should not provide added inducement to existing medium and large corporations to split up into multiple corporations. Therefore, the bill limits the benefits of the tax reduction in cases where a parent corporation owns or controls one or more other corporations, or where a single individual, trust, or estate owns or controls two or more corporations.

By limiting the benefits of the tax rate reductions in the case of groups of multiple corporations, it is possible to grant a substantial tax reduction to small business in reducing the normal tax rate to 22 percent, as was recommended by the President, without granting the same benefits to medium and large enterprises which use, or might choose to use, the multiple corporate form of organization. The method of taxing controlled corporations contained in the bill will, in the opinion of the House and your committee, when coupled with repeal of the 2-percent additional tax on consolidated returns, encourage some controlled groups to file consolidated returns, while leaving groups which do not choose to file consolidated returns in approximately the same relative position they are in under present law.

While the House and your committee recognize the advantages of use of multiple corporations, it is believed, as it has been in the past, that, where corporations owned and controlled by the same interests engage in different businesses in the same area or conduct the same type business in different geographical locales, there are legitimate business reasons for use of separate corporations and, therefore, the separate corporations should generally be recognized as separate taxpayers, retaining the benefit of use of multiple surtax exemptions. However, the House and your committee do not intend to encourage the formation of these multiple corporations and therefore propose to apply higher tax rates to corporations which are members of an affiliated group of corporations. Of course, nothing in this bill is intended as changing the application of sections 269, 1551, or 482 if the multiple corporation form of organization is adopted to avoid taxes.

(c) *General explanation of provision.*—If a controlled group exists, three basic alternatives are available to corporations which are members of the group:

(1) The corporations in the group may forego the use of multiple surtax exemptions, i.e., they each file separate income tax returns and allocate one $25,000 surtax exemption among the members of the group (and either elect or not elect the 100-percent dividends received deduction provided by sec. 215 of this bill).

(2) Corporations in the group may elect to pay a penalty tax and file a multiple surtax exemption return. Under this election each member of the group (subject to the tax avoidance provision) may claim a separate $25,000 surtax exemption, but each must also agree to pay an additional tax of 6 percent on the first $25,000 of its taxable income. With the generally applicable rates of 22 percent on the first $25,000 of taxable income and 50 percent or 48 percent on income over $25,000, this means a total tax for such companies of 28 percent on the first $25,000 of income and 50 percent in 1964 and 48 percent in 1965 and subsequent years on income over $25,000.

(3) A controlled group which also qualifies as an "affiliated group" of corporations may, as under present law, file a consolidated income tax return.

This third alternative is similar to the first alternative in that only one $25,000 surtax exemption is available to the corporations filing the consolidated return. However, there are additional benefits in filing a consolidated return arising from the ability to declare and receive dividends between members of the group without tax, and to offset losses of one company against another.

The bill does not attempt to achieve complete symmetry between the definition of a controlled group of corporations for purposes of foregoing multiple surtax exemptions and the definition of a group eligible to file a consolidated return. Several differences arise. However, many complicated problems are involved in equating the two, and many avoidance possibilities might be created if they were equated. Thus, for example, a foreign corporation doing business in the United States is included in the controlled group definition. However, if the foreign corporation is also doing business abroad and was permitted to join in a consolidated return, it could pass a dividend, out of its foreign earnings, tax free to the domestic parent, and thus escape all U.S. taxes. Moreover, neither the House nor your committee is aware of any situations in which the discrepancies in the two definitions would create a hardship (especially with the 100 percent dividends received deduction provided by this bill). If it develops, however, that the differing definitions create a substantial hardship for certain groups subject to the penalty tax which cannot file consolidated returns (or obtain a 100-percent deduction for dividends received), the decision would have to be reconsidered and adjustments made to the extent possible.

(c)(i) *Test of control.*—In determining whether a controlled group of corporations exists, the bill draws a distinction between a parent-subsidiary controlled group and a brother-sister controlled group. In a parent-subsidiary controlled group one corporation, called a parent corporation, owns at least 80 percent of the total combined voting power of all classes of stock entitled to vote, or at least 80 percent of the total value of all classes of stock, of one or more corporations called subsidiary corporations. The parent-subsidiary controlled group also includes corporations below the first tier subsidiary level which are 80-percent owned by the other corporations in the group. For example, if corporation A owns 80-percent of the stock of corporation B, and corporation B owns 80 percent of the stock of corporation C, corporations A, B, and C constitute a parent-subsidiary controlled group.

A brother-sister controlled group exists where a single individual, trust, or estate owns at least 80 percent of the total combined voting power of all classes of stock entitled to vote, or at least 80 percent of the total value of all classes of stock, of each of two or more corporations.

In determining whether a corporation, or a single individual, trust, or estate, owns 80 percent of the value or voting power of the stock of a corporation, the stock of the corporation is considered not to include nonvoting preferred stock, which more closely approximates a debt obligation than an equity interest, and treasury stock, which, from the standpoint of ownership, constitutes unissued stock. Moreover, certain outstanding stock, although owned by separate persons, could, unless neutralized for purposes of determining control, be used by some owners as a means of divesting themselves of sufficient stock to avoid the application of this section without, as a practical matter, divesting themselves of the benefits of ownership of a corporation. Therefore, in determining whether a parent-subsidiary controlled group exists, stock of a subsidiary corporation owned by (1) individuals who are 5-percent shareholders of the parent corporation, (2) officers of the parent corporation, (3) employees of the subsidiary if the stock is subject to restrictions which favor the parent or subsidiary corporation, and (4) trusts which are part of a plan of deferred compensation for the benefit of the employees of the parent or subsidiary corporation, will not be treated as outstanding stock if the parent corporation owns 50 percent or more of the value or voting power of the stock of the subsidiary. In addition, in determining whether a brother-sister controlled group exists, stock of a corporation owned by (1) a trust forming a part of a stock bonus, pension, or profit-sharing plan for the benefit of the employees of the corporation, and (2) employees of the corporation if the stock is subject to conditions which run in favor of such corporation or the common owner and which substantially restrict or limit the employee's right to dispose of stock will not be treated as outstanding stock if the individual, estate, or trust owns

50 percent or more of the value or voting power of the stock of the corporation.

In determining whether a single individual, trust, or estate owns 80 percent of the value or voting power of the stock of a corporation, such individual, trust, or estate is, in addition to the stock owned directly, considered to own stock by virtue of certain relatively limited attribution rules. The first rule provides that an individual is considered to own stock owned by his spouse. However, it is recognized that in many cases a husband and wife may each own and operate their separate businesses. In order to prevent attribution in such cases, which may have the effect of denying separate surtax exemptions to each corporation, an individual is not considered to own stock owned by or for his spouse if (1) the individual does not directly own stock in the corporation in which his spouse owns stock, (2) the individual is not a director or employee of such corporation and does not take part in the management of such corporation, (3) not more than 50 percent of the gross income of the corporation is derived from rents, royalties, dividends, interest, and annuities, and (4) the stock of the corporation owned by the spouse is not at any time during the taxable year subject to conditions which substantially restrict or limit the spouse's right to dispose of such stock if such right runs in favor of the individual or his children who have not attained age 21 years.

The bill also provides limited attribution rules in cases involving other family relationships. Thus, an individual is always considered to own the stock owned by his children who have not attained age 21. However, an individual is considered to own the stock owned by his children who have attained age 21 and grandchildren only if such individual owns, directly or indirectly, more than 50 percent of the value or voting power of the stock in the corporation. Similarly, children who have not attained age 21 are considered to own the stock held by their parents, but children who have attained age 21 and grandchildren are considered to own the stock held by their parents or grandparents, respectively, only if the child or grandchild owns, directly or indirectly, more than 50 percent of the stock of the corporation. There is no attribution between brothers and sisters. Limited attribution rules are also provided in cases involving stock held by trusts, estates, and partnerships. Stock owned by a corporation, directly or indirectly, is considered to be owned proportionately by any shareholder owning a 5-percent or greater interest in the corporation. If an individual, estate, trust, or corporation owns an option to buy stock in a corporation, for purposes of ascertaining a controlled group, such "person" is deemed to own the stock covered by the option.

(c)(ii) *Method for determining existence of a controlled group of corporations.*—Determination of whether a controlled group of corporations exists is made once each year on December 31 by taking into account the stockownership of each person who owns stock in the corporation for the taxable year including such December 31. Although the determination of the corporations included within a parent-subsidiary controlled group, or a brother-sister controlled group, is made without regard to the type of corporation involved, provision is made to limit the reduction in the surtax exemption (or payment of the additional tax) to those corporations, referred to in the bill as component members, whose income tax is determined in whole or in part by reference to the normal and surtax rates. Thus, exempt organizations which do not have unrelated business income, and foreign corporations which are subject to a flat rate tax on their income from sources within the United States, are not considered to be component members.

In order to limit reduction of surtax exemptions (or payment of the additional tax) to cases in which the common owner of the controlled group would otherwise derive the principal benefit from the allowance of the exemption, the bill excepts from the definition of component member those corporations which are members of the controlled group for less than one-half of the days in their taxable year which precede the applicable December 31 determination date.

In addition to corporations which meet the ownership tests described above on the applicable December 31 determination date, the term "component member" also includes a corporation whose stock is not owned by the parent corporation or common owner on such December 31 but was so owned one-half or more of the number of days in the corporation's taxable year which includes the applicable December 31. The inclusion of such "additional members" as component members prevents corporations whose stock is sold before the end of the year from obtaining the benefits of an extra surtax exemption in the year in which they leave the controlled group.

The bill also provides for cases where certain manufacturing corporations, in an effort to facilitate the retail distribution of products which they produce, enter into agreements with individuals whereby the manufacturer and the individual each contribute capital to a distributing corporation under a plan by which a portion of the compensation of the individual from the distributing corporation is applied toward the retirement of the stock held by the manufacturer. In most cases, franchised corporations of this type are, by definition, excluded from a controlled group due to the fact that the manufacturer owns less than 80 percent of the value and voting power of the stock of the distributing corporation. However, in some cases the corporate structures of these corporations are arranged in a manner which results in the parent corporation, or common owner, owning more than 80 percent of the vote, but not more than 80 percent of the value, of the stock of the distributing corporation.

Your committee agrees with the House that it would serve no useful purpose to cause these corporations to reorganize their corporate structures and has, therefore, excluded them from the definition of the term "component member" of a controlled group.

Finally, due to the nature of the business conducted by life insurance companies, and the fact that a life insurance company is not permitted to file a consolidated return other than with another life insurance company, a life insurance company is excluded from the definition of a "component member" of a controlled group unless the controlled group contains two or more life insurance companies, in which case the life insurance corporations are treated as component members with respect to each other since they may then elect to file a consolidated return with each other. A mutual insurance company, other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 821, which is included in a controlled group is also excluded from the definition of a "component member."

(c)(iii) *Privilege of groups to elect multiple surtax exemptions.*—The bill provides that the component members of a controlled group of corporations may elect to have each component member of the controlled group claim a separate surtax exemption in lieu of having one surtax exemption apportioned among such members. However, if the component members of a controlled group so elect, the income tax on each member is increased by 6 percent on so much of its taxable income which does not exceed $25,000. For example, assume individual A is a common owner of a brother-sister controlled group of corporations consisting of corporations X and Y. Further assume that corporations X and Y each have taxable income of $35,000 and that they elect to have each member claim a separate surtax exemption and pay the additional 6 percent. By taking separate surtax exemptions, each corporation would pay a total tax of $7,000 on the first $25,000 of income (28 percent, consisting of a 22-percent normal tax and a 6-percent additional tax), and a tax of $4,800 on the remaining $10,000 of income (48 percent, consisting of a 22-percent normal tax and a 26-percent surtax), for a total tax on each corporation of $11,800. On the $70,000 combined income of the controlled group this would be a tax of $23,600. Alternatively, if the group did not make the election, the total tax on the controlled group would be $27,100 (22 percent of the first $25,000 of income and 48 percent on the remaining $45,000 of income). Under these circumstances, corporations X and Y presumably would choose separate surtax exemptions with the penalty tax, rather than apportioning a single surtax exemption between the component members of the controlled group.

For the component members of a controlled group to elect to claim multiple surtax exemptions, all component members of the group must join in the election. Such an election must be made within 3 years after the date when the income tax return is required to be filed for the taxable year of the component member of the controlled group whose taxable year ends first on or after the December 31 for which the election applies. An election once made may be terminated by the consent of the members, by the refusal of a new member of the controlled group to consent, by the filing of a consolidated return by any component members of the group, or by the termination of the group. Once an election is terminated, the bill provides that the group may not again elect multiple surtax exemptions until the expiration of 5 years. In the case of reorganizations involving groups of corporations some of which, for example, are, and some of which are not, prevented from filing new elections under the 5-year period, the Secretary of the Treasury is required to issue regulations which provide which group is to be treated as the predominant (or successor group) and hence which group's characteristics are to carry over.

(c)(iv) Disallowance of surtax exemption and accumulated earnings credit.—The bill makes two basic changes to present section 1551. The first change provides that if a corporation transfers property (other than money) directly *or indirectly* to a corporation which it controls, and such transferee corporation was created for the purpose of acquiring such property, or was not actively engaged in business at the time of such acquisition, the Secretary of the Treasury or his delegate may disallow the $25,000 exemption from surtax, or the $100,000 accumulated earnings credit, unless the transferee corporation establishes by the clear preponderance of the evidence that the securing of the exemption or credit was not a major purpose of the

transfer. As presently interpreted, existing law applies only to direct transfers of property other than money. The bill does not affect the transfer of money to a new corporation if the money is not used to indirectly acquire property from the shareholder making the transfer. Therefore, the amendment does not in any way inhibit the organization of new corporations with money transfers even though the corporation is organized for the purpose of acquiring a surtax exemption or accumulated earnings credit. However, the new corporation may be a component member of a controlled group in which case a single surtax exemption is allocated among the members of the group unless the group elects to file a multiple surtax exemption return.

The second change from present law extends the application of section 1551 to transfers of property (other than money) by an individual to a corporation which he and not more than four other individuals control. For purposes of determining whether the transferor is considered to be in control of the transferee corporation, the individual who makes the transfer, together with no more than four other individuals, must own at least 80 percent of the value or voting power of the stock in two or more corporations, one of which is the transferee corporation, and the same individuals must own more than 50 percent of the value or voting power of the stock in each corporation (only taking into account identical stock holdings) after the transfer. In determining ownership of stock, the constructive ownership rules for determining if a controlled group exists are applicable.

(c)(v) *Effective date.*—The amendment with respect to the limitation of the number of surtax exemptions allowable to component members of a controlled group and authority for component members to elect to file multiple surtax exemption returns is effective with respect to taxable years of corporations ending after December 31, 1963. The amendment made to section 1551 is effective with respect to transfers made after June 12, 1963.

(d) *Revenue effect.*—It is expected that this provision will increase revenues by about $35 million in a full year of operation.

46. Validity of tax liens against mortgagees, pledgees, and purchasers of motor vehicles (sec. 238 of the bill and secs. 6323(c) and 6324 of the code)

(a) *Present law.*—An assessed tax—income, estate or gift, excise, or withheld income or social security tax—if not paid within 10 days after notice and demand, constitutes a lien upon all of the property of the taxpayer, both real and personal. This lien follows the taxpayer's possessions, but it is valid as against a purchaser, mortgagee, or judgment creditor only if the notice of the tax lien has been filed prior to the sale or mortgage in the place designated by the State for the filing of such notices—usually the county recorder's office.

(b) *General reasons for provision.*—A prospective purchaser or mortgage lender with respect to real estate will check with the county recording office to ascertain whether there are any outstanding liens on the property. Ordinarily, liens against automobiles and trucks are not recorded in the county recorder's office. In many States any lien upon the automobile or truck is stated on the title. The one who wants to record a chattel mortgage, for example, upon an automobile must present his chattel mortgage and the certificate of title to the motor vehicle department of the State. Dealers in used automobiles, therefore, rely upon these title certificates to determine whether or not there is any adverse lien on the automobile which they intend to purchase. However, the certificate of title does not show any Government tax lien. Thus, a dealer having unknowingly bought a car from a delinquent taxpayer may find that the car is seized by the Internal Revenue Service to satisfy the lien.

An automobile or truck dealer buying hundreds of used cars or trucks each year finds it difficult to follow the normal procedures—search of the records in the county recording office—with respect to each car which he wishes to buy. A similar situation exists with respect to the sale of stocks and bonds, which are ordinarily sold on the stock exchanges or over the counter without knowledge of any Federal tax lien which might exist with respect to such securities. For this reason, the law has long provided in the case of securities (sec. 6323(c)) that even though the Federal tax lien has been filed in the appropriate recorder's office, the lien will not be effective as against any mortgagee, pledgee, or purchaser of a security if at the time of the mortgage, pledge, or purchase the mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien. Your committee believes that a similar procedure with respect to autos and trucks would be appropriate.

(*c*) *General explanation of provision.*—This section of your committee's bill provides a similar protection for dealers and other persons purchasing or making loans upon motor vehicles as is now provided in the case of securities, so that the lien of the Federal Government will not be effective against a purchaser, mortgage lender or pledgee unless the purchaser, mortgage lender or pledgee has actual notice or knowledge of the existence of the Government's lien.

The definition of the motor vehicle to which this provision will apply is a vehicle (except a house trailer) registered for highway use under the laws of any State or foreign country.

(*c*)(*i*) *Effective date.*—The amendments made by this section apply only with respect to mortgages, pledges, and purchases made after the date of enactment of this bill.

(*d*) *Revenue effect.*—This provision is expected to result in a negligible loss of revenue.

C. HOUSE PROVISIONS DELETED BY YOUR COMMITTEE

1. Reimbursement of medical expenses in excess of such expenses (sec. 204 of the House bill)

(*a*) *Present law.*—Present law provides that gross income is not to include amounts received through accident or health insurance for medical expenses for personal injuries or sickness (secs. 104(a)(3) and 105(b) of the code).[1] At the same time medical expense deductions may be claimed (if they exceed the 3-percent floor) for accident or health insurance premium payments.

(*b*) *Reasons for deleting the House provision.*—Cases were called to the attention of the House Committee on Ways and Means where individuals have been covered by more than one accident or health insurance program. This occurs on occasion when the individual himself carries more than one policy, and occurs in other cases when

[1] An exception to this rule provides that amounts received under accident or health insurance policies are to be included in gross income to the extent they represent medical expense deductions allowed in previous years.

the individual may carry a policy and also his employer may provide for the payment of medical care either through an insurance policy or through self-insurance. In these cases, the employee may receive double payments with respect to the same expenses incurred with respect to a given injury or sickness. In these cases, the House provision would have treated the excess of the amounts received over the actual expenses incurred as income received by the individual.

Your committee is in agreement with the objective of the House provision. However, it has been called to the attention of your committee that the National Association of Insurance Commissioners this last December adopted a report on overinsurance recommending the enactment of legislation at the State level pertaining to this subject. The legislation recommended in effect would provide amendments to the uniform individual accident and sickness policy provisions of State law providing that health insurance benefits are to be prorated in the event of overinsurance among the carriers on the risk. This recommendation of NAIC is likely to lead to changes in State law within the next year or two in many, if not most, of the States. This in effect would eliminate the overinsurance with which the House bill provision is concerned. In view of this, your committee concluded that it would be better to remove the House provision from the bill and see if the problem of overinsurance is not met in the relatively near future by action by the various States. Your committee will review this matter within the next year or two and should implementing legislation not be acted upon by most of the States, it will then reconsider this provision. Your committee has concluded, however, that the problem is broader than merely the tax aspect and, therefore, that it would be more appropriately handled by the States than by amendment to the Internal Revenue Code.

2. Carrying charges (sec. 215(c) of the House bill)

(*a*) *Present law.*—Among the itemized deductions allowed taxpayers under present law is the deduction for interest payments. Administrative practice has long allowed as an interest deduction the portion of any carrying charges on installment purchases to the extent the interest element is stated separately. In 1954, Congress also provided that an interest deduction was to be available in the case of carrying charges stated separately even where the interest charged could not be ascertained directly. In such cases, the law provides that so much of the carrying charges as equal a 6-percent interest charge on the average unpaid balance under the contract is to be allowable as an interest deduction. This provision applies, however, only in the case of "personal property" purchased under an installment contract.

(*b*) *Reasons for deleting the House provision.*—Cases were called to the attention of the House Committee on Ways and Means where carrying charges are imposed with respect to tuition payments to various educational institutions. On the basis of this, the House bill would have extended the deduction for part of the carrying charge as interest in the case of carrying charges for services as well as personal property. Your committee would have no objection to extending this provision to cover service charges which are in the form of tuition payments; however, before this is extended to service charges, generally, your committee believes that there should be a further investigation of what might be covered under such a provision.

3. *Increase in basis with respect to certain foreign personal holding company holdings (sec. 216(j) of the House bill)*

(*a*) *Present law.*—Under present law the undistributed income of a foreign personal holding company is included in the income of the U.S. shareholders of the company and taxed to them. This treatment applies only where 50 percent or more in value of the outstanding stock of the corporation is owned directly or indirectly by five or fewer individuals who are citizens or residents of the United States. In addition, in the first year, 60 percent, and in subsequent years 50 percent, of the corporation's gross income must be "foreign personal holding company income." In general terms, this income consists of passive or investment forms of income, such as dividends, interest, etc. To a substantial degree, the same type of income is classified as foreign personal holding company income as is classified as personal holding company income in the case of domestic companies.

Stock in a foreign personal holding company differs from most other property in that, at the time of the death of the U.S. shareholder, it generally does not receive a new basis equal to its fair market value. Actually, the applicable rule in this case is that the basis of the stock at the time of the death of the decedent is to be the fair market value at that time or the basis of the stock in the hands of the decedent, whichever is lower.

For foreign corporations, including foreign personal holding companies, to participate in a tax-free reorganization it must be determined to the satisfaction of the Secretary of the Treasury that the exchange was not in the pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax. Of the two basic tax provisions on corporate liquidations, sections 331 and 333, foreign companies can use only section 331. Section 331 provides for the imposition of the regular capital gains tax on appreciation in the value of the stock. Section 333, which foreign corporations cannot use, provides that the accumulated earnings and profits of the corporation are to be taxed to the noncorporate shareholders as dividends and that capital gains are to be recognized on other appreciation in the stock only to the extent of the money and stock or securities acquired by the corporation after December 31, 1953, exceed the earnings and profits received as dividends. However, this provision also provides, in the case of assets acquired by the corporation before January 1, 1954, that no gain is to be recognized to the shareholder but that instead the shareholder is to receive the same basis for the assets received which he had for the stock (increased for gain recognized and decreased for money received).

(*b*) *Reasons for deleting the House provision.*—The House Committee on Ways and Means noted that the stock of a foreign personal holding company, when the shareholder dies, received much harsher treatment than is true of practically all other property included in the decedent's estate. Generally, property receives a new basis at a decedent's death equal to its fair market value, either at the time of the decedent's death or at the alternate valuation date 1 year later. Moreover, in the case of gifts where the donee carries over the basis of the donor, an increase in the basis (up to fair market value) is allowed to the donee with respect to any gift taxes paid on the property.

The House recognized that a relatively harsher treatment for the basis of the stock of these foreign personal holding companies is justified in order to discourage their use generally. However it was believed that it was appropriate to permit the same general type of adjustment to the basis as is presently permitted in the case of gifts; namely, to permit an increase in the basis of the stock of the foreign personal holding company equal to the death transfer tax imposed with respect to the appreciation in the value of the stock.

In view of the fact that the issue of a carryover of basis at date of death has not been dealt with by your committee in this bill, it concluded that it would be more appropriate to postpone consideration of this amendment until that broader topic was under consideration.

In addition, the House bill provided that these foreign personal holding companies were to be treated the same as domestic corporations for purposes of section 333 if the liquidation is completed shortly after the date of enactment of this bill. Since such companies are likely to have little if any accumulated earnings and profits, this in effect means that the shareholders would pay a capital gains tax on the appreciation of their stock in the corporation only to the extent they receive money, or stock or securities acquired after December 31, 1953, and that the basis of assets received in the liquidation is the basis of their stock in the corporation increased by the gain recognized. In such cases this property was to receive the same basis as it would if the shareholder died still holding the stock in the foreign personal holding company until this property had passed through one estate—the shareholder's or any transferee's.

Your committee has also decided not to include this aspect of the House provision in your committee's amendments. The same issue of the basis at date of death is involved here as where the stockholder dies still holding the stock of such a company.

4. Capital gains and losses (sec. 219 of the House bill)

(*a*) *Present law.*—Under present law, capital gains and losses are divided into two general classifications: short-term capital gains and losses and long-term capital gains and losses. The former are gains and losses on assets held for not more than 6 months and the latter are gains or losses on assets held for longer periods of time.

Gains and losses in each category are first offset against other gains or losses in the same category. Thus, there is determined "net," short-term gains or losses and "net" long-term gains or losses. Next, any net short-term gains are offset by net long-term losses or vice versa.

Net short-term gains in excess of net long-term losses are taxed to individuals or to corporations as ordinary income. In the case of net long-term gains in excess of net short-term losses, however, the tax treatment applicable to individuals and corporations differs somewhat. In the case of individuals, such a gain is included in the taxpayer's ordinary income and then reduced by a 50-percent deduction, or alternatively, the entire gain is omitted from the taxpayer's ordinary income base and a flat 25-percent tax paid with respect to this gain. In the case of corporations, there is no special 50-percent deduction. Instead, the corporation either includes the entire gain in its ordinary income, or alternatively, pays a tax of 25 percent on these capital gains.

The tax treatment of capital losses also differs somewhat between individuals and corporations. As previously indicated, any net short-term loss is first offset against any net long-term capital gain and vice versa. If there still remains an excess of capital losses (either short term or long term), these losses may be offset against ordinary income in the case of individuals but only to the extent of $1,000. If any net loss still remains, it may be carried forward for a period of up to 5 years as a short-term capital loss (whether such loss was in reality a long- or short-term loss) and as such in each of the years in succession first offset against net short-term capital gains, then against net long-term capital gains and finally against ordinary income to the extent of $1,000.

In the case of corporations, capital losses as in the case of individuals are first offset against gains in their own category (short term or long term) and then against gains in the other category. However, any remaining loss may not be offset against ordinary income to any extent, but it may be carried forward as a short-term loss and offset against short-term and long-term capital gains in each of the 5 succeeding taxable years.

The capital gain and loss treatment described above applies in the case of the sale or exchange of capital assets. In addition, certain other items are taxed in the same manner as capital gains. The principal category of assets treated in this manner are depreciable assets. Such assets, if the gains exceed the losses, are treated as capital gains; but, if the losses are in excess of the gains, they are treated as ordinary losses. Included with depreciable property for this purpose also are gains or losses from—

1. the sale of timber;
2. coal royalties;
3. livestock held by the taxpayer for draft, breeding, or dairy purposes if held by him for 12 months or more;
4. the sale of an unharvested crop sold in connection with the sale of the land.

Other types of items which are eligible for capital gain treatment are patent royalties received by the creator of the patent, certain lump-sum pension payments, and certain termination payments received by employees with more than 20 years employment. Income arising from the sale of stock acquired under a restricted stock option represents still another form of income accorded capital gains treatment under present law. In addition, this bill (sec. 228) provides capital gain treatment for iron ore royalties.

(*b*) *Reasons for deleting the House provision.*—The House bill would make three basic changes in the tax treatment of capital gains and losses. First, it would decrease from 50 to 40 percent, in the case of individuals, the proportion of the capital gain included in the tax base where the asset involved has been held for more than 2 years, and it would provide in such a case a maximum tax rate of 21 percent in lieu of the 25 percent; second, it would limit the more favorable capital gains treatment described above so that this treatment would not be made available with respect to transactions where the capital gains treatment under present law is made applicable to certain types of assets which are not capital assets; and, third, it would provide an indefinite carryover of unused losses in the case of individuals in lieu of the present 5-year limitation.

The Secretary of the Treasury in his testimony before your committee requested that the first two of the changes listed above not be made. He based this primarily on the fact that the administration in recommending lower capital gains tax rates had done so only as a part of a recommendation providing additional taxation on unrealized gains at death. Subsequently, this recommendation was modified to call for a carryover of the decedent's basis in such a case to the one receiving the property from the decedent. The House Committee on Ways and Means considered this latter proposal but rejected it at least in part on the grounds that there were technical problems which had not been satisfactorily worked out. In view of this, the Secretary of the Treasury in his testimony before your committee strongly urged that it not consider reducing the capital gains tax rates at this time.

In addition to the question raised by the Secretary of the Treasury as to whether capital gains tax rates should be lowered at the present time in view of the fact that other related structural changes are not now being made, questions arise as to the desirability of dividing the long-term capital gains group into two parts. Information submitted to your committee made it quite clear that this would substantially further complicate an already complex capital gains tax schedule. If the House provision had been adopted, not only would it be necessary to report separately three instead of two general categories of capital gains, but it would also be necessary to subdivide the proposed class A and class B gains between those coming under section 1231 and those which do not. Although gains from the sale of such assets result in capital gains where there is a gain from all such assets taken together, nevertheless, if there is a loss from the aggregate of these transactions with respect to these assets, they give rise to ordinary gain or loss. In addition, it is necessary on this schedule to account for the "recapture" of ordinary income provided generally for tangible personal property in the Revenue Act of 1962 and the somewhat different "recapture" rule provided in this bill with respect to real estate. As a result of the interrelationship of these factors, your committee concluded that it would be better not to further complicate this schedule at the present time by this further breakdown of what are presently long-term capital gains or losses for individuals.

Your committee also was concerned about the capital gains provision of the House bill because the benefit from this provision would have been largely concentrated in the very highest income brackets. The concentration of capital gains in the higher income levels in fact is a major factor accounting for the effective rates in the highest brackets being substantially below the rates shown in the tax rate schedule. Table 11 shows, for example, that, although those with incomes over $200,000 represent a small fraction of 1 percent of all the taxpayers, nevertheless they receive 16 percent of all capital gains. This is about the same percentage of capital gains received by the 58 percent of all taxpayers having incomes below $5,000. Those with incomes of $100,000 or over, although representing only 0.04 of 1 percent of all taxpayers, nevertheless receive 24 percent of all capital gains.

The effect of reducing the capital gains inclusion factor, or alternative rate, because of this concentration of these gains in the higher income classes would, of necessity, have meant that most of this relief would have gone to those with the highest income levels. This is shown in table 12, which presents the overall distributional effects of the House and your committee's bill in detail for incomes over $50,000. This table indicates that, although the capital gains reduction in the House bill as a percentage of the present total tax amounted to only 0.7 of 1 percent, nevertheless the tax reduction which this would have accorded those with incomes between $100,000 and $200,000 would have been 3.4 percent; and this percentage would have risen to 7.4 percent for those with incomes of $1 million or over. This can be compared with the capital gains tax reduction accorded those with incomes of $3,000 and under of 0.3 of 1 percent. Your committee did not believe that a reduction of this type was justified in view of the overall distribution of reductions in this bill.

TABLE 11.—*Capital gains, by income levels*

Returns with adjusted gross income of—	Comprise this percentage of all taxpayers—	But receive this percentage of all capital gains
$200,000 and over	0.0096 of 1 percent	16
$100,000 and over	0.04 of 1 percent	24
$50,000 and over	0.2 of 1 percent	35
$10,000 and over	8.7 percent	69
Less than $5,000	57.8 percent	17

Source: Treasury Department.

TABLE 12.—*Overall distributional effects of the House bill (including capital gains changes) and the Finance Committee bill (which retains present law capital gains treatment)*

Adjusted gross income class (in thousands of dollars)	Total tax reduction as percentage of present tax		Capital gains tax reduction in House bill as percentage of total present tax
	House bill	Finance Committee bill	
0 to 3	38.6	38.6	0.3
3 to 5	26.5	27.3	.3
5 to 10	20.1	20.9	.2
10 to 20	16.9	17.3	.4
20 to 50	16.0	15.8	1.0
50 to 100	13.5	12.3	2.0
100 to 200	12.2	9.7	3.4
200 to 500	12.4	8.1	5.0
500 to 1,000	12.1	5.7	7.2
1,000 and over	12.0	5.6	7.4
Total	18.9	19.1	.7

Source: Treasury Department.

It should be noted that the great bulk of capital gains is accounted for by taxpayers by including 50 percent of the gain in income rather than by subjecting these gains to a separate flat 25 percent tax. It has been estimated that most of the capital gains fall in the former category where 50 percent is included in the ordinary income tax base. As a result, the regular rate reductions provided in this bill, which range from 30 percent for those in the bottom brackets to 23 percent for those at the top, will also be applicable in the case of these capital gains. Thus, even without any special tax treatment for capital gains, a substantial reduction in tax is provided by your committee's bill with respect to these gains.

INDIVIDUAL VIEWS OF SENATOR PAUL H. DOUGLAS

Good Features of the Bill

There are many good features in the present tax bill, H.R. 8363. Among these are (1) the fact of tax reduction itself which will stimulate demand, production, and employment; (2) the minimum standard deduction of $300 per taxpayer plus $100 for each family dependent (this with the per capita exemption of $600 means that families of four whose yearly incomes are less than $3,000 will be exempted from taxation—as they should be—instead of those under $2,666 as is now the case, i.e., $2,400 plus the 10 percent standard deduction); (3) the shifting of the corporation tax collection period from the present delayed system to roughly the same basis as taxes are now collected from individuals; (4) the repeal of the 4 percent dividend credit against taxes actually owed, and certain other features as well; and (5) the elimination by the Finance Committee of the reduction in the capital gains tax.

The capital gains loophole is already the largest loophole in our tax system. Between $5 and $6 billion a year are lost because of this provision. The bill as it came from the House of Representatives would have widened and deepened this hugh loophole by reducing the rate on long-term capital gains from 50 to 40 percent, subject to a maximum of 21 percent instead of the present inadequate rate of 25 percent. This was eliminated by a narrow margin in the committee. There is grave danger that this reduction will be restored in the conference committee. This danger will be reduced if the Senate itself, by a decisive vote, approves the action of the Finance Committee in eliminating this section from the House bill. This, in my judgment, should occur early in the Senate proceedings.

There are some grave defects in the bill as presented which I believe the Senate should correct. The bill also fails to effect much needed reforms in our tax system which are long overdue and for which there will not be another opportunity for some years.

Generally speaking, our present tax structure is riddled with injustices and inequities. There are so many loopholes that 20 people with incomes over $500,000 in 1959 paid absolutely no taxes at all while the average amount of taxes actually paid by all those with incomes of $5 million or more came to slightly less than 25 percent instead of the 90 percent they would theoretically be expected to pay. This is less than the amount which a typical American family with a taxable income of $12,000 derived from wages and salaries would be expected to pay or, because of collection at the source, would actually pay.

If we could close the various loopholes and "truckholes" in the Revenue Act, we could reduce the individual income tax rate from the present scale of 20 to 91 percent to a range of from 10 percent as the minimum to a maximum of 50 percent. In doing so we would raise as much revenue as we do with our apparently high rates which, as a matter of fact, are not paid by the vast majority of those in the upper income tax brackets. In this connection it is appropriate to quote a salient passage from Philip M. Stern's forthcoming book entitled "The Great Treasury Raid" in which that keen student of our tax system, comments as follows:

> For a raid of its magnitude, the time (high noon) and setting (the U.S. Treasury, a stone's throw from the White House) showed a breathtaking boldness of design and planning. From out of nowhere, it seemed, they appeared—old people and young, rich and poor, an oil millionaire here, a factory worker there, a real estate tycoon, a working mother, several well-known movie stars, some corporation presidents, even the chairman of a powerful congressional committee. It was a mixed lot, all right, that converged on the Treasury Building that high noon. Into the building they strolled, gloriously nonchalant. No one stopped them; not a guard looked up to question them. Quickly and quietly they found their way to the vaults; opened them noiselessly with the special passkeys each had brought with him. Like clockwork, with split-second timing, each went to his appointed spot, picked up a bag and walked out as calmly as he had entered. At the exits the guards sat motionless. At precisely 12:04 it was all over. Each of the "visitors" had vanished into thin air.
>
> So had $40 billion from the U.S. Treasury.

The administration initially made a partial but somewhat ineffectual effort at tax reform. But when most of its proposals were rejected by the House Ways and Means Committee, they ceased to fight with any vigor except on two matters, namely (*a*) the abolition of the unjust 4 percent dividend credit inserted under the Eisenhower administration in 1954, and (*b*) the removal of the reduction in the capital gains tax. Neither of these features is in the present bill, and I hope we can hold these gains.

In other words, the great mass of citizens, primarily in the lower income brackets, have to pay high taxes because the laws have been so shaped that a minority are able, by avoidance and evasion and counseled by highly paid and able tax attorneys, to take advantage of every twisting and turning of the laws. I repeat, if we could plug the loopholes and "truckholes," we could collect the same total amount of revenue with half of the present tax rates. Our failure to do so means that the present unfair and unjust system continues. As a consequence, the present bill, except for the unjustifiable provision with respect to utilities, remains neutral with respect to remedying the great injustices in the tax system. Its failures are not, for the most part, acts of commission, but rather acts of omission. Because of the stimulus which the tax cut itself should bring to the economy, there are many like myself who can therefore support the bill because its stimulating features are good, but in the meantime express dissatisfaction over the failure of the House and the Senate committees to remedy many of the well-known and major loopholes in the tax system. To us, tax reform is as important as tax reduction. But this bill has a great deal of reduction but very little reform.

The major loopholes in the system are (1) the present provisions for capital gains—the biggest loophole of them all. Huge amounts of ordinary income are taxed at a special lower rate, and other gains are not taxed at all, as in the case of the failure to tax capital gains at death.

The abuses involved in the oil depletion allowance, the writeoff of intangible drilling and development costs in the first year, and the ability of the oil industry to count royalties abroad as a tax payment instead of a deduction of expenses, is another area of grave abuse.

There are additional areas such as the unlimited charitable deduction, which is responsible for people with millions of dollars of income escaping any Federal taxation at all, and such other well-known loopholes as stock options, collapsible corporations, and corporate spin-offs, which mean that the favored few pay a smaller proportion of their income in taxes than the many with modest incomes.

Furthermore, State and local systems of taxation are highly regressive. That is to say, those with low incomes pay a higher proportion of their incomes in taxes than do those with high incomes. The progressive features of the Federal system should offset this so that the overall tax system of the country—Federal, State, and local—is at least proportional. But the fact that the Federal system is riddled with loopholes which favor high income groups, plus the fact that about $13 billion a year is collected in excise or sales taxes at the Federal level, means that even the Federal system has very little, if any, progression in it, and the total tax system is probably somewhat regressive in nature. The present bill fails to correct this situation. The repeal of some of the most onerous and least justifiable of the excise taxes could help to make our tax system more fair.

I therefore hope that we may take the following action to improve this bill:

First. We should try to get the Senate, by an overwhelming vote, to uphold the Finance Committee's action in knocking out the new capital gains loophole. This would strengthen the Senate's position in the conference committee. Otherwise, the capital gains provision in the tax law may end up worse than under present law. This should be a minimum position and it would certainly help if the Senate would also try to do something in the area of capital gains at death.

Second. The Senate should eliminate that feature of the tax bill which has no rightful place in a tax bill, namely, section 202(e) which states that the Federal regulatory commissions need not pass through the tax savings from the investment credit to the consumer. Apart from its lack of merit, this is basically a regulatory rather than a tax matter and really has no place in this bill.

Third. We should retain in the law the Long amendment of 1962 with respect to the investment credit. Corporations which invest $100 in investment reduce their taxes by $7. This is the equivalent of a $14 before-tax deduction. The Long amendment in 1962 said that a corporation could not depreciate more than $93 worth of investment, but the bill before us will allow the full depreciation of the asset even though its actual cost was less because of the investment credit. The elimination of the Long amendment will ultimately cost about $600 million a year and hence raise the investment credit to about 11 percent.

Fourth. The present provisions in the law with respect to stock options should be greatly modified and the provision in the bill with respect to the amount of term insurance which a corporation can purchase for its employees should be reduced at least to the House figure.

Fifth. We should try to repeal some of the retail excise taxes, such as those on leather goods, women's handbags, inexpensive jewelry, cosmetics, and furs, but we should place a limit of $100 on the amount which is free of tax so that we do not reduce the tax on luxury expenditures.

Sixth. Furthermore, we should certainly try to do much more than is done in the bill with respect to the oil depletion allowance. As a minimum, we should prohibit excess depletion from being used to offset income from sources other than direct oil production. This was proposed by Senator Williams in the committee, accepted twice, but finally considerably watered down at the last moment.

We should also consider an amendment to the depletion allowance which, while retaining depletion for the small producer who does take considerable risks, reduces the depletion allowance for those whose income from gas and oil is between $1 and $5 million to 21 percent, and for those with incomes from gas and oil in excess of $5 million to 15 percent. This would save $400 million a year.

Seventh. We should also not undo the minor progress made with respect to travel and entertainment allowance loopholes in 1962. We should not finally adopt some of the provisions either in the bill or which have been proposed to the bill.

Eighth and finally. We should consider the equity of the rate structure itself. The present bill grants about $2½ billion in tax reductions to corporations and over $9 billion to individuals. The latter is done by reducing the rates; namely, from the present 20 to 91 percent to a figure of 14 to 70 percent.

In addition, the bill splits the rates for the first bracket and gives a new minimum standard deduction. These last two features redeem the inequities in the nature of the personal tax reduction so that there is some degree of equity. However, there is neither a strong case nor any equity considerations involved in reducing corporate taxes by $2½ billion. Since 1954, corporations have had tax reductions of almost $5 billion through the 1954 fast tax writeoff and depreciation provisions, and the 1962 investment credit, and revision of Bulletin F. This bill grants another $2½ billion to corporations while individuals receive some reduction for the first time.

Because of this, it would be well to use some of the corporate reduction to increase the minimum standard deduction or to increase the $600 exemption. Personally, I would propose taking at least $1 billion from the corporate reduction and using the funds to increase the personal income tax reduction. This would be more equitable, would make the tax system more just, and, in my judgment, would give a much stronger stimulus to the economy than the present method.

Moreover, the Senate and the Congress should give serious consideration to simplifying the tax structure and making it more equitable by the simple process of repealing most of the existing loopholes and truckholes in the tax laws and then using the gain in revenue to bring a drastic reduction in income tax rates. By closing most of the present loopholes, the tax rates could be reduced from the present level of 20 to 91 percent to a new level of about half that amount, or from 10 to 50 percent. This would simplify the tax structure, make it more just and equitable, and improve its enforcement, while benefiting the great mass of Americans who pay their taxes and who do not either avoid or evade them. The longer we put off tax reforms the more unjust our system becomes. The time to act is now.

PAUL H. DOUGLAS.

INDIVIDUAL VIEWS OF SENATOR RIBICOFF

This tax bill will have my vote, but not my unqualified approval.

Many unwise provisions have been included, some desirable provisions have been omitted, and the bill as a whole will not achieve all of the results that have been claimed for it.

Rate reduction and reform are the principal needs to which this bill should be directed. It achieves rate reduction. It does not achieve reform.

Unfortunately, the public has been largely unaware that the issues in this bill included anything more than simple rate reduction. To judge from the general reaction to the bill, one would think it contained a single provision saying, "Taxes shall be reduced by $11 billion." The fact is the bill containes more than 300 pages of detailed provisions, making a great number of changes in 37 separate areas of the Internal Revenue Code, in addition to the provisions making reductions in tax rates. In a few instances, these so-called structural changes do make modest reforms. But many needed reforms have not been made, and many of the changes in the bill are the opposite of reform: they are special preferences for a few taxpayers.

I do not agree that we should benefit—

utility companies by prohibiting the "flowthrough" of the investment credit to consumers;

department stores by allowing special tax treatment of revolving credit sales;

iron ore companies by providing capital gain treatment for certain royalty payments;

companies with foreign subsidiaries by permitting a 10-year carryforward for expropriation losses;

insurance companies by giving them capital gain treatment of bond discounts in certain situations; and

purchasers of new equipment by doubling the benefit of the investment credit.

These provisions are all included in the bill. The revenue loss for 1964 is estimated at $305 million.

Left out of the bill are provisions to reduce depletion allowances, end the immediate writeoff of intangible drilling and development costs for oil and gas, and abolish the preferential treatment of stock options. These provisions would have prevented a revenue loss in 1964 of $1,150 million.

These sums of money would more than pay for two other provisions which I believe should be included in this bill. These provisions would benefit the national interest and help millions of individuals. I will offer them as amendments on the Senate floor.

My principal amendment provides an income tax credit for college costs. The amendment provides a credit based on the first $1,500 of tuition, fees, books, and supplies at an institution of higher education. The credit is available to anyone who pays these costs—parents, students, or any other person who wants to pay for the education of a deserving boy or girl. The credit is 75 percent of the first $200, 25 percent of the next $300, and 10 percent of the next $1,000. The credit is reduced by 1 percent of the amount by which the taxpayer's adjusted gross income exceeds $25,000—in other words, reduced $50 for each $5,000 of income above $25,000.

The financial burdens of high college costs are just as entitled to be eased through tax relief as medical expenses and casualty losses. These college costs hit middle income and lower middle income families with a serious impact. The man earning $8,000, $10,000, or $15,000 is generally not eligible for scholarship or loan funds for his son or daughter, and he faces a heavy burden in paying $2,000, $1,000, or even $500 for college costs.

One of the premises of this bill is that incentives should be given to capital investment. Yet there is no better form of capital investment we can make than investment in education. The investment credit in the 1962 tax bill and the revised depreciation guidelines provide over $2 billion in tax relief for investment in machinery. The pending bill provides millions more for this purpose. I believe we should invest in the education of our youth. In the last analysis, trained minds, not just new machines, will insure the success of this Nation.

Four main objections have been raised against this proposal:

1. It is claimed the amendment helps the wealthy. The fact is the credit benefits the $30,000 man less than the $5,000 man, and does not benefit the $60,000 man at all. Under this amendment, 91 percent of the dollar benefit goes to families with incomes below $20,000, 63 percent to families with incomes below $10,000.

2. It is claimed the amendment discriminates against the poor. The fact is the credit operates exactly like all other tax relief provisions of the Internal Revenue Code: it is available only to those who pay a tax. The medical deduction is not used by nontaxpayers, yet few would oppose it on this ground.

Those in the very low income groups who pay no taxes need a sound program of student aid including scholarships. I am for such a program. It is needed in addition to tax relief for the middle-income families. These are not alterntives. They are both necessities.

3. It is claimed the amendment favors the high tuition colleges, most of which are private colleges. The fact is the amendment favors the low tuition colleges, most of which are public colleges. The credit on a $200 expense is $150. That's 75 percent. The credit on a $1,000 expense is $275. That's only 27 percent. Even where a college charges no tuition, the expense of fees, books, and supplies invariably totals $200 or more.

4. It is claimed all the tax benefit will be absorbed in tuition increases. The fact is that tuitions go up whether tax relief is granted or not. Furthermore, any colleges that want to raise tuition because they know parents have some extra money will take advantage of the rate reductions in this bill. They can absorb the tax dollars that come from rate reductions, whether or not my amendment is added to the bill. Finally, the amendment provides only a 10-percent credit on expenses over $500, so every added $100 of tuition over $500 results in only a $10 saving to the parent—scarcely an incentive to the college.

For years proposals similar to this one have regularly been introduced by many Members of the Senate. I believe there should be an opportunity for every Senator to vote on this proposal. I intend to see that this opportunity is provided.

My second amendment permits accelerated deductions of expenses for air and water pollution control equipment. If we are ever to make substantial progress in combating air and water pollution, we must recognize that private industry has a major part to play. But playing that part costs money. Since these expenditures are for a public purpose, the public should assume part of the burden through tax relief.

Industry needs financial encouragement to speed the acquisition of this equipment. This equipment produces no revenue to the company that installs it. Yet the Internal Revenue Code and many new amendments provided in this bill provide billions in tax relief for expenditures that are revenue producing. In fact, the Treasury Department last year proposed that fast tax writeoffs be provided for all equipment purchased for research and development expenditures which are clearly revenue producing.

When we are providing hundreds of millions to establish air and water pollution control programs, we should not overlook the need to help industry make the purchases of pollution control equipment which can make the difference between success or failure in cleaning up our environment.

Finally, I must express a word of caution concerning the claims that have been made for this bill as a whole. It can legitimately be called a needed stimulant to an economy that is not operating at full capacity. But it cannot and should not be expected, in and of itself, to spur that economy to full capacity or to solve many of the difficult problems that have been preventing our economy from reaching full capacity. Chief among these is unemployment and while this bill will help create new jobs, I do not believe it will solve the basic problem of structural unemployment. Economists with views as divergent as Leon Keyserling and Roger Freeman agreed on this point in testimony before the committee.

"I doubt that tax reduction can make a major impact on our present type of unemployment," said Freeman. "Even well-designed tax reduction cannot cope with a large portion of the unemployment problem," said Keyserling.

This joint warning should be well heeded. As we enact this tax cut bill, let us not delude ourselves or the country into thinking that it is a cure-all for our problems, especially for our unemployment problem.

We should pass this bill despite its imperfections. Taxes are too high and do act as a deterrent to individual initiative. This bill will be of benefit to all segments of our society and will be helpful to the economy. But we must continually strive toward the goals that remain: tax reform, a meaningful reduction in unemployment, and a fully productive economy.

ABRAHAM RIBICOFF.

MINORITY VIEWS OF SENATOR ALBERT GORE

Position in Brief

On balance, in the light of its design and consequences, and in view of its scope and magnitude, this is one of the most important and most ill-advised bills ever to come before the Congress for serious consideration.

Born of ineptitude in economic forecasting, sired by political considerations, and nurtured by the greed of special interests, it creates more inequity in many respects and bears no resemblance to true tax reform. Favoritism in tax law, furthered by H.R. 8363, threatens to erode our economic, political, and social structure.

Specifically, this bill—

(1) Is the embodiment of fiscal folly. While it is generally recognized, and I am no exception, that a balnced budget is not necessary or even desirable in every year, and in all circumstances, debt and deficit cannot be ignored indefinitely. After 3 years of unprecedented prosperity, expansion, and growth, and with nearly all the important economic indicators pointing upward, we certainly should not seek deliberately further to increase debt and deficit and to impair, for all foreseeable time our capacity to meet pressing public problems by a drastic reduction of governmental revenue.

(2) Provides no solution to our economic or social problems. The vast, unfulfilled economic needs of our society lie in the public sector—better housing for low-income groups, better mass transit systems, better educational facilities at all levels, better highways, more and better hospitals and nursing homes, more clean drinking and industrial water. The private sector of our economy is the wellspring of our continued prosperity, but this sector is fat with unused productive capacity. The unemployed and those burdened by poverty need specialized assistance in overcoming specific problems. Those who are so enamored of aggregates and macroeconomics fail to recognize that specific solutions are needed for very specific and pointed problems. The war on poverty is thus far but a skirmish of words—we need a pitched battle, with live and heavy ammunition, aimed at specific targets. Necessary programs require more, not less, revenue.

(3) Would provide the wrong type of tax cut, even if a large reduction in revenues were justified at this time. The tax reduction provided by this bill for the already very rich, through both a drastic reduction in high bracket personal income rates and a cut in corporate rates is unconscionable. Equity aside, sound economic theory is violated. If any shortage exists in our economy in the private sector, it is to be found in an absence of broadly based purchasing power. An equitable solution by way of revenue reduction would dictate a tax cut which would restore some of the prewar purchasing power which has, ever since that

time, been withheld. An increase in the personal exemption, with possible consideration being given to the restoration of some preferential treatment for earned income would be not only more equitable but more defensible from a purely economic standpoint. The reconcentration of wealth directly attributable to the tax cuts as well as indirectly realized from increased interest payments—acting as transfer payments—which will be stepped up by virtue of the built-in deficits created or increased by this bill, poses grave dangers. Political democracy can hardly survive without economic democracy.

Rate Reduction

GENERAL

The subject bill represents one of the most flagrant, obvious, and dangerous attacks of the past 35 years on the ideals, purposes, and underlying machinery of our economic democracy. Economic democracy is one of the hallmarks of our society, without which political democracy, social progress, and national purpose would soon cease to be.

In the name of equity this frontal attack is being made on the graduated income tax. The result will be a reconcentration of income and wealth in the 1929 pattern—an increased inequity.

In the name of economic expansion and employment opportunities, this bill would increase the already high liquidity of corporations, resulting not in increased jobs, but in increased automation, increased outflow of investment funds and jobs to Europe, and increased dividends to line the pockets of the rich and very rich.

In the name of social justice—the war on poverty, ignorance, disease, the hopelessness of those who dwell in city slums or in areas of worked out agricultural and mineral production—this bill would put the Federal Government in a fiscal straitjacket, denying to the Government the revenues required for any successful assault on poverty and its ugly bulwarks.

In the name of tax reform, this bill would, for at least a generation, dull the spur for real reform. Professed liberals will fain surprise in future wars for reform when they find themselves deserted by some of their current allies, even as the armies of David withdrew from Bathsheba's husband, leaving him naked and alone before the walls.

If the pattern of this bill is followed, we will likely witness, within the next few years, a worsening of our economy. We may well find ourselves repeating the 1954–57 pattern of nonsustainable productive capacity and increased unemployment.

Government—society organized for political purposes—does not exist for economic reasons alone, and I would never equate economic prosperity with the good life. But a society does not long live when it supports a politicoeconomic system which gives to the man who has one loaf two, while withholding from the man who has half a loaf or none.

Ideals and attitudes are as important as economics. The cynicism of some of the backers of this bill will be long remembered by those who are now without effective representation in Washington. Propaganda, like morphine, soon wears off. It will not be long before the majority of our citizenry awake to the realization of reality and know that their bag is still empty and there never really was a snipe in the woods at all.

We decry and deplore waste and inefficiency in Government spending—and rightly so. But those who are so enamored of aggregates and mesmerized by macroeconomic manipulation in the private sector seem to assume that they have discovered in a tax cut economic perpetual motion—without waste, without inefficiency, without friction. All we need to do, we are told, is to release the "brake" of taxation on the economy and the private sector will expand in exactly the right ways to cure unemployment, without inflation of course, and will with perfect equity insure the good life for all, without Government interference or activity.

And all this without error in decisionmaking. Where was Adam Smith's "unseen hand" when the Edsel automobile was stillborn?

The theory behind a tax cut of this type and magnitude, under conditions existing today, will not stand close examination. Indeed, it is difficult to pin down the theory upon which some base their support for this bill.

Regardless of theory, the practical results of a tax cut of the type proposed will be diametrically opposed to the ostensible goals of many of its proponents. The implementation of this fiscal folly is a reckless gamble with our entire national economy.

In theory, assuming we are all Keynesians, and assuming further that conditions today fit the situation envisioned by Lord Keynes when he tried to adapt economic theory to fit the world stagnation of the late 1920's and early 1930's, a deficit will inflate the economy. This deficit can be achieved by increased spending or decreased revenues. But conditions are far different in these days of dynamic expansion.

The result of this bill will be to transfer yet another large slice of national production and wealth from those who produce wealth to those who parasitically participate in its enjoyment.

II. THE ADMINISTRATION POSITION

From the early and recurring rumors of a tax cut which gained wide circulation in the early fall of 1962 to the present time, it has been difficult to understand from statements issued by spokesmen for the administration the specific purposes of this proposed tax reduction.

At times this bill seems to have been regarded as a vehicle for long-range tax reform.

At other times it appers to have been sold as a hedge against more or less imminent recession.

At still other items, it appears to be straight Keynesian deficit financing for the avoidance of low-level equilibrium in the economy.

Under current conditions, and in the form in which this bill now exists. This legislation makes a mockery of any and all these purported positions.

The late President Kennedy in his tax message of January 24, 1963, stated:

> My recommendation for early revision of our tax structure is not motivated by any threat of imminent recession * * *.

But by March, when some of the indicators seemed to hang a bit, he seemed to have something else in mind, telling us:

> If we don't have the tax cut, it substantially, in my opinion, increases the chance of a recession * * *.

By May it became apparent that 1963 would be a good business year, and Secretary Dillon came back to the original theme. On May 7, 1963, the Secretary of the Treasury—a consistent follower of Republican theory and doctrine—told the Chamber of Commerce of New York:

> Above all, it must be borne in mind that the President's program is not intended—and is not designed—merely as a quick and temporary shelter against recession. It was designed—and has always been intended—as a permanent program to raise our long term rate of overall economic growth.

But again, the late President Kennedy on September 9 expressed concern that without a tax cut in 1963 "we may move into a period of economic downturn."

Meanwhile, Dr. Heller was working the Keynesian theme. I must say he has stuck pretty closely to this line, which he set out most explicitly in an article which appeared in November 1962 in Nation's Business:

HOW CUT WOULD SPUR GROWTH

> The U.S. economy has consistently fallen short of its employment, production, income, and profits goals in the past 5 years. A sizable cut in tax liabilities both of households and businesses throughout the Nation would push the economy toward more robust activity in three main ways—ways which would bring business stronger markets, expanded investment opportunities and healthier profits:
>
> 1. Tax reduction would increase the disposable income—the take-home pay of consumers. Careful analysis of past experience indicates that consumers consistently spend from 92 to 94 percent of their disposable income. History also shows that when this income is increased, a high proportion of the increase is promptly spent.
>
> When consumers spend this income, markets strengthen, production rises, new jobs are created, and income and profits rise accordingly. This creates added cycles of private spending. Boosted spending and income results in what economists call the "multiplier effect." It produces an increase in gross national product of perhaps two or three times the original reduction in taxes. Gross national product, the total output of goods and services, is, of course, a major indicator of growth.
>
> 2. By strengthening sales and pushing output closer to capacity, tax reduction spurs investment in inventories and in new equipment and new plants. This impact on investment in productive capacity is called the "accelerator effect." The increased production of capital goods expands gross national product, stimulates further consumption and increases profits. It reduces the deterrent effect of excess capacity,

which has tended to discourage investment in productive facilities during the past 5 years or so.

3. Reducing personal and corporate taxes raises profit margins for businessmen and enlarges the supply of internal business funds available for investment. Tax reduction thus strengthens the incentive to invest in two ways: Businessmen have money available to undertake the risks of new investment. And there is the prospect of larger after-tax returns to be earned on new productive facilities.

So, tax reduction would help business directly by reducing the tax load on business enterprise and indirectly by stimulating demand for both consumer goods and capital goods, thereby boosting the volume of sales and output. Indeed, tax cuts achieve their stimulating effect mainly by inducing business to employ, produce, and innovate.

President Johnson stated in his Economic Report, "The tax cut will give a sustained lift, year in and year out to the American economy." This would seem to indicate that this action is in the nature of some sort of permanent reform.

Its proponents claim this bill will:

1. Stimulate economic growth.
2. Balance the budget.
3. Relieve unemployment.
4. Solve the balance-of-payments problem.
5. Avoid inflation.
6. Promote tax equity.

This is just what the doctor ordered, and it all comes in one little pill which causes the happy patient no pain whatsoever.

III. ECONOMIC EXPANSION

It is claimed that this bill would stimulate the economy in two ways. First, consumers, having more money to spend by virtue of a tax cut, will spend more and thus create additional demand. Second, investors will have more money to invest by virtue of being able to show a better rate of return.

But these are only the first steps. At that point the "multiplier" and the "accelerator" take over and we bootstrap ourselves up to the point where—within a relatively short time, of course—we increase our gross national product by at least three times the amount of the tax cut.

If there were a shortage of funds for investment, a tax cut for corporations might induce more investment. If there were a shortage of spendable personal income, a tax cut for consumers might create increased consumer demand.

But do these conditions prevail? Not at all. Corporations are highly liquid and rarely need to go to the capital markets for outside money. Corporations sold only about $1 billion of new common stock last year. Personal income, although poorly distributed, continues to rise. The irony of the tax cut is that it would give increased spending and purchasing power to those who need it least and who would use it sparingly. The man on the bottom of the poverty pile pays no income taxes now. He needs income, not a tax cut.

Now, what is the likelihood of complete, or nearly complete, and prompt, spending of increased personal income? The prospects are not good.

Already personal savings are high. Increased take-home pay by way of a tax cut is apt to increase savings, at least for several months. Of course, the man who is out of a job, or the man who is trying to get by on such a small income that he has no tax to pay, would spend more money if he could get it, but this bill does nothing for him.

Savings are up 25 percent in the past 3 years. Secretary Dillon, himself, in an interview reported in Banking for May 1963, said, "At present when our economy is not operating at full speed, it is characterized by what one might call an excess of savings."

If there is now an "excess of savings," why would it be thought that marginal income would be largely spent rather than saved?

I am not the only one who questions this aspect of this bill. As long ago as February 26, 1963, an article appeared in the Wall Street Journal emphasizing this point. Here are two paragraphs from that article:

> To many economists, the savings rise suggests that a tax cut to spur consumer spending—as proposed by the Kennedy administration—may not be particularly effective, at least in the middle and upper income brackets. If consumer demand continues to lag, they argue, a considerable part of extra income from reduced taxes would go into savings, rather than be spent.
>
> "The theory behind the tax cut idea is that it will stimulate demand," says J. Walter Thompson's Mr. Johnson. "But the savings accumulation suggests this may not happen." John R. Bunting, vice president of the Philadelphia Federal Reserve Bank, expresses "concern" that income consumers may receive through lower taxes "will be siphoned out of the spending stream" into more savings.

There is now no shortage of investment funds in the corporate structure. On the other hand, corporations are highly liquid. Profits are rising, and cash flows are rising even faster.

I do not see how hard statistics can be overlooked. In 1963, corporate cash flows, after allowing for taxes, amounted to about $60 billion. After record dividend payments, this left well over $40 billion in the hands of corporate management. Investment in plant and equipment amounted to only about $39 billion. Would anyone logically think that increasing cash flows by way of a tax cut would materially increase investment in plant and equipment—given these conditions?

We now have further statistical proof that a tax cut will induce little in the way of increased plant and equipment expenditures.

According to Dr. Heller, in addressing the Printing Industries of Metropolitan New York on May 20, 1963, a McGraw-Hill investment survey reported that business executives attributed $1.2 billion of the planned increase in plant and equipment expenditures for 1963 over actual expenditures for 1962 to the investment credit passed in 1962 by Congress and to the depreciation revisions instituted the same year by the Treasury Department. When one considers that the tax reduction given business as a result of these two changes in taxation amounted to about $2.25 billion, and this reduction in revenues induced a 50-cent investment of each tax dollar lost, can we expect any better results from an across-the-board tax cut?

I can see no way by which this tax cut can increase the GNP by $30 to $40 billion—not without inflation—even if we accept Keynesian theory as valid and apply it to existing conditions.

The principal results of a tax cut for corporations will be increased dividends and increased foreign investment which adds to balance-of-payments difficulties. A side effect is further to entrench the Big Three's and make it more nearly impossible for new enterprises to grow up and challenge them. Competition will be increasingly a thing of the past.

Certainly a tax cut will have some effect on economic growth. But that effect, under current conditions, will be much smaller, and slower in developing, than we have been led to believe. A tax cut, especially one weighted largely in favor of those who need it least, is the most expensive and least efficient way imaginable to get an economic boost.

IV. BUDGET BALANCING

It is a bit difficult to understand how this proposed tax cut is to balance the budget.

Dr. Heller and other more or less straight Keynesians have reasoned that through the magic of the "multiplier" and "accelerator" a tax cut of about $11 billion will cause an increase in the GNP of $40 billion or so and this increased economic activity will, in turn, bring in enough taxes at the new, lower rates to balance or nearly balance the budget.

President Kennedy seemed to start out on this tack in his tax message to Congress last January. He stated, as I have already pointed out, "It would be a grave mistake to require that any tax reduction today be offset by a corresponding cut in expenditures." This is genuine Keynesian theory. A deficit-creating tax cut will spur the economy, but this stimulating action would be offset and negated by a corresponding cut in Government expenditures. If these two actions were taken at the same time, they would pretty well cancel each other out.

There was, last January, no evidence that the late beloved President Kennedy wanted to cut back on worthwhile programs. Indeed, his budgets emphasized positive programs of development and were partially responsible for our economic expansion since 1961.

Mr. Ford's group issued a pronouncement during last year's "millionaire's march on Washington" which stated:

> We, therefore, believe it possible to hold Federal expenditures in fiscal 1964 below the level set forth in the budget this January. We believe this would have been impossible without the current pressures for economics generated by a proposed tax reduction. We urge the Congress and the administration to work jointly to achieve this goal.

This rationale is interesting. We are urged to cut taxes, reduce revenues, run up larger deficits, and it is argued that this will put additional pressure on the President and the Congress to cut spending. Of course, the spending which some want to cut is in the fields devoted to the social advancement of the whole country, to the attack on poverty, ignorance, disease, and hopelessness.

If we adopt the wrong kinds of expenditure reductions, we will certainly do untold harm to the Nation and to the economy. For we must continue to pursue worthwhile programs. Highways, education, health, etc., must not suffer if the Nation is to make any worthwhile progress. But these are the programs which will suffer under the kind of philosophy embraced by Mr. Ford.

V. THE "BRAKE" THEORY

We are told that our high tax structure acts as a "brake" on the economy, stifling both investment and consumer purchasing. Releasing this "brake" will, according to the argument, promote investment and increase final demand.

A favorite propaganda trick is to state a conclusion as the basis for a second conclusion, hoping that the first conclusion will be uncritically accepted as a proven fact. Those who try to sell this "brake" theory are indulging in just such sleight of hand.

We have heard the European countries praised for their swift postwar recovery, and for their wise fiscal policies which have reportedly promoted high rates of growth. How does the tax take of these countries compare with our own?

Secretary Dillon has testified that total taxes collected by all levels of government in the United States in 1961 amounted to 28 percent of gross national product. No major European country collected a smaller percentage—France, 35 percent; Germany, 35 percent; United Kingdom, 29 percent; Italy, 28 percent.

One might legitimately discuss the incidence of certain taxes, and argue that our tax structure needs to be reformed. But this is no argument for a reduction in total revenues. It is this latter situation which we face in this bill. Will those who now advocate tax cuts for the rich soon come before the Congress to propose replacing the revenue loss by a general excise tax, further to oppress the poor?

What about this "brake" theory so far as high bracket individual taxpayers in this country are concerned?

The regrettable fact is that the rich and the very rich do not now pay their fair share of the tax burden. And this bill makes the situation more, not less, inequitable.

The very rich now pay a low percentage of their realized income in taxes. From table I below, furnished by the Treasury Department, I have developed table II which shows just how light is the taxload at the upper end of the income scale.

The "brake" theory simply does not appear plausible unless one examines the lower end of the tax and income scale. It is here that we may need to restore the broad base of purchasing power which existed prior to World War II.

TABLE I.—*Tax savings and increase in after-tax income under House bill*

[Married couple with 2 dependents, with typical dividends, capital gains and other income,[1] and typical itemized deductions]

Adjusted gross income [1]	Present law		House bill		Tax cut or increase in after-tax income		
	Tax	After-tax income [2]	Tax	After-tax income [2]	Amount	Percentage tax cut	Percentage increase in after-tax income
$3,000	0	$3,131	0	$3,131			
$4,000	$143	3,987	$103	4,027	$40	28	1
$5,000	299	4,827	219	4,907	80	27	2
$6,000	455	5,671	339	5,787	116	26	2
$7,500	719	6,971	569	7,067	150	21	2
$10,000	1,193	8,993	972	9,214	221	19	2
$12,500	1,657	11,079	1,373	11,363	284	17	3
$15,000	2,196	13,189	1,830	13,555	366	17	3
$17,500	2,745	15,288	2,296	15,737	449	16	3
$20,000	3,369	17,344	2,820	17,893	549	16	3
$25,000	4,755	21,271	3,983	22,043	772	16	4
$30,000	6,322	25,139	5,297	26,164	1,025	16	4
$40,000	10,026	32,305	8,392	33,939	1,634	16	5
$50,000	14,254	38,947	12,217	40,984	2,037	14	5
$75,000	23,799	57,421	20,672	60,548	3,127	13	5
$100,000	33,965	79,247	29,670	83,542	4,295	13	5
$200,000	63,318	184,262	56,675	190,905	6,643	11	4
$500,000	154,249	567,116	138,216	583,149	16,033	10	3
$1,000,000	261,929	1,239,659	238,037	1,263,551	23,892	9	2

[1] Includes such income as wages and salaries, interest, rents, business and partnership income, royalties, and typical dividends and capital gains. Estimates of typical dividends and realized capital gains and itemized deductions are based on 1960 tax return data.

[2] After-tax income exceeds adjusted gross income for very-high-income-tax payers because 50 percent of the long-term capital gains, which constitute a high proportion of income for such taxpayers, is included in adjusted gross income under present law and 40 percent is included under the House bill.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Oct. 11, 1963.

TABLE II.—*Effective tax rates under H.R. 8363*

[Married couple with 2 dependents, with typical dividends, capital gains, and other income,[1] and typical itemized deductions]

Adjusted gross income [1]	Realized income [2]	Tax under H.R. 8363	Tax as percentage of realized income	Adjusted gross income [1]	Realized income [2]	Tax under H.R. 8363	Tax as percentage of realized income
$3,000	$3,131	0	0	$25,000	$26,026	$3,983	15.3
$4,000	4,130	$103	2.5	$30,000	31,461	5,297	16.8
$5,000	5,126	219	4.3	$40,000	42,331	8,392	19.8
$6,000	6,126	339	5.5	$50,000	53,201	12,217	23.0
$7,500	7,636	569	7.4	$75,000	81,220	20,672	25.5
$10,000	10,186	972	9.5	$100,000	113,212	29,670	26.2
$12,500	12,736	1,373	10.8	$200,000	247,580	56,675	22.9
$15,000	15,385	1,830	11.9	$500,000	721,365	138,216	19.2
$17,500	18,033	2,296	12.7	$1,000,000	1,501,588	238,037	15.9
$20,000	20,713	2,820	13.6				

[1] Includes such income as wages and salaries, interest, rents, business and partnership income, royalties, and typical dividends and capital gains. Estimates of typical dividends and realized capital gains and itemized deductions are based on 1960 tax return data.

[2] Realized income exceeds adjusted gross income largely because adjusted gross income includes only 40 percent of capital gains under H.R. 8363 (50 percent under existing law).

NOTE.—Several items, such as tax-exempt interest, ½ of long-term capital gains, including so-called statutory gains which often have no logical relationship to capital transactions, depletion, and intangible drilling costs, are omitted from adjusted gross income and from realized income.

Source of basic data: Office of the Secretary of the Treasury, Office of Tax Analysis. See table on p. 709 of Finance Committee hearings.

The proponents of this legislation also err when they attempt to apply the "brake" theory to corporate taxation. Although stated corporate rates have not been reduced in recent years, the actual tax burden has been considerably lightened by changes in laws and regulations applicable to depreciation, and to the investment credit. Such positive Government programs as stepped up research and development expenditures, most of which go to and through industry, have relieved corporations of the necessity for spending their own funds for activities they would otherwise have to budget for and undertake.

But let us look at corporation taxes as they are assessed against corporate gross income, not as they appear to be levied as a percentage of certain bookkeeping figures.

Just as it is necessary to go behind the stated rates and look at total income in order to know just what effective tax rate any individual pays, so is it necessary to look behind the stated 52 percent rate for corporations to determine just what the true tax and profit figures are.

Effective tax rates for corporations have been reduced quite steadily and regularly during the past few years. There were rapid amortization procedures during the Korean war, accelerated depreciation enacted in 1954, administrative changes in depreciation approved by the Treasury last year, the investment credit enacted last year, and the further liberalizing of this credit contained in the subject bill. Of course, we have retained the same stated rates, but the effect of these rates has been drastically altered, thus materially reducing the effective rate.

It seems difficult for some, economists and laymen alike, to understand that these actions have the effect of reducing the burden of income taxation on corporations. But the effect is just as real as is the effect on individuals when a new deduction, or an increase in an exemption, is enacted.

As proof of this, one has merely to look at the profits curve on page 7 of the Economic Indicators. Due to the fact that depreciation guidelines were revised so drastically last year, a new curve had to be started. The corporate profit figures are not now comparable to the figures prior to 1962.

Some facts relative to corporate profits, taxes, and cash flows are shown on table III below.

TABLE III

[In billions of dollars]

	Gross national product	Dividends paid	Corporate profits after tax	Corporate profits after tax plus capital consumption allowances	Dividends as a percent of gross national product	Dividends as a percent of corporate profits after tax	Corporate profits after tax plus CCA as a percent of gross national product	Dividends as a percent of corporate profits after tax plus CCA
1946	210.7	5.8	13.4	18.6	2.8	43.3	8.8	31.2
1947	234.3	6.5	18.2	24.5	2.8	35.7	10.5	26.5
1948	259.4	7.2	20.5	28.2	2.8	35.1	10.9	25.5
1949	258.1	7.5	16.0	24.5	2.9	46.9	9.5	30.6
1950	284.6	9.2	22.8	32.2	3.2	40.4	11.3	28.6
1951	329.0	9.0	19.7	30.7	2.7	45.7	9.3	29.3
1952	347.0	9.0	17.2	29.6	2.6	52.3	8.5	30.4
1953	365.4	9.2	18.1	32.2	2.5	50.8	8.8	28.6
1954	363.1	9.8	16.8	32.7	2.7	58.3	9.0	30.0
1955	397.5	11.2	23.0	41.4	2.8	48.7	10.4	27.0
1956	419.2	12.1	23.5	43.5	2.9	51.5	10.4	27.8
1957	442.8	12.6	22.3	44.1	2.8	56.5	10.0	28.6
1958	444.5	12.4	18.8	41.4	2.8	66.0	9.3	30.0
1959	482.7	13.7	24.5	48.7	2.8	55.9	10.1	28.1
1960	502.6	14.5	22.0	47.6	2.9	65.9	9.5	30.5
1961	518.2	15.3	21.8	48.6	3.0	70.2	9.4	31.5
1962	554.9	16.6	24.6	55.4	3.0	67.5	10.0	30.0
1963	575.7	17.4	26.1	58.0	3.0	66.7	10.1	30.0

Source: Staff of the Joint Committee on Internal Revenue Taxation.

This table shows that corporate profits after taxes just barely doubled between 1946 and 1963, while GNP almost tripled. This has led many to believe, and to state, that corporate profits have not kept pace with GNP. This has been cited as one of the reasons for our alleged slow rate of growth in recent years. It has been said that this is one reason for the lack of sufficient investment in new plant and equipment, and that this has, in turn, been one of the main causes of unemployment. Thus, the need for a tax cut for corporations.

But corporate profits after taxes plus capital consumption allowances have kept pace with GNP, running at a pretty steady 10 percent. Furthermore, dividends have kept pace with GNP, running about 3 percent.

If one claims that only the profit figures are to be considered, then he must of necessity condemn corporate management for paying out too much in dividends. Dividends being paid out today amount to about two-thirds of corporate profit after taxes. As a percentage of corporate profit after taxes, dividends have gone up 50 percent since 1946. If bookkeeping profit is in reality the key figure, then dividend payments are, without question, too high and more earnings ought to be retained.

The fact is that corporations are highly liquid, and cash flows have in recent years exceeded investment in new plant and equipment.

As for effective taxation, corporations got about $2.4 billion in tax reduction under the 1954 Internal Revenue Code. Last year they got another $2.25 billion as a result of changes in depreciation and enactment of the investment credit. What is the effective corporate tax rate? In 1946, corporate taxes amounted to about 33 percent of profits plus capital consumption allowances. Today, the comparable figure is about 29 percent. This is an effective tax reduction of about 12 percent.

Not only have we been cutting tax rates in a disguised form, but these cuts have not really been effective—or they have been inefficient—in promoting investment in plant and equipment. We have concrete proof of this.

The most optimistic statements I have seen about the effects of the $2.25 billion tax reduction given corporations last year have been to the effect that this cut has induced $1.2 billion of increased spending for plant and equipment. This is an efficiency of about 50 percent. Can we expect any better performance from this year's proposed cuts? I think not.

We give corporations a tax cut of $2 to induce them to spend $1 for plant and equipment. Hopefully this kind of expenditure, costly as it is to the Government, will create jobs. Actually it has not, and likely will not, at least not in manufacturing. We have lost about 1 million production jobs in manufacturing during the past 6 or 7 years, despite increased production.

Equity does not dictate a reduction in corporate tax rates, because dividends are maintaining pace with the economy as a whole, and the high income individuals, who own the large blocks of stock, are being given a drastic reduction in their own rates under the bill, H.R. 8363.

Economic reasons also fail to convince. A tax cut is a most inefficient way to induce expenditures by corporations. And plant and equipment expenditures in industry are not likely to create many jobs. Indeed, industry is daily accelerating the trend toward automation, thereby not only failing to create jobs, but even failing to maintain current job levels.

VI. UNEMPLOYMENT AND POVERTY

One of the more appealing arguments in favor of a mammoth tax cut is that this action will result in a drastic decrease in unemployment. It is a sad commentary on our economic and social system that so many who want and need jobs are unable to find them. Even worse, in some respects, is the fact that in many cases when jobs are available those who need those jobs are not qualified to fill them.

This is an appealing argument, because we want to insure, insofar as we are able, the right and the opportunity for each of our citizens who wants and needs a job to have one. We want our people to be self-supporting, self-reliant, prosperous, and secure.

But it is far from certain that the tax cut will reduce our excessive unemployment. Indeed, in my view, it is more likely, after about 18 months, to cause increased unemployment. A tax cut is not the place to start—or to stop a war on poverty and unemployment.

We need to look squarely at our unemployment and see just what it consists of and what has caused it. In what geographical, age, health, and ethnic areas is it concentrated? Can increased general demand cure it without causing inflation?

To begin with, we are not suffering unemployment because of a recession or depression. On the contrary, the economic indicators are, by and large, at alltime highs. We are not in that desperate condition we faced during the great depression when almost any gamble seemed in order—no matter how inefficient, or how dangerous.

We are not suffering unemployment because of lack of capital or productive capacity. The corporate sector is highly liquid; and about 12 to 15 percent of plant capacity is idle. Certainly our basic productive structure is sound, and we would have no trouble increasing production in almost any area where demand is spurred. But would this put many of the presently unemployed to work? Some confuse poverty and unemployment, and the two are closely linked. But we should always keep in mind that we do not have poverty for lack of production. Our situation economically is almost unique in recorded history. Characteristically and historically, there has been, in every society, a problem of sufficient total production. This is not our problem. We have an almost unlimited capacity to produce. Our basic problem is distribution, and the understanding of this fact is a necessary prerequisite to formulating any workable plan for an attack on unemployment and poverty. There must be a proper distribution of the fruits of national production, and this is best achieved in our society by a proper distribution of jobs which pay a decent wage.

There are two general ways of attacking unemployment. Such an attack can be directed toward increasing production and creating additional jobs. A slightly different type of attack focuses on a more equitable distribution of jobs without materially increasing total national production. We need to launch this two-pronged attack.

A tax cut does not fit into this picture. I am sorry to say that it will likely make matters worse. This is particularly true of the type of tax cut contained in the subject bill.

The first type of attack must be concentrated on increased production in the public sector, for this is where our unfulfilled demands now largely lie—for better rapid transit systems, better housing for low income groups, better educational facilities at all levels, better highways, more and better hospitals and nursing homes, more clean drinking and industrial water. It is here that jobs could readily, directly, and with profit to society, be created. But this takes public funds, which will be less available after passage of the tax bill.

Furthermore, to the extent this tax cut is effective in spurring increased investment, we are likely to build up a capacity which cannot be sustained by demand in the private sector, just as was the case in 1956–57. This may worsen unemployment in the not distant future, and especially so when accompanied by policies of economic retrenchment and monetary squeeze.

Those who would fight unemployment and poverty only by trying to increase overall demand do not understand the nature of the problem or the composition of the unemployed segment of our labor force, and the poverty-stricken in the midst of our affluence.

Present unemployment is largely structural. It is concentrated in certain geographical localities, certain age groups, certain social and ethnic categories. Unemployment is daily being worsened, or at least made more difficult to cure, by technological advances—automation, if one uses the term loosely.

From 1953 to 1962 investment in scientific research and development tripled. As a result, partially, of this effort, we are now losing 2 million jobs each year because of the laborsaving effects of increasing productivity. Manufacturing employs about 1 million fewer production workers than was the case just 6 or 7 years ago, despite vastly increased production.

This may be all to the good, and I know of no latter-day Luddites, but we must recognize the fact that no longer does increased production through increased overall demand create jobs in large numbers for the unskilled. The seeds of inflation would be sown by a shortage of skilled labor long before profitable work could be found for the bulk of presently unemployed. Altogether too large a proportion of our unemployed are not qualified to hold down productive positions in our highly mechanized and automated economy, even if those jobs could, somehow, be created.

Unemployment, and poverty, sprouting from such roots, cannot be cured by a tax cut. The type of unemployment problem we have requires more specific treatment. We must concentrate more on the public sector as well as upon encouraging and assisting private enterprise to play its part as the mainstay of our economy.

The other half of our two-pronged attack centers around encouraging certain types of persons to delay or refrain from entering the labor market—some temporarily, some permanently. After all, unemployment is a product of the participation rate—the numbers of people who say they want a job—as well as of the total number of jobs available.

One obvious place to begin here—and with profit to society—is to set up programs designed to delay the entry of young people into the labor market until they are better qualified. This would not only make for a more stable labor force, but it would also assist these young people individually to achieve a more well-rounded life, as well as specifically to fit them for more productive jobs when they do enter the labor force. We have been altogether too timid about moving into this area. Education is the key here, not a tax cut. This kind of realistic and highly beneficial attack on unemployment will cost money, thus indicating the need for more, not less, Government revenue.

Another approach of this sort is to assist those wives and mothers who wish to devote more time to their homes and children and who really do not want to work, but who feel they must, to stay out of the active labor force. We could help them in their home life, and society as a whole, if we took steps to insure that the head of the household earned a proper wage so the family could maintain a decent standard of living without the mother having to leave the home every day to seek employment.

It is not generally realized, perhaps, just to what extent women have increasingly come into the labor force since World War II. At the same time, relatively more men have been dropping out of the labor force. This may not be socially desirable.

In 1947, the participation rate for women was 31.0 percent. This figure rose in 1962 to 36.7 percent. During the same period of time, the participation rate for men went down from 84.5 percent in 1947 to 79.3 percent in 1962.

Let me make it very, very plain that I favor full employment opportunities for men and women alike—the opportunity for a decent job for any man or woman who is able and willing to work. But I am opposed to a social and economic structure which forces wives and mothers to leave their homes and children daily to seek work because the head of the household is not paid a wage or salary which will keep the family in decent comfort. I am opposed, too, to a tax system that penalizes the parent as a taxpayer.

A tax cut for corporations and the high income brackets hardly fits in here. If a tax cut must be had, then tax relief for parents of the largest numbers of children would be fairest and of greatest benefit.

In this connection, also, we need to look more closely into the area of the minimum wage, overtime pay, and the length of the workweek.

Unemployment can be partially cured, of course, by increasing production. But, as I have pointed out, the increased production that is needed is not in the private sector where there are neither shortages nor reasonably full utilization of capacity, but in the public sector. A tax cut does not fit in here at all. Worse still, the capacity of the Government to provide for our pressing public needs will be seriously and permanently impaired by a drastic reduction in revenue.

We cannot cure unemployment and poverty by reducing revenues and leaving ourselves defenseless, bereft of our most useful weapon, before the onslaught of the next recession.

VII. BALANCE-OF-PAYMENTS CONSIDERATIONS

Because the economic royalists who are now running the Treasury Department refuse to take positive action to stem the outflow of private capital, or to take such other steps as might be indicated, the balance-of-payments problem persists. Indeed, our situation can hardly be said to have improved at all.

During 1962 there was some apparent improvement—more apparent than real, because there were several special operations, such as advance repayments well ahead of schedule, on obligations of certain foreign governments.

During the first half of 1963, capital flows reached runaway proportions. The apparent improvement during the last half of the year may be illusory, representing only a partially balancing of forces at work earlier in the year.

It is felt by proponents of the subject bill that a tax cut will help materially in solving our balance-of-payments problem. It will not.

It is felt, first, that the cost of production will be lower and our goods will be more competitive in world markets. We have not achieved lower prices as a result of the investment credit and depreciation changes, and both had the effect of reducing corporate taxes. We will not achieve lower prices as a result of this tax cut.

Even if we were to achieve lower prices through any mechanism whatsoever, this would not materially increase exports. Other countries use direct controls to regulate imports of merchandise and exports of capital. Witness the "chicken war." We will certainly not achieve a sufficiently large favorable balance in goods and services to overcome other areas of deficiency.

Proponents of this bill also claim that the economy will be so booming—without inflation, of course—and domestic investment will pay off so handsomely as a result of the enactment of this bill that no longer will money go abroad to find a higher rate of return.

This is an argument which is so fantastic that it is difficult to answer.

Investment decisions are dictated by many considerations—markets, raw materials, costs, taxes—and so long as out investors can earn high rates of return abroad, and build up their investment without the necessity of paying U.S. taxes, there will be continued encouragement to send funds abroad.

In 1962, the Congress took a timid step in the direction of closing off some of the tax haven operations abroad, but this did not really reach the direct investment problem.

In 1963, after it became apparent that interest rates could not be pushed high enough to stop portfoilo outflows without doing untold damage to the domestic economy, the administration proposed the so-called interest equalization bill. The threat of this legislation appears to have had some effect on portfolio outflows, but this effect now appears to be wearing thin.

It seems to be obvious that a positive program of regulation of capital flows is the answer to our direct and portfolio outflow of capital. But it would appear that no action along this line will be taken. Barring such action, the approach of indirect regulation by taxation is the next best thing. It is not sufficiently selective. Methods of avoidance will be found. But if this is the best we can do, let us at least do that.

All other modern industrial countries invoke positive controls whenever it appears to be in their interest to do so. The fact that we do not is difficult to understand or justify.

The most likely effects of the bill on the balance of payments are—

1. Increased imports.
2. No material change in exports. The domestic price level is, to the extent the bill is at all effective, likely to be inflated. This will likely make exports move more slowly.
3. Higher interest rates. This may slow down portfolio outflows, but it will, in turn, slow down the whole domestic economy.

All in all, it would seem that the bill will not help achieve a balance in our international payments.

VIII. TAX REDUCTION AND INFLATION

If I understand correctly the position of the proponents of this bill, it is not that it will help to curb inflation; rather, it will boost economic activity without causing inflation.

It is claimed that, because we now have high unemployment and unused plant capacity, we can have greatly increased production without inflationary pressures.

Although inflation does not seem to be a matter of major concern at the moment, the Consumer Price Index has crept up consistently, and some commodities are now beginning to push upward in price.

But what will happen if the tax cut really does react in the way its proponents hope it will?

Can any really large dent be made in the ranks of the unemployed without putting pressure on certain skills and categories of workers?

There are some relatively scarce categories of trained personnel, and pressures will be felt in these categories even though we still have several million of the unskilled and uneducated unemployed.

But what really concerns me more is the tight rope which must be walked—it is felt—by our money managers. My fear is that, in attempting to guard against monetary inflation, the Federal Reserve Board will raise interest rates and restrict the supply of money so that, having rid our house of the supposed evil spirit of high taxes, we will find it filled with the even more malevolent spirits of high interest rates, tight money, restrictive debt management, and reduced spending. Truly our final state will be worse than our former.

IX. EQUITY

Although economic considerations are important when considering the tax structure, equity must not be ignored.

There is little equity in this bill.

The new minimum standard deduction gives some relief to the lowest income groups, but it is not enough.

There is no better way to show the basic inequity of the changes in the rate structure which this bill makes—by far the most important part of the bill—than to note the increase in after-tax income or take-home pay which this bill gives to various income groups.

The tables below were prepared by the staff of the Joint Committee on Internal Revenue Taxation, and show (col. 8) the treatment which taxpayers in various income groups will receive from the rate reductions.

TABLE IV.—*Individual income tax liability: Under present-law tax rates, under H.R. 8363 tax rates, and under uniform percentage increase in taxable income after present-law tax; selected levels of taxable income, 1965, single person*

Taxable income	Tax		Taxable income after tax		Reduction in tax or increase in taxable income after tax				
					Under H.R. 8363			Under uniform percentage increase in taxable income after tax (5.95 percent)	
	Present law	H.R. 8363	Present law	H.R. 8363	Amount	As percent of present-law tax	As percent of taxable income after present-law tax	Amount	As percent of present-law tax
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
$500	$100	$70	$400	$430	$30	30.0	7.5	$24	24.0
$1,000	200	145	800	855	55	27.5	6.9	48	24.0
$1,500	300	225	1,200	1,275	75	25.0	6.3	71	23.7
$2,000	400	310	1,600	1,690	90	22.5	5.6	95	23.8
$4,000	840	690	3,160	3,310	150	17.9	4.7	188	22.4
$6,000	1,360	1,130	4,640	4,870	230	16.9	5.0	276	20.3
$8,000	1,960	1,630	6,040	6,370	330	16.8	5.5	359	18.3
$10,000	2,640	2,190	7,360	7,810	450	17.0	6.1	438	16.6
$12,000	3,400	2,830	8,600	9,170	570	16.8	6.6	512	15.1
$14,000	4,260	3,550	9,740	10,450	710	16.7	7.3	580	13.6
$16,000	5,200	4,330	10,800	11,670	870	16.7	8.1	643	12.4
$18,000	6,200	5,170	11,800	12,830	1,030	16.6	8.7	702	11.3
$20,000	7,260	6,070	12,740	13,930	1,190	16.4	9.3	758	10.4
$22,000	8,380	7,030	13,620	14,970	1,350	16.1	9.9	810	9.7
$26,000	10,740	9,030	15,260	16,970	1,710	15.9	11.2	908	8.5
$32,000	14,460	12,210	17,540	19,790	2,250	15.6	12.8	1,044	7.2
$38,000	18,360	15,510	19,640	22,490	2,850	15.5	14.5	1,169	6.4
$44,000	22,500	18,990	21,500	25,010	3,510	15.6	16.3	1,279	5.7
$50,000	26,820	22,590	23,180	27,410	4,230	15.8	18.2	1,379	5.1
$60,000	34,320	28,790	25,680	31,210	5,530	16.1	21.5	1,528	4.5
$70,000	42,120	35,190	27,880	34,810	6,930	16.5	24.9	1,659	3.9
$80,000	50,220	41,790	29,780	38,210	8,430	16.8	28.3	1,772	3.5
$90,000	58,620	48,590	31,380	41,410	10,030	17.1	32.0	1,867	3.2
$100,000	67,320	55,490	32,680	44,510	11,830	17.6	36.2	1,944	2.9
$150,000	111,820	90,490	38,180	59,510	21,330	19.1	55.9	2,272	2.0
$200,000	156,820	125,490	43,180	74,510	31,330	20.0	72.6	2,569	1.6
$300,000	247,820	195,490	52,180	104,510	52,330	21.1	100.3	3,105	1.3
$400,000	338,820	265,490	61,180	134,510	73,330	21.6	119.9	3,640	1.1
$600,000	520,820	405,490	79,180	194,510	115,330	22.1	145.7	4,711	.9
$800,000	696,000	545,490	104,000	254,510	150,510	21.6	144.7	6,188	.9
$1,000,000	870,000	685,490	130,000	314,510	184,510	21.2	141.9	7,735	.9

Source: Staff of the Joint Committee on Internal Revenue Taxation, Oct. 4, 1963.

TABLE V.—*Individual income tax liability under present law tax rates, under H.R. 8363 tax rates, and under uniform percentage increase in taxable income after present law tax; selected levels of taxable income; 1965; married couple—joint return*

Taxable income	Tax		Taxable income after tax		Reduction in tax or increase in taxable income after tax				
					Under H.R. 8363			Under uniform percentage increase in taxable income after tax (5.95 percent)	
	Present law	H.R. 8363	Present law	H.R. 8363	Amount	As percent of present law tax	As percent of taxable income after present law tax	Amount	As percent of present law tax
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
$1,000	$200	$140	$800	$860	$60	30.0	7.5	$48	24.0
$2,000	400	290	1,600	1,710	110	27.5	6.9	95	23.6
$3,000	600	450	2,400	2,550	150	25.0	6.3	143	23.8
$4,000	800	620	3,200	3,380	180	22.5	5.6	190	23.6
$8,000	1,680	1,380	6,320	6,620	300	17.9	4.7	376	22.4
$12,000	2,720	2,260	9,280	9,740	460	16.9	5.0	552	20.3
$16,000	3,920	3,260	12,080	12,740	660	16.8	5.5	719	18.3
$20,000	5,280	4,380	14,720	15,620	900	17.0	6.1	876	16.6
$24,000	6,800	5,660	17,200	18,340	1,140	16.8	6.6	1,023	15.0
$28,000	8,520	7,100	19,480	20,900	1,420	16.7	7.3	1,159	13.6
$32,000	10,400	8,660	21,600	23,340	1,740	16.7	8.1	1,285	12.4
$36,000	12,400	10,340	23,600	25,660	2,060	16.6	8.7	1,404	11.3
$40,000	14,520	12,140	25,480	27,860	2,380	16.4	9.3	1,516	10.4
$44,000	16,760	14,060	27,240	29,940	2,700	16.1	9.9	1,621	9.7
$52,000	21,480	18,060	30,520	33,940	3,420	15.9	11.2	1,816	8.5
$64,000	28,920	24,420	35,080	39,580	4,500	15.6	12.8	2,087	7.2
$76,000	36,720	31,020	39,280	44,980	5,700	15.5	14.5	2,337	6.4
$88,000	45,000	37,980	43,000	50,020	7,020	15.6	16.3	2,559	5.7
$100,000	53,640	45,180	46,360	54,820	8,460	15.8	18.2	2,758	5.1
$120,000	68,640	57,580	51,360	62,420	11,600	16.1	21.5	3,056	4.5
$140,000	84,240	70,380	55,760	69,620	13,860	16.5	24.9	3,318	3.9
$160,000	100,440	83,580	59,560	76,420	16,860	16.8	28.3	3,544	3.5
$180,000	117,240	97,180	62,760	82,820	20,060	17.1	32.0	3,734	3.2
$200,000	134,640	110,980	65,360	89,020	23,660	17.6	36.2	3,889	2.9
$300,000	223,640	180,980	76,360	119,020	42,660	19.1	55.9	4,543	2.0
$400,000	313,640	250,980	86,360	149,020	62,660	20.0	72.6	5,138	1.6
$600,000	495,640	390,980	104,360	209,020	104,660	21.1	100.3	6,209	1.3
$800,000	677,640	530,980	122,360	269,020	146,660	21.6	119.9	7,280	1.1
$1,000,000	859,640	670,980	140,360	329,020	188,660	21.9	134.4	8,351	1.0

Source: Staff of the Joint Committee on Internal Revenue Taxation, Oct. 4, 1963.

These tables show some very disturbing results. Whereas a married couple filing a joint return, having a taxable income subject to ordinary income rates of $3,000 per year, will gain $150 from the rate reductions in the bill, the more affluent couple with a taxable income of $300,000 will pick up an extra $42,660. As a percentage of taxable income, this would mean an extra 6.3 percent to this $3,000 couple, but an extra 55.9 percent to the $300,000 couple. For the really rich, the gain would be more than 100 percent in take-home pay after tax income.

It has been pointed out, and I want this clearly understood, that the table does not reflect the full picture insofar as the rich and very rich are concerned. The typical high income taxpayer is able to take advantage of many loopholes in the law. The affluent do not pay taxes in accordance with the regular, ordinary income tax rates. But the table does show the true picture with respect to whatever taxable income any taxpayer has to which the published ordinary income rates apply.

The majority of Americans pay their taxes in accordance with the stated rates. This is not true, however, of the "typical" taxpayer with a very large income. But the gain which would be realized under the tax bill by those in the upper income groups would be tremendous. In my view, it would be grossly unfair.

A far more equitable way of reducing taxes, if we can afford a large reduction in governmental revenue, would be to raise the personal exemption for each taxpayer and each dependent. This would give everyone a more nearly equal and equitable amount of tax benefit.

Referring again to the table, it shows that a taxpayer with a small income would receive a very small percentage increase in take-home pay. It would be a percentage increase of a small amount. But those who have large taxable incomes would receive a large percentage increase in take-home pay. It would be a large percentage of a large amount.

Instead of the pending bill making our tax system more progressive, more equitable, more stimulative primarily of the consumer element of our economy, it would do just the reverse. Its enactment would bring a more regressive tax law, a more unfair tax law, a more unjust tax law, and would allow those with really large incomes, who now do not pay their fair share now to pay less.

X. SUMMARY OF RATE REDUCTION ASPECTS OF THE BILL

With 3 years of rapidly expanding economy behind us and the prospect of another good year—perhaps the best in our history—before us, it would appear that our economy is doing quite well.

From the viewpoint of those who would use fiscal policy actively in a countercyclical way, this would appear to be the worst possible time to initiate and carry through a tax cut.

If a tax cut is indicated, the nature and magnitude of the cut could hardly coincide with the one provided by this bill. The broad base of our consumer purchasing power has not been restored since World War II, and it is this element of our economy, in the private sector, which may possibly need some stimulation. This kind of stimulation can best be brought about by raising the personal exemption. Equity, likewise, would dictate such a change.

We do have high unemployment and pockets of poverty, but the indicated corrective action must take into account specific problems and any acceptable solution must provide specific solutions. Increasing overall demand artificially through a tax cut which is poorly balanced will do little and at great cost.

Positive programs of education, and increased production in the public sector, will accomplish much, and at less cost in money. Moreover the benefits to society would be immeasurable in the long run.

STRUCTURAL CHANGES

I. GENERAL

This bill makes a mockery of tax reform. There has been a tremendous slippage in reform from the general tenor of the remarks of administration spokesmen in 1962, to the actual proposals advanced by President Kennedy in January 1963, to the bill as approved by the Ways and Means Committee, and finally to the bill now reported from the Finance Committee.

I think it is not too extreme to say that this bill, providing as it does for enormous tax benefits for the rich and very rich through rate reduction in the upper brackets has rung the death knell for tax reform. What little reform there is in the bill, and it is miniscule when measured by obvious needs, will mark the last serious effort at reform for a generation.

Given a decent amount of time, the Senate might possibly be prevailed upon to make some significant moves toward reform. But the drumfire of propaganda and pressure for passage of this bill without quite taking the time to read it has made any serious discussion difficult if not impossible.

Under the circumstances, it is necessary to concentrate on a very few structural changes. My efforts shall be directed toward defending the public interest against special interest raids. There is so little hope of positive reform. There is such great fear of further damage.

II. THE INVESTMENT CREDIT

As is so often the case, a tax loophole once opened is quickly widened. The crevice deepens and an apparently slight erosion of the tax base soon becomes a great gully. Often this is a process which takes a few years. In the case of the investment credit, however, the ink was hardly dry when the beneficiaries of this tax refund—a refund which must come out of the pockets of average taxpayers—began efforts to fatten themselves further.

I will not here repeat what was stated in minority views signed by Senator Paul Douglas and me when the investment credit was first adopted in 1962. For anyone who might be interested, I would cite the Report of the Committee on Finance on the Revenue Act of 1962, page 396.

Section 203 of the subject bill as reported by the Finance Committee simply makes the investment credit twice as bad as it was when it was enacted. The credit now becomes an outright gift, with not even the pretense of partial recovery through slightly decreased depreciation allowances.

There is one additional provision in this section, however, which does not even relate to revenues, and therefore has no place in this bill, but which is conducive of untold mischief. I refer to section 203(e), which would direct the Federal regulatory agencies not to order any of the benefits of the investment credit "flowed through" to consumers.

Regulatory agencies have two basic choices in handling the treatment of the tax refunds represented by the investment credit.

One method is to "flow through" the tax cut, that is, put the tax savings into the net profit figure, where it would, of course, operate to raise the utility's rate of return. It does so operate, even if the company and the regulatory agency agree to allow it to be hidden somewhere else in the books—or to pretend it does not exist, that all apparent taxes were actually paid. But if logic, equity, and decency prevail, this tax savings will be shown as a reduction of costs, or an increase in profits, and the consumer, the customer of the utility, will eventually benefit through reduced rates.

The other choice, and the one which would in effect be ordered by this bill, is to "normalize" the tax savings, that is, to permit the utility to use this tax refund as it sees fit, while continuing to charge its customers the full price it would be allowed to charge if these taxes were, in fact, actually paid.

I think it is not putting the matter too strongly to say that the Congress is, with the passage of this bill with this section intact, ordering the regulatory agencies to participate in the perpetration of a fraud on the consumers of electricity, gas, and other goods and services which come to them from these favored companies which have been given monopolies, and against whom the consumer has no recourse—there is no competitive choice available to him.

On January 23, 1964, the Federal Power Commission announced its decision in favor of "flow through." Other Federal regulatory agencies are reluctant and indecisive, and are dawdling in the hope the Congress will prohibit them from performing their duty. They have been standing by since the investment credit was enacted in 1962.

But even industry spokesmen have, in some instances, spoken out against this unconscionable theft from their customers.

Mr. Donald C. Cook, president of American Electric Power Co., Inc., in a letter to the chairman of the Finance Committee, a copy of which was very kindly sent to me, and I am sure to all members of the committee, by Mr. Cook, has set out his views on this subject.

Here is a paragraph from Mr. Cook's letter:

> It is my view that the investment credit does in fact represent a reduction in current Federal income tax expense, and therefore a reduction in current operating expenses; that the investment credit will stimulate capital expenditures by utilities even if all or part of the tax saving is passed on to customers, or if the tax saving forestalls or reduces an otherwise necessary increase in rates; and, indeed, that the use of this tax saving to reduce or avoid an increase in the price of the taxpayer's product is best calculated to increase demand and in turn to stimulate plant investment, and thus to carry out the basic objectives underlying the adoption of the credit.

Mr. Cook went on to say that he understood that his views were shared by many other utility companies and regulatory agencies.

The question of equity and forced, if not false, bookkeeping aside, there are tremendous sums of money involved. By the passage of this section, the Congress is taking away from consumers some $300 million per year by forcing higher rates on the customers of natural gas pipelines and electric utilities under the jurisdiction of the Federal Power Commission alone, considering both their interstate and intrastate business. And this is just one segment of regulated activities.

If the matter would stop with the handling of the investment credit, the situation would be bad enough. But already proposals have been advanced to have the Congress order the Federal regulatory agencies to allow regulated monopolies to "normalize" with respect to other funds.

During the Korean war, rapid amortization certificates were issued to many companies. In the 1954 Code, accelerated depreciation was approved. As a consequence, the sums of money collected from consumers by the monopolies operating in the utility field—supposedly regulated—are truly astronomical.

Amendment No. 350 to this bill has already been offered and may well be brought up during floor debate. This amendment would order the Federal regulatory agencies to give the same treatment this bill accords the investment credit to amounts set aside under liberalized depreciation provisions.

Accumulated deferred taxes of companies under the jurisdistion of the Federal Power Commission amounted to some $2 billion at the end of 1962.

These amounts, set aside under provisions of section 167 and 168 of the code, have given rise to sizable tax-free dividends. With the enactment of the principle enunciated in this bill, section 203(e), consumers will be denied the benefit of past rate reductions. They will continue to pay rates based on phantom, nonexistent taxes which show on the books, but which are never, in actuality, paid.

III. CAPITAL GAINS TREATMENT

In one major respect, the Finance Committee has improved the bill. The committee decided to delete the provision in the House-passed version of this measure which provided for an inclusion factor of only 40 percent (50 percent under present law) and a maximum rate of 21 percent (25 percent under present law) for capital gains on assets held for 2 years or longer.

It is in the capital gains area that muchof the tax dodging takes place, and this action on the part of the committee is highly commendable. At least, it is commendable in that the committee did not make a sorry situation sadder. The committee did not, of course, go so far as to make any real improvement in existing law. Holding the line, however, is a noteworthy accomplishment.

It has become customary to reduce effective tax rates by allowing many transactions which are not logically capital transactions to be so classified. One often hears of a highly compensated executive "running his money through" oil or timber or cattle. Hopefully the time will come when some real progress can be made toward correcting the many abuses associated with capital gains. In the meantime, it is important that things not be made even more unwholesome by reducing capital gains rates.

It is through the capital gains route that the rich and very rich are often able to reduce their effective tax rates. In this connection, the table prepared by the Treasury and which appears on page 2606 of the Finance Committee hearings, is most revealing.

This table shows that, under existing law, a taxpayer with adjusted gross income of $700,000 may pay an effective tax rate which will vary from 20.1 percent to 47.6 percent, according to whether he has a high or low proportion of capital gains in his income. Under the House bill, of course, the situation is worse, his rates varying from 18.1 to 39.9 percent.

What ever happened to the 91 percent, so-called "confiscatory" tax rate?

This table also shows that the taxpayer with adjusted gross income of $2 million might pay a rate as high as 46 percent if he has little capital gains, or as low as 18.5 percent if he has a lot of capital gains, under terms of the bill.

Incidentally, although the Treasury elsewhere has tried to show that the rich and very rich gain little from the bill's rate reductions for ordinary income, this table shows that this $2 million man with little capital gains keeps a full 10 percentage points more after taxes under the bill, and would have his effective rate cut from 56.7 percent under existing law to 46 percent under the House bill. This is a pretty good measure of the benefits he receives from the rate reduction part of this bill—upward of $200,000.

IV. STOCK OPTIONS

So much has been said by me and others on the evils of the restricted stock option that it would serve no useful purpose to repeat it here. I would call attention, for those who might be interested, to remarks which I made on the Senate floor during 1961, specifically on April 14, April 24, April 27, May 4, June 8, and August 8. The hearings held by the Finance Committee on this subject on July 20 and 21, 1961, also contain useful information, as do the hearings on the subject bill.

There are some basic objections to the restricted stock option.

First, it is a device which enables corporate insiders to take money from the corporation which rightfully belongs to the stockholders.

Second, it is another of the many gimmicks associated with capital gains by which ordinary income, in this case compensation, is treated as a capital gain for income tax purposes.

Third, it encourages manipulation on the part of corporate insiders which will work harm, in varying degrees, to the whole economy, and specifically to the securities markets.

The recently publicized Chrysler Corp. incident involving options is a good case in point, and I commend to my colleagues as interesting reading the report prepared by the Treasury for the Finance Committee on this maneuver.

The subject bill makes some improvement in the option area. It will, if enacted into law, cure some abuses. It will not cure all abuses, however, and I shall renew my efforts to remove from the bill the new "qualified" stock option which replaces the old section 421 type of "restricted" stock option.

ALBERT GORE.

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Calendar No. 805

88TH CONGRESS } SENATE { REPORT No. 830
2d Session } { Part 2

1565-5

REVENUE ACT OF 1964

SUPPLEMENTAL REPORT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

TO ACCOMPANY

H.R. 8363

A Bill To Amend the Internal Revenue Code of 1954 To Reduce Individual and Corporate Income Taxes, To Make Certain Structural Changes With Respect to the Income Tax, and for Other Purposes

JANUARY 31, 1964.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
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Calendar No. 805

88TH CONGRESS 2d Session | SENATE | REPT. 830 Part 2

REVENUE ACT OF 1964

JANUARY 31, 1964.—Ordered to be printed

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

SUPPLEMENTAL REPORT

[To accompany H.R. 8363]

TECHNICAL EXPLANATION OF THE BILL

SECTION 1. SHORT TITLE, ETC.

(a) *Short title.*—Subsection (a) of section 1 of the bill (sec. 2 of the bill as passed by the House) provides that the bill may be cited as the "Revenue Act of 1964."

(b) *Amendment of 1954 Code.*—Subsection (b) of section 1 of the bill provides that whenever in the bill an amendment or repeal is expressed in terms of an amendment to or repeal of a section or other provision, the reference is considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I—REDUCTION OF INCOME TAX RATES AND RELATED AMENDMENTS

PART I—INDIVIDUALS

SECTION 111. REDUCTION OF TAX ON INDIVIDUALS

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-9 of the report of the Committee on Ways and Means on the bill (H. Rept. 749, 88th Cong., 1st sess.).

SECTION 112. MINIMUM STANDARD DEDUCTION

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-10 of the report of the Committee on Ways and Means on the bill.

SECTION 113. RELATED AMENDMENTS

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-12 of the report of the Committee on Ways and Means on the bill.

SECTION 114. CROSS REFERENCES TO TAX TABLES, ETC.

Section 114 of the bill contains cross references to the provisions of the bill relating to optional tax if adjusted gross income is less than $5,000 (sec. 301) and income tax collected at source (sec. 302).

PART II—CORPORATIONS

SECTION 121. REDUCTION OF TAX ON CORPORATIONS

Your committee has approved this section except for a technical clarifying change discussed below.

Section 121 of the bill amends section 11 of the code (relating to tax on corporations). Under the bill as passed by the House, subsection (d) of section 11 of the code provided that for purposes of subtitle A of the code (relating to income tax) the surtax exemption for any taxable year was to be $25,000 or the amount determined under section 1561 of the code (relating to surtax exemptions in case of certain controlled corporations), as added by section 237 of the bill (section 223 of the bill as passed by the House). Your committee has made a clarifying amendment, and as amended subsection (d) of section 11 provides that for purposes of subtitle A the surtax exemption for any taxable year is $25,000, except that, with respect to a corporation to which section 1561 applies, the surtax exemption is the amount determined under such section.

For the technical explanation of this section of the bill, see page A-12 of the report of the Committee on Ways and Means on the bill.

SECTION 122. CURRENT TAX PAYMENTS BY CORPORATIONS

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-13 of the report of the Committee on Ways and Means on the bill.

SECTION 123. RELATED AMENDMENTS

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-16 of the report of the Committee on Ways and Means on the bill.

PART III—EFFECTIVE DATES

SECTION 131. GENERAL RULE

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-17 of the report of the Committee on Ways and Means on the bill.

SECTION 132. FISCAL YEAR TAXPAYERS

Except for conforming changes referring to the "Revenue Act of 1964" (instead of the "Revenue Act of 1963"), this section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-17 of the report of the Committee on Ways and Means on the bill.

TITLE II—STRUCTURAL CHANGES

SECTION 201. DIVIDENDS RECEIVED BY INDIVIDUALS

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-20 of the report of the Committee on Ways and Means on the bill.

SECTION 202. LIMITATION ON RETIREMENT INCOME

Section 202 of the bill, which is a new section added to the bill as passed by the House, amends section 37 of the code by inserting a new subsection (i) therein. Section 37 relates to the retirement income credit.

Under existing law eligible taxpayers 65 or over who receive taxable pensions or annuities, interest, rents, dividends, etc., and eligible taxpayers, regardless of age, who receive taxable pensions or annuities under public retirement systems (as defined in section 37(f)), are allowed a retirement income credit. To be eligible for the retirement income credit, a taxpayer must have received in each of any 10 calendar years before the taxable year earned income (as defined in section 37(g)) in excess of $600. The amendments made by section 202 of the bill make no change in existing law with respect to the foregoing.

Under existing law, the retirement income credit is computed by multiplying the amount of retirement income, limited to a maximum of $1,524, by the rate of tax on the first $2,000 of taxable income. The amendments made by your committee increase the limitation on retirement income under certain circumstances and are discussed below. Also under subsection (a) of section 113 of the bill, the rate against which retirement income (as defined in subsection (c) and as limited by subsection (d) of section 37) is to be multiplied for purposes of computing the retirement income credit is established as 15 percent.

Under existing law, the maximum retirement income of an individual on which the credit may be based ($1,524) is reduced by amounts received as a pension or annuity either under title II of the Social Security Act or under the Railroad Retirement Act of 1935 or 1937, and by amounts received from other pensions or annuities which are exempt from tax. In the case of an individual who has attained the age of 62 but who has not attained the age of 72 before the close of the taxable year, the maximum retirement income on which credit may be based is also reduced by the sum of one-half the amount of earned income received during the taxable year in excess of $1,200 but not in excess of $1,700 and the amount of earned income in excess of $1,700. In the case of an individual who has not attained the age of 62 before the close of the taxable year, the maximum retirement income is reduced by the amount of earned income received during the taxable year in excess of $900.

Under existing law, the retirement income credit is computed separately for each spouse and each spouse is required to meet the earned income test in section 37(b) ($600 of earned income in each of any 10 prior years); except that in the case of a widow or widower whose spouse had received such earned income, such widow or widower is considered to have received earned income.

Subsection (a) of section 202 of the bill adds a new subsection (i) to section 37 of the code. The new subsection (i) provides for an increase, in certain cases, in the limitation on retirement income in the case of married taxpayers both of whom have attained the age of 65 before the close of the taxable year and who file a joint return for the taxable year.

Paragraph (1) of new section 37(i) provides that if both spouses meet the earned income test in subsection (b) of section 37 and if the sum of the retirement income and the amounts described in paragraphs (1) and (2) of subsection (d) of such section received by either spouse during the taxable year is less than $762, the $1,524 amount referred to in subsection (d) shall, with respect to the other spouse, be increased by an amount equal to the amount by which such sum is less than $762. If such sum is equal to or greater than $762, no such adjustment shall be made. The application of the provisions of paragraph (1) of new section 37(i) may be illustrated by the following example:

Example 1.—H and W, each of whom are 66 years of age and each of whom meets the earned income test in section 37(b), file a joint return for the calendar year 1964. During 1964, H receives as his only income $8,000 of retirement income and no social security benefits or other amounts described in paragraph (1) of section 37(d). During 1964, W receives as her only income $100 of retirement income and $500 under title II of the Social Security Act.

Under existing law, H is entitled to a retirement income credit computed on the maximum retirement income of $1,524. W is entitled to a retirement income credit computed on $100 of retirement income.

Under the new section (i), the $1,524 limitation on the retirement income of H would be increased by $162. The $162 increase is computed under paragraph (1) of new subsection (i) by subtracting from $762 the sum of the retirement income received by W ($100) and the social security benefits received by W ($500). The retirement income credit of W is not affected.

Paragraph (2) of new section 37(i) provides that if either spouse does not meet the earned income test in subsection (b) of section 37, the $1,524 amount referred to in subsection (d) of such section shall, with respect to the other spouse, be increased by $762 minus the sum of the amounts described in paragraphs (1) and (2) of subsection (d) received by the spouse who did not meet the earned income test.

The application of the provisions of paragraph (2) of new section (i) may be illustrated by the following example:

Example 2.—Assume the same facts as in example 1 above except that W does not meet the earned income test in section 37(b). Under existing law, H is entitled to a retirement income credit computed on the maximum retirement income of $1,524. (W is not entitled to any retirement income credit.)

Under the new section 37(i), the $1,524 limitation on the retirement income of H would be increased by $262. The $262 increase is computed under paragraph (2) of new subsection (i) by subtracting from $762 the social security benefits received by W ($500).

Subsection (b) of section 202 of the bill provides that the amendments made by section 202 of the bill apply to taxable years beginning after December 31, 1963.

SECTION 203. REPEAL OF REQUIREMENT THAT BASIS OF SECTION 38 PROPERTY BE REDUCED BY 7 PERCENT; OTHER PROVISIONS RELATING TO INVESTMENT CREDIT

Your committee has approved subsection (a) of section 203 of the bill (section 202(a) of the bill as passed by the House) with changes in the effective dates (discussed below); and has approved subsections (b) through (f) without change. For the technical explanation of subsections (b) through (f) of section 203 (sec. 202 of the bill as passed by the House) of the bill, see page A–25 of the report of the Committee on Ways and Means on the bill.

(*a*) *Repeal of requirement that basis be reduced.*—Subsection (a) of section 203 of the bill repeals section 48(g) of the code, which relates to adjustments to basis of section 38 property (that is, property with respect to which an investment credit is allowable), with respect to such property placed in service after December 31, 1963. In the case of property placed in service before January 1, 1964, subsection (a) of section 203 of the bill repeals section 48(g) with respect to taxable years beginning after December 31, 1963, and provides for an increase in basis as of the first day of the taxpayer's first taxable year which begins after December 31, 1963. Subsection (a) of section 203 also makes certain related amendments to the code.

Repeal of reduction in basis under section 48(g)(1)

Paragraph (1) of section 203(a) of the bill repeals paragraph (1) of section 48(g) of the code. (See below for discussion of repeal of paragraph (2) of sec. 48(g).) Under paragraph (1) of section 48(g), the basis of any section 38 property is reduced by an amount equal to 7 percent of the qualified investment (as determined under sec. 46(c)) with respect to such property. This reduction in basis is taken into account for purposes of subtitle A of the code, relating to income tax, except for purposes of computing, or recomputing, the investment credit. Thus, the reduction in basis is taken into account for purposes of computing depreciation deductions and for purposes of computing gain or loss on the sale or other disposition of the property.

This repeal is effective (under par. (4) of sec. 203(a) of the bill), in the case of section 38 property placed in service after December 31, 1963, with respect to taxable years ending after December 31, 1963; and in the case of property placed in service before January 1, 1964, with respect to taxable years beginning after December 31, 1963. Thus, a taxpayer who makes his return on the basis of a fiscal year ending March 31, must reduce the basis of any section 38 property placed in service before January 1, 1964, but is not required to reduce the basis of any section 38 property placed in service after December 31, 1963. No reduction in basis is to be made in the case of section 38 property the construction, reconstruction, or erection of which is completed, or which is acquired, before January 1, 1964, but which is placed in service after December 31, 1963.

Repeal of increase in basis under section 48(g)(2)

Paragraph (1) of section 203(a) of the bill also repeals paragraph (2) of section 48(g) of the code. Under paragraph (2) of section 48(g), if the tax under chapter 1 of the code is increased for any taxable year under paragraph (1) or (2) of section 47(a) of the code (relating to certain dispositions, etc., of sec. 38 property) or an adjustment in carrybacks or carryovers is made under paragraph (3) of such section, the basis of the property described in such paragraph (1) or (2) of section 47(a) is increased by an amount equal to the portion of such increase in tax, or the portion of such adjustment to carrybacks or carryovers, attributable to such property. The increase in basis is made immediately before the event which causes paragraph (1) or (2) of section 47(a) to apply. Thus, the increase in basis is taken into account for purposes of determining gain or loss on a disposition of the property.

This repeal is effective (under par. (4) of sec. 203(a) of the bill), in the case of section 38 property placed in service after December 31, 1963, with respect to taxable years ending after December 31, 1963; and in the case of property placed in service before January 1, 1964, with respect to taxable years beginning after December 31, 1963. Thus if, in February 1964, section 47(a) (1) or (2) applies to increase the tax of a taxpayer who makes his return on the basis of a fiscal year ending March 31, under chapter 1 of the code with respect to property placed in service in 1962, the basis of such property is increased under section 48(g)(2) by the amount of such increase in tax.

Increase in basis of property on account of prior reduction

Paragraph (2)(A) of section 203(a) of the bill provides, in general, that the basis of any section 38 property (as defined in sec. 48(a) of the code) placed in service before January 1, 1964, is to be increased, under regulations prescribed by the Secretary of the Treasury or his delegate, by an amount equal to 7 percent of the qualified investment with respect to such property. In determining the amount of such increase in basis, any prior increase in basis with respect to the property under section 48(g)(2) (in taxable years beginning before Jan. 1, 1964) is to be taken into account. Thus, the amount of the increase in basis under paragraph (2)(A) of section 203(a) of the bill is equal to the amount of the reduction in basis under section 48(g)(1) less any increase in basis under section 48(g)(2) with respect to such property. The basis of any section 38 property is not increased under paragraph (2)(A) of section 203(a) of the bill if the taxpayer dies in a taxable year beginning before January 1, 1964.

The increase in basis provided by paragraph (2)(A) of section 203(a) of the bill is to be made, under paragraph (2)(C) of section 203(a), as of the first day of the first taxable year of the taxpayer which begins after December 31, 1963. Generally, such increase in basis is to be taken into account by the person whose basis of the property was reduced under section 48(g)(1). Thus, in the case of partnership section 38 property, the increase in basis is to be taken into account by the partnership as of the first day of its first taxable year which begins after December 31, 1963. If a transaction to which section 381(a) of the code applies or a mere change in the form of conducting a trade or business (within the meaning of sec. 47(b) of the code) occurs before the increase in basis has been taken into account by the transferor, the increase in basis is taken into account by the transferee. For example, if calendar-year individual A, who placed section 38 property in service before January 1, 1964, transfers the section 38 property to calendar-year corporation X on September 1, 1963, in a transaction to which section 47(a) does not apply because such transaction constitutes a mere change in the form of conducting the trade or business, the increase in basis is to be taken into account by corporation X as of January 1, 1964.

The increase in basis is to be taken into account for purposes of computing depreciation deductions for the taxpayer's first taxable year which begins after December 31, 1963, and for all subsequent periods, and for purposes of computing gain or loss on the sale or other disposition of the property.

The provisions of paragraph (2)(A) of section 203(a) of the bill are illustrated by the following example:

Example.—X corporation, which makes its returns on the basis of the calendar year, acquires and places in service on January 1, 1962, an item of new section 38 property with a basis of $10,000 and an estimated useful life of 10 years. For the taxable year 1962, X is allowed a credit of $700 (7 percent of $10,000). Under section 48(g)(1) of the code, the basis of the property is reduced by $700. Under paragraph (2)(A) of section 203(a) of the bill, the basis of the property is increased on January 1, 1964, by $700 (7 percent of $10,000, the qualified investment). However, if such property had been sold by X on December 1, 1963, on such date the basis of such property is increased under section 48(g)(2) by $700, and there would be no further increase on January 1, 1964. If X was a partnership and if a partner had disposed of his partnership interest on December 1, 1963, and on such date the basis of such property had been increased under section 48(g)(2) by $500, the basis of the property would be increased on January 1, 1964, by only $200 ($700 minus $500). If X was an individual who died on December 1, 1963, there would be no increase under section 203(a)(2)(A) of the bill in the basis of such property.

Increase in rental deductions

Paragraph (2)(B) of section 203(a) of the bill provides that if, with respect to any section 38 property placed in service before January 1, 1964, a lessor made the election (provided by sec. 48(d) of the code) to treat the lessee as having purchased such property for purposes of the investment credit, the basis of such property is not to be increased under paragraph (2)(A) of section 203(a) of the bill. However, under regulations prescribed by the Secretary of the Treasury or his delegate, the deductions otherwise allowable under section 162 of the code to the lessee with respect to such property for amounts paid to the lessor under the lease (hereinafter referred to as rental deductions) are to be adjusted in a manner consistent with paragraph (2)(A). The amount of the increase in rental deductions with respect to a leased property placed in service before January 1, 1964, may not exceed the sum of the actual decreases made (under the last sentence of sec. 48(d)) in the rental deductions with respect to such property. In determining the amount of the increase in such rental deductions, any prior increase in such deductions under the last sentence of section 48(d) because of the application of section 47(a) (in taxable years beginning before Jan. 1, 1964) is to be taken into account. The rental deductions with respect to any section 38 property are not to be increased under paragraph (2)(B) of section 203 (a) of the bill if the lessee dies in a taxable year beginning before January 1, 1964.

The amount of the increase in rental deductions with respect to a leased property is to be taken into account, commencing with the first taxable year beginning after December 31, 1963, over the remaining portion of the useful life used in making the decreases in rental deductions with respect to such property. Generally, if the lessee terminates the lease during this period, the portion of the increase which has not yet been taken into account is allowed as a deduction in the taxable year in which such termination occurs. If the lessee actually purchases the leased property during this period, the portion of the increase which has not yet been taken into account is added to the basis of the property at the date of purchase.

If a lessor of property makes the election under section 48(d) to treat the lessee as having purchased section 38 property for purposes of the investment credit and if such lessee in a taxable year beginning before January 1, 1964, actually purchases such property, the basis of such property is increased by 7 percent of the qualified investment with respect to such property (in a manner consistent with par. (2)(A) of sec. 203(a) of the bill) as of the first day of the first taxable year beginning after December 31, 1963.

The provisions of paragraph (2)(B) of section 203(a) of the bill are illustrated by the following example:

Example.—X corporation constructs a machine after December 31, 1961, and on February 1, 1962, leases the machine to Y, a calendar year taxpayer, who places it in service. The fair market value of the machine on the date on which possession is transferred to Y is $25,200 and the machine has an estimated useful life to X of 12 years. X elects to treat Y as the purchaser of the property for purposes of the investment credit. For purposes of computing qualified investment under section 46(c) of the code, the basis of the property to Y is $25,200 and Y's credit earned for 1962 with respect to such machine is $1,764 (7 percent of $25,200). Y's rental deductions with respect to such machine are decreased by $12.25 each month ($1,764 divided by 144 months). Under paragraph (2)(B) of section 203(a) of the bill, Y's rental deductions are increased by $281.75 ($12.25 multiplied by 23 months). Such increase is taken into account over the remaining 121 months of the useful life of the machine commencing with the taxable year 1964. If Y had actually purchased the machine from X on January 1, 1963, and had reduced the basis of the machine on such date by $1,629.25

($1,764 minus $134.75), the basis of such machine in Y's hands would be increased, on January 1, 1964, by $1,764 (7 percent of the qualified investment).

Certain leased property

Paragraph (3)(A) of section 203(a) of the bill repeals the last sentence of section 48(d) of the code. Under the last sentence of section 48(d), if a lessor makes an election to treat the lessee of section 38 property as having acquired such property for purposes of the investment credit, section 48(g) (relating to adjustments to basis) does not apply with respect to such property and the deductions otherwise allowable to the lessee under section 162 of the code for amounts paid to the lessor under the lease must be adjusted in a manner consistent with the provisions of section 48(g).

This repeal is effective (under par. (4) of sec. 203(a) of the bill), in the case of section 38 property placed in service after December 31, 1963, with respect to taxable years ending after December 31, 1963; and in the case of property placed in service before January 1, 1964, with respect to taxable years beginning after December 31, 1963. Thus, if lessor X elects to treat calendar year lessee Y, who placed section 38 property in service in July 1962, as the purchaser of the property for purposes of the investment credit, Y reduces his deductions for rental payments under section 162 of the code for his 1962 and 1963 taxable years, but does not reduce his rental deductions for any subsequent taxable year. If in December 1963 section 47(a) (1) or (2) of the code applies to increase Y's tax with respect to such property, Y's rental deductions with respect thereto are adjusted, under the last sentence of section 48(d), in a manner consistent with section 48(g)(2). However, if Y had placed the property in service on January 1, 1964, Y would not reduce or otherwise adjust his deductions for rental payments for any taxable year.

Deduction for certain unused investment credit

Paragraph (3)(B) of section 203(a) of the bill repeals section 181 of the code. Under section 181, if the amount of the credit earned for any taxable year exceeds the limitation provided by section 46(a)(2) (relating to limitation based on amount of tax) for such year and if any portion of such excess is not allowed as a credit after the application of the 3-year carryback and the 5-year carryover provisions, then the portion of such excess not so allowed as a credit in any of such taxable years is allowed to the taxpayer as a deduction in the sixth taxable year following the taxable year in which the credit was earned. Section 181 further provides that if a taxpayer dies or ceases to exist prior to such sixth taxable year, such taxpayer is allowed as a deduction, for the taxable year of such death or cessation, an amount equal to the proper portion of such excess.

This repeal is effective (under par. (4) of sec. 203(a) of the bill), in the case of section 38 property placed in service after December 31, 1963, with respect to taxable years ending after December 31, 1963; and in the case of property placed in service before January 1, 1964, with respect to taxable years beginning after December 31, 1963.

Adjustments to basis under section 1016

Paragraph (3)(C) of section 203(a) of the bill makes a technical amendment to section 1016(a)(19) of the code (relating to adjustments to basis).

Clerical amendment

Paragraph (3)(D) of section 203(a) of the bill amends the table of sections for part VI of subchapter B of chapter 1 of the code.

Effective date

Paragraph (4) of section 203(a) of the bill provides effective dates for the amendments made by paragraphs (1) and (3) of section 203(a). Paragraph (4)(A) provides that if the property involved is placed in service after December 31, 1963, then the amendments made by paragraphs (1) and (3) apply with respect to taxable years ending after December 31, 1963. Paragraph (4)(B) provides that if the property is placed in service before January 1, 1964, then the amendments made by paragraphs (1) and (3) apply with respect to taxable years beginning after December 31, 1963.

SECTION 204. GROUP-TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES

(*a*) *Inclusion in income.*—Subsection (a)(1) of section 204 of the bill (sec. 203 of the bill as passed by the House) adds a new section 79 to part II of subchapter B of chapter 1 of the code (relating to items specifically included in gross income).

SECTION 79. GROUP-TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES

(*a*) *General rule.*—The new section 79(a) has been approved by your committee with one change. In the bill as passed by the House, an exclusion was provided for the cost of the first $30,000 of group-term life insurance provided for an employee. Your committee has increased such exclusion to the cost of the first $70,000 of such insurance. For the technical explanation of the new section 79(a) of the code (other than the amendment made by your committee), see page A–29 of the report of the Committee on Ways and Means on the bill.

(*b*) *Exceptions.*—The new section 79(b) has been approved by your committee without change. For a technical explanation of this section, see page A–31 of the report of the Committee on Ways and Means on the bill.

(*c*) *Determination of cost of insurance.*—The new section 79(c) as passed by the House provides rules for determining the cost of group-term life insurance protection with respect to an employee. Your committee has modified this section to eliminate one of the two alternative methods of determining cost. As passed by the House, section 79(c) contains three paragraphs, paragraph (1), (2), and (3). Your committee has deleted paragraph (2) and has combined without substantive change the provisions contained in paragraphs (1) and (3) into section 79(c).

Uniform premium table method

Under the bill as passed by the House, paragraph (1) of section 79(c) provides that the cost of group-term life insurance protection on the life of an employee provided during any period is determined on the basis of uniform premiums (computed on the basis of 5-year age brackets) to be set forth in a table prescribed in regulations by the Secretary of the Treasury or his delegate. Your committee has made this method the sole method of determining the cost of group-term life insurance with respect to any employee. Under the bill as amended by your committee, this method of determining cost is now set forth in the first sentence of the new section 79(c).

Policy cost method

Under the bill as passed by the House, paragraph (2) of section 79(c) provides that, in lieu of using the uniform premium table, the employer may elect, with respect to any employee, to determine the cost of such employee's group-term life insurance on the basis of the average premium cost under the policy for the ages included within the age bracket which is applicable to the employee under the provisions of paragraph (1). Your committee has deleted this provision from the bill.

Employed individuals over age 64

Under the bill as passed by the House, paragraph (3) of section 79(c) provides that in the case of an employee who has attained age 64, the prescribed cost cannot exceed the cost with respect to the individual if he were age 63. Under the bill as amended by your committee this provision is incorporated in the second sentence of the new section 79(c).

Example.—The operation of the new section 79 as amended by your committee may be illustrated by the following example. Assume that for a full taxable year an employee, age 52, is provided (under a policy carried by his employer) with $110,000 of group-term life insurance on his life and that his spouse is the beneficiary. Assume further that the uniform premium applicable at his age is $10.87 per $1,000 of protection and that the employee contributes $1 per $1,000 of protection. Based on these facts, the amount includible in the employee's income is computed as follows:

Total group-term life insurance protection	$110, 000
Less $70,000 exclusion	70, 000
	40, 000
Cost of $40,000 of insurance (40×$10.87)	434. 80
Less employee's contributions (110×$1)	110. 00
Amount includible in employee's gross income	324. 80

SECTION 204. GROUP-TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES—Continued

Full-time life insurance salesmen

Subsection (a)(3) of section 204 of the bill amends section 7701(a)(20) of the code to provide that a full-time life insurance salesman who is considered an employee for purposes of chapter 21 of the code shall also be considered an employee for purposes of the new section 79. This subsection has been approved by your committee with a clerical change.

Certain contributions by employees for group-term life insurance

Subsection (b) of section 203 of the bill as passed by the House added a new section 218 to part VII of subchapter B of chapter 1 of the code (relating to additional itemized deductions for individuals). Your committee has deleted this subsection from the bill.

(*b*) *Withholding.*—Subsection (b) of section 204 of the bill (subsec. (c) of sec. 203 of the bill as passed by the House) amends section 3401(a) of the code (relating to definition of wages) by adding a new paragraph (14) at the end thereof. Under this new paragraph (14), as passed by the House, the term "wages" (for purposes of withholding of income tax at source on wages) includes remuneration paid in the form of group-term life insurance on the life of an employee, but only to the extent that the cost of such insurance is includible in the employee's gross income under the provisions of section 79(a) of the code (added to the code by this section of the bill). Your committee has amended the new paragraph (14) to provide that the term "wages" (for purposes of withholding of income tax at source on wages) does not include remuneration paid in the form of group-term life insurance on the life of an employee. In lieu of the deleted withholding provision, your committee has provided an information reporting requirement.

(*c*) *Information reporting.*—Subsection (c)(1) of section 204 of the bill adds a new section 6052 to subpart C of part III of subchapter A of chapter 61 of the code (relating to information concerning transactions with other persons).

The new section 6052(a) provides that every employer who, during any calendar year, provides group-term life insurance on the life of an employee during part or all of such calendar year under a policy (or policies) carried directly or indirectly by such employer shall make a return according to the forms or regulations prescribed by the Secretary of the Treasury or his delegate setting forth the cost of such insurance and the name and address of the employee on whose life such insurance is provided, but only to the extent that the cost of such insurance is includible in the employee's gross income under section 79(a). For purposes of the new section 6052(a), the cost of group-term life insurance is determined with reference to the cost of the life insurance (computed as provided in sec. 79(c)) provided to the employee, without regard to the time when the premium is paid by the employer. Under the provisions of the new section 6052(a), each employer paying remuneration to an employee in the form of group-term life insurance determines the amount includible in such employee's gross income under section 79(a) of the code as if such employer were the only employer paying the employee remuneration in the form of such insurance. Thus, an employer computes the amount includible in the gross income of an employee by applying a full $70,000 exclusion, without regard to whether another employer may also be furnishing group-term life insurance for the same employee during the same period.

The new section 6052(b) provides that every employer making a return under subsection (a) is to furnish to each employee whose name is set forth in such return a written statement showing the cost of the group-term life insurance shown on such return. The written statement required under the preceding sentence is to be furnished to the employee on or before January 31 of the year following the calendar year for which the return under subsection (a) was made.

Your committee has also provided that the penalties imposed by section 6652(a) of the code (relating to penalty for failure to file certain information returns) and section 6678 of the code (relating to penalty for failure to furnish certain statements) are to apply in the case of each failure to file, with respect to an employee, a return or statement required by the new section 6052. See paragraph (2) of section 204(c), and paragraph (2) of section 222(b), of the bill.

(*d*) *Effective dates.*—Subsection (d) of section 204 of the bill provides that the amendments made by subsections (a) and (c) of this section of the bill, and paragraph (2) of section 222(b) of the bill, apply with respect to group-term life insurance provided after December 31, 1963, in taxable years ending after such date. The amendment made by subsection (b) applies with respect to remuneration paid after December 31, 1963, in the form of group-term life insurance provided after such date.

SECTION 205. AMOUNTS RECEIVED UNDER WAGE CONTINUATION PLANS

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-35 of the report of the Committee on Ways and Means on the bill.

SECTION 206. EXCLUSION FROM GROSS INCOME OF GAIN ON SALE OR EXCHANGE OF RESIDENCE OF INDIVIDUAL WHO HAS ATTAINED AGE 65

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-36 of the report of the Committee on Ways and Means on the bill.

SECTION 207. DENIAL OF DEDUCTION FOR CERTAIN STATE, LOCAL, AND FOREIGN TAXES

Section 207 of the bill as passed by the House consisted of three subsections. Subsection (a) of such section 207 revised subsections (a), (b), and (c) of section 164 of the code (relating to deduction for taxes). Subsection (b) of such section 207 made a number of technical amendments to the code and subsection (c) thereof contained the effective date provisions.

Your committee has made changes in subsection (a) of section 207 of the bill which affect subsections (a) and (b) of section 164 of the code. Subsection (b) of section 207 of the bill, as passed by the House, has been approved by your committee without change. Your committee has changed subsection (c) of section 207 of the bill by adding a new paragraph (2) thereto.

For the technical explanation of section 207 of the bill (other than the amendments made by your committee), see page A-40 of the report of the Committee on Ways and Means on the bill.

Section 164(a) as amended

Subsection (a) of section 164 of the code, as amended by the bill as passed by the House, provided, in part, that the following taxes would be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

(2) State and local personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) State and local general sales taxes.

Your committee has added to the foregoing list State and local taxes on the sale of gasoline, diesel fuel, and other motor fuels and State and local taxes on the registration or licensing of highway motor vehicles and on licenses for the operation of highway motor vehicles. As a result of your committee's amendment, any State and local taxes within the scope of the amendment which are now deductible under section 164 remain so; any such taxes which are not presently deductible are not made deductible by such amendment

Section 164(b) as amended

Your committee has added a new paragraph (5) to section 164(b) of the code, as amended by the bill as passed by the House, to provide a special rule in the case of separately stated general sales taxes and any tax on the sale of gasoline, diesel fuel, or other motor fuel. This provision corresponds to section 164(b)(2)(E) as passed by the House except that its scope has been broadened to apply to taxes on the sale of gasoline, diesel fuel, and other motor fuel. If a tax to which this special rule has application is imposed on the seller, but the amount of such tax is separately stated, then (as under existing law), to the extent that the amount so stated is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount is treated as a tax imposed on, and paid by, such consumer.

Subsection (c) of section 207

Under the bill as passed by the House, paragraph (1) of section 164(c) of the code denied a deduction for taxes assessed against local benefits of a kind tending to increase the value of the property assessed, except for the portion of such taxes properly allocable to interest or maintenance charges. Such paragraph (1) retained the rules of present law now contained in paragraph (5) of section 164(b) of the code but did not retain the exception to those rules now contained in section 164(b)(5)(B) which allow the deduction of local benefit taxes levied by a special taxing district if the taxes meet the tests specified therein.

Your committee has made no change in the language of paragraph (1) of section 164(c) of the code as contained in the House bill. However, your committee has added a new paragraph (2) to section 207(c) of the bill which provides that section 164(c)(1), as amended, shall not prevent the deduction under section 164, of taxes levied by a special taxing district—

(1) which is described in section 164(b)(5) of the code (as in effect for a taxable year ending on Dec. 31, 1963), and

(2) which was in existence on December 31, 1963,

but only in the case of taxes levied for the purpose of retiring indebtedness which existed on December 31, 1963.

SECTION 208. PERSONAL CASUALTY AND THEFT LOSSES

This section has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-45 of the report of the Committee on Ways and Means on the bill.

SECTION 209. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS

(*a*) *Certain organizations added to additional 10-percent charitable limitation.*—Subsection (a) of section 209 of the bill as passed by the House has been approved by your committee without change. For the technical explanation of this subsection of the bill, see page A–47 of the report of the Committee on Ways and Means on the bill.

(*b*) *Limitation of unlimited charitable contribution deduction.*—Your committee has added a new subsection (b) to section 209 of the bill to provide a limitation on the existing unlimited charitable contribution deduction.

Existing law

An individual taxpayer is presently allowed an unlimited charitable contribution deduction if in the taxable year, and in 8 of the 10 preceding taxable years, the charitable contributions and income taxes paid by the taxpayer during such year exceed 90 percent of his taxable income computed without deduction for charitable contributions, personal exemptions, and net operating loss carrybacks. Under existing law, the charitable contributions which may be used to satisfy the 90-percent requirement include contributions to both publicly and privately supported organizations.

Changes made by your committee

Subsection (b) of section 209 of the bill, as reported, amends section 170(b)(1) of the code by redesignating subparagraph (D) as (E) and by inserting a new subparagraph (D). The new subparagraph provides that only contributions described in subparagraph (A) of section 170(b)(1) (i.e., contributions to those organizations to which the additional 10-percent limitation is applicable) will qualify as charitable contributions for purposes of the unlimited charitable contribution deduction provisions. In general, these organizations include churches, certain educational organizations, certain hospitals and medical research organizations, certain organizations affiliated with State colleges and universities, certain governmental units, and certain other publicly supported organizations. Thus, for taxable years begining after December 31, 1963, only contributions to such organizations shall be taken into account in determining whether the taxpayer has satisfied the 90-percent requirement of section 170(b)(1)(C) for the current taxable year and for those taxable years preceding the current taxable year which begin after December 31, 1963. Contributions not described in section 170(b)(1)(A), such as contributions to private foundations, will not qualify as charitable contributions for purposes of the unlimited charitable contribution deduction provisions.

The new section 170(b)(1)(D) also provides that for purposes of section 170(b)(1)(C), the amount of charitable contributions shall be determined without regard to new paragraph (5) of section 170(b) of the code (added by sec. 209(c) of the bill, as reported). Therefore, in determining whether a taxpayer has satisfied the 90-percent requirement of subparagraph (C) for a current taxable year which begins after December 31, 1963, and for those taxable years preceding the current taxable year which begin after December 31, 1963, contributions made in prior years, but which under the provisions of new paragraph (5) are treated as having been paid in subsequent years, shall not be taken into account.

The new section 170(b)(1)(D) provides that section 170(b)(1)(C) shall apply only if the taxpayer so elects. Such election can only be made by those taxpayers who satisfy the requirements of section 170(b)(1)(C), as modified by new section 170(b)(1)(D). The time and manner of such election shall be prescribed under regulations promulgated by the Secretary of the Treasury or his delegate. If a taxpayer makes such election, subsection (a) of section 170 shall apply only with respect to contributions described in subparagraph (A) of section 170(b)(1). Thus, a taxpayer who elects to apply section 170(b)(1)(C) and thus to deduct contributions to a publicly supported charitable organization in excess of the generally applicable 30-percent limitation may not also deduct contributions which he makes to private foundations. In addition, the new section 170(b)(1)(D) provides that if a taxpayer elects to apply section 170(b)(1)(C), contributions made in the current taxable year, or in any prior taxable year, may not be treated under new paragraph (5) of section 170(b) of the code as having been made in the current taxable year or in any succeeding taxable year.

Effective date

New section 170(b)(1)(D) shall apply with respect to contributions which are paid in taxable years beginning after December 31, 1963.

(*c*) *Five-year carryover of certain charitable contributions made by individuals.*—Subsection (c) of section 209 of the bill, as reported, adds a new paragraph (5) to section 170(b) of the code (relating to limitations on charitable contribution deduction) to provide a carryover of certain excess contributions made by individuals.

Subparagraph (A) of new section 170(b)(5) provides, in general, that in the case of an individual, if the amount of charitable contributions described in paragraph (1)(A) of section 170(b) (relating to contributions to churches, certain educational organizations, certain hospitals and medical research organizations, certain organizations affiliated with State colleges or universities, certain governmental units, and certain other publicly supported organizations), payment of which is made within a taxable year, exceeds 30 percent of the taxpayer's adjusted gross income for such year (computed without regard to any net operating loss carryback to such year under section 172), such excess shall be treated as a charitable contribution described in paragraph (1)(A) paid in each of the 5 succeeding taxable years in order of time. However, with respect to any such succeeding taxable year, the amount which is to be treated as paid in such succeeding taxable year is limited to the extent of the lesser of two amounts: (*i*) the amount by which 30 percent of the taxpayer's adjusted gross income for such succeeding taxable year (computed without regard to any net operating loss carryback to such succeeding taxable year under section 172) exceeds the sum of the charitable contributions described in paragraph (1)(A) payment of which is made by the taxpayer within such succeeding taxable year (determined without regard to new paragraph (5)) and the charitable contributions described in paragraph (1)(A) payment of which was made in taxable years before the contribution year which are treated under this new rule as having been paid in such succeeding taxable year; or (*ii*) in the case of the first succeeding taxable year, the amount of such excess contribution, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess not treated under new paragraph (5) as a charitable contribution described in paragraph (1)(A) paid in any taxable year intervening between the contribution year and such succeeding taxable year.

Under the provisions of new paragraph (5), no excess contribution carryover will be allowed with respect to contributions to organizations not described in subparagraph (A) of section 170(b)(1), such as private foundations.

The new paragraph (5) of section 170(b) does not apply with respect to estates or trusts.

The application of new paragraph (5) is illustrated by the following examples:

Example 1.—Taxpayer A has adjusted gross income for 1964 of $50,000. In 1964 A contributes $16,500 to a church and $1,000 to a private foundation. Under existing law, A could claim a charitable contribution deduction of $15,000 (30 percent of $50,000). Under the bill, as approved by your committee, A could claim a charitable contribution deduction of $15,000 in 1964 and would have a charitable contribution carryover of $1,500 (excess of $16,500 contribution to the church over 30 percent of adjusted gross income of $50,000) to succeeding taxable years. No carryover would be allowed with respect to the $1,000 contribution to the private foundation.

Example 2.—Assume the same facts as in example 1. Assume further that for 1965 A has adjusted gross income of $40,000, and in 1965 contributes $11,000 to a church and $400 to a private foundation. Under existing law, A could claim a charitable contribution deduction of $11,400. Under the bill, as approved, by your committee, $1,000 ($40,000×30 percent=$12,000−$11,000 contribution paid to church in 1965) of the $1,500 excess contribution to the church which was paid in 1964 would be treated as paid in 1965 and therefore A could claim a total charitable contribution deduction of $12,000 for 1965. The remaining $500 of the excess contribution paid to the church in 1964 would be available for purposes of computing the carryover from 1964 to 1966, 1967, 1968, and 1969. No carryover would be allowed with respect to the $400 contribution to the private foundation.

Subparagraph (B) of new section 170(b)(5) provides that in the application of subparagraph (A), the excess determined under such subparagraph for the contribution year shall be reduced to the extent that such excess reduces taxable income as computed for purposes of the second sentence of section 172(b)(2) (relating to amount of net operating loss carrybacks and carryovers) and increases the net operating loss deduction for a taxable year succeeding the contribution year. To prevent a double deduction which might arise from the interrelationship of the charitable contribution carryover and the net operating loss carryover, subparagraph (B) of new section 170(b)(5) provides, in effect, that an excess charitable contribution shall reduce taxable income only once.

Paragraph (2) of section 209(c) of the bill contains technical amendments. Section 545(b)(2) (relating to deductions for charitable contributions by personal holding companies) and section 556(b)(2) (relating to deductions for charitable contributions by foreign personal holding companies) are each amended, in effect, to provide that new paragraph (5) of section 170(b) shall not apply for purposes of computing the deduction for charitable contributions provided under section 170 with respect to these organizations.

Effective date

New paragraph (5) of section 170(b) shall apply with respect to charitable contributions which are paid in taxable years beginning after December 31, 1963.

(*d*) *Five-year carryover of certain charitable contributions made by corporations.*—Subsection (b) of section 209 of the bill as passed by the House has been redesignated as subsection (d) and, with the exception of a change made in the effective date of this subsection, has been approved by your committee without change.

Under the bill as passed by the House, the 5-year corporate carryover applied only with respect to contributions which are paid (or treated as paid under sec. 170(a)(2) of the Internal Revenue Code of 1954) in taxable years beginning after December 31, 1963. Under the bill, as approved by your committee, the 5-year corporate carryover shall apply to taxable years beginning after December 31, 1963, with respect to contributions which are paid (or treated as paid under sec. 170(a)(2) of the Internal Revenue Code of 1954) in taxable years beginning after December 31, 1961.

For the technical explanation of this subsection of the bill, see page A–48 of the report of the Committee on Ways and Means on the bill.

(*e*) *Future interests in tangible personal property.*—Subsection (c) of section 209 of the bill as passed by the House has been redesignated as subsection (e) and has been approved by your committee with an amendment.

As passed by the House, a new subsection (f) was added to section 170 of the code. Section 170(a) of the code provides that a charitable contribution is allowable as a deduction for the taxable year during which payment thereof is made. The new section 170(f) adds a special rule to determine when a charitable contribution consisting of a future interest in tangible personal property is considered to be paid. Under the bill as reported, the new section 170(f) provides, in effect, that the gift of such an interest will be considered to be incomplete for so long as the contributor (or a person standing in a relationship to the contributor described in sec. 267(b) of the code (relating to losses, expenses, and interest with respect to transactions between related taxpayers)) retains an intervening interest or right to the actual possession or enjoyment of the property. Under this special rule, a charitable contribution of a future interest in tangible personal property is deemed paid only when (1) all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired, or (2) all intervening interests in, and rights to the actual possession or enjoyment of, the property are held by a person or persons other than the contributor or related parties.

The bill as passed by the House also contains an exception which was stated in the last two sentences of new subsection (f). Such exception provided that the special rule of section 170(f) does not apply to a contribution in which the sole intervening interest or right is a nontransferable interest reserved by the donor which expires upon the donor's death, or, in the case of a joint gift by husband and wife, the sole intervening interest or right is a nontransferable interest reserved by the donors which expires upon the death of whichever of such donors dies later. However, the right to transfer the reserved life interest to the donee of the future interest (i.e., the charity which receives the future interest contributed) was not treated as making a life estate transferable.

New subsection (f), as approved by your committee, eliminates this exception.

The application of new subsection (f), as approved by your committee, may be illustrated by the following example. If a taxpayer contributes a remainder interest in a painting which he owns to a charity, reserving to himself the right to possession of the painting during his lifetime, the retention of the right to possession is treated as a postponement in the payment of such contribution until his right to possession terminates. Thus, if the taxpayer subsequently transfers his intervening right to possession to the charity, or to an unrelated person (a person who does not stand in a relationship to the donor which is set forth in sec. 267(b)), payment of the remainder interest is thereupon deemed to have been completed and the value of such interest (computed as of the date the contribution is deemed to have been completed) is allowed as a deduction, subject to the limitations imposed by subsection (b) of section 170, in the year the donor's intervening right to possession is transferred. On the other hand, if the taxpayer retains any right to possession of the painting until his death, he is not entitled to an income tax deduction with respect to the remainder interest transferred on any return during his lifetime or on his final return. However, the retention of the right to possession until death would result in the inclusion of the painting in the taxpayer's gross estate and a deduction for the included value would be allowed to his estate, as a charitable transfer, for estate tax purposes.

Effective date

The amendments made by subsection (e) of the bill shall apply to transfers of future interests made after December 31, 1963, in taxable years ending after such date.

SECTION 210. LOSSES ARISING FROM EXPROPRIATION OF PROPERTY BY GOVERNMENTS OF FOREIGN COUNTRIES

Section 210 of the bill, which is a new section added to the bill as passed by the House, amends section 172 of the code to provide a 10-year carryover of certain expropriation losses.

(*a*) *Net operating loss carryover.*—Under the existing section 172(b)(1) of the code, relating to years to which a net operating loss may be carried, generally a net operating loss for any taxable year is a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss and is a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

Paragraph (1) of section 210(a) of the bill, as added by your committee, amends subparagraph (A)(i) of section 172(b)(1) of the code, relating to years to which a net operating loss may be carried, to provide that the 3-year carryback rule does not apply to the portion of a net operating loss for a taxable year attributable to a foreign expropriation loss.

Paragraph (2) of section 210(a) of the bill, as added by your committee, amends subparagraph (B) of section 172(b)(1) of the code to provide that the 5-year carryover rule does not apply to the portion of a net operating loss for a taxable year attributable to a foreign expropriation loss.

Paragraph (3) of section 210(a) of the bill, as added by your committee, amends section 172(b)(1), relating to years to which a net operating loss may be carried, by adding to such section a new subparagraph (D). The new subparagraph (D) of section 172(b)(1) of the code provides that in the case of a taxpayer which has a foreign expropriation loss for any taxable year ending after December 31, 1958, the portion of the net operating loss for such year attributable to such foreign expropriation loss shall not be a net operating loss carryback to any taxable year preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 10 taxable years following the taxable year of such loss. The term "foreign expropriation loss" is defined in a new subsection (k) added to section 172 of the code by paragraph (5) of section 210(a) of the bill, as added by your committee.

Paragraph (4) of section 210(a) of the bill, as added by your committee, amends section 172(b)(3), relating to special rules for net operating loss carrybacks and carryovers, by adding to such section new subparagraphs (C) and (D). Clause (i) of the new subparagraph (C) provides that the new subparagraph (D) of section 172(b)(1) of the code which allows the portion of a net operating loss for a taxable year attributable to a foreign expropriation loss to be carried forward for 10 years shall apply only if the foreign expropriation loss for the taxable year equals or exceeds 50 percent of the net operating loss for the taxable year.

Clause (ii) of the new subparagraph (C) provides that, in the case of a foreign expropriation loss for a taxable year ending after December 31, 1963, the new 10-year carryover provision shall apply only if the taxpayer elects (at such time and in such manner as the Secretary of the Treasury or his delegate by regulations prescribes) to have such new subparagraph (D) of section 172(b)(1) of the code apply.

Clause (iii) of the new subparagraph (C) provides that, in the case of a foreign expropriation loss for a taxable year ending after December 31, 1958, and before January 1, 1964, the new 10-year carryover provision shall apply only if the taxpayer elects (in such manner as may be prescribed by the Secretary of the Treasury or his delegate) on or before December 31, 1965, to have such new subparagraph (D) of section 172(b)(1) of the code apply.

The new subparagraph (D) of section 172(b)(3) of the code provides that if a taxpayer makes an election under such subparagraph (C)(iii), then (notwithstanding any law or rule of law), with respect to any taxable year ending before January 1, 1964, affected by such election (1) the time for making or changing any choice or election under subpart A of part III of subchapter N (relating to foreign tax credit) shall not expire before January 1, 1966, (2) any deficiency attributable to the election under subparagraph (C)(iii) of section 172(b)(3) of the code or the application of clause (i) of section 172(b)(3)(D) of the code may be assessed at any time before January 1, 1969, and (3) refund or credit of any overpayment attributable to the election under subparagraph (C)(iii) of section 172(b)(3) of the code or the application of clause (i) of section 172(b)(3)(D) of the code may be made or allowed if claim therefor is filed before January 1, 1969. In the event that the period within which a deficiency may be assessed or a claim for refund filed would expire at a date subsequent to January 1, 1969, under section 6501 or 6511 of the code, then such later date shall apply.

Paragraph (5) of section 210(a) of the bill, as added by your committee, amends section 172, relating to net operating loss deduction, by redesignating the existing subsection (k) as subsection (l) and by adding to such section a new subsection (k). The new subsection (k) provides that (1) the term "foreign expropriation loss" means, for any taxable year, the sum of the losses sustained with respect to property by reason of the expropriation, intervention, seizure, or similar taking of such property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing, and (2) the portion of the net operating loss for such year attributable to a foreign expropriation loss is the amount of the foreign expropriation loss for such year (but not in excess of the net operating loss for such year). The amount of any loss sustained is determined under section 165 of the code.

(*b*) *Technical amendments.*—Paragraph (1) of section 210(b) of the bill, as added by your committee, amends subparagraph (B) of section 172(b)(2) of the code, relating to amount of carrybacks and carryovers, by placing the existing provisions of such subparagraph (B) in a new subparagraph (B)(i) and by adding to such section a new subparagraph (B)(ii). Under existing section 172(b)(2) of the code the portion of a net operating loss which shall be carried to each of the taxable years other than the earliest taxable year to which such loss may be carried shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. The new subparagraph (B)(ii) provides that, in computing taxable income for any such prior taxable year, the amount of the net operating loss deduction shall be determined without regard to that portion, if any, of a net operating loss for a taxable year attributable to a foreign expropriation loss, if such portion may not, under paragraph (1)(D) of section 172(b) of the code, be carried back to such prior taxable year.

Paragraph (2) of section 210(b) of the bill, as added by your committee, amends section 172(b)(2), relating to amount of carrybacks and carryovers, by adding at the end of such section a new sentence. The new sentence provides, in effect, that the portion of a net operating loss for a loss year attributable to a foreign expropriation loss shall be considered to be a separate net operating loss for such loss year. Such portion attributable to a foreign expropriation loss is to be applied after the other portion of such net operating loss for such loss year, but prior to any net operating losses for subsequent taxable years.

(*c*) *Effective date.*—Subsection (c) of section 210 of the bill, as added by your committee, provides that the amendments made by such section 210 shall apply in respect of foreign expropriation losses sustained in taxable years ending after December 31, 1958.

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SECTION 211. ONE-PERCENT LIMITATION ON MEDICINE AND DRUGS

Section 211 of the bill (sec. 210 of the bill as passed by the House) has been approved by your committee without change. For the technical explanation of this section of the bill, see page A-51 of the report of the Committee on Ways and Means on the bill.

SECTION 212. CARE OF DEPENDENTS

Section 212 of the bill (sec. 211 of the bill as passed by the House) amends section 214 of the code (relating to expenses for care of certain dependents). Subsections (a), (c), and (d) of section 214 of the code as amended by the bill as passed by the House and the effective date provision for this section of the bill have been approved by your committee without change. For the technical explanation of this section of the bill (other than the amendments made by your committee), see page A-52 of the report of the Committee on Ways and Means on the bill.

Subsection (b) of section 214, as amended by the bill as passed by the House, prescribed certain limitations on the allowability of the deduction otherwise authorized by subsection (a) of such section. The changes made by your committee in respect of these limitations are discussed below.

Dollar amount

Under the bill as passed by the House, subsection (b) of section 214 limited the deduction under section 214(a) to $600 for any taxable year except that such limit would be increased (to an amount not above $900) by the amount of expenses incurred by a taxpayer for any period during which the taxpayer had two or more dependents (within the meaning of amended sec. 214(d)(1) of the code). However, in the case of a woman who is married, the $600 limit would be increased only in respect of expenses incurred during a period while her husband was incapable of self-support because mentally or physically defective.

As amended by your committee, subsection (b) of section 214 limits the deduction under section 214(a) to $600 for any taxable year, except that such $600 limit—

(1) shall be increased (to an amount not above $900) by the amount of expenses incurred by the taxpayer for any period during which the taxpayer had two dependents (within the meaning of amended sec. 214(d)(1) of the code), and

(2) shall be increased (to an amount not above $1,000) by the amount of expenses incurred by the taxpayer for any period during which the taxpayer had three or more dependents (within the meaning of amended sec. 214(d)(1) of the code).

The provision of the bill as passed by the House dealing with the increase in the $600 limit in the case of a married woman (see the last sentence of the preceding paragraph) has been deleted.

Working wives and husbands with incapacitated wives

Under the bill as passed by the House, subsection (b) of section 214 further provided, in the case of a woman who is married and a husband whose wife is incapacitated, that the deduction otherwise allowable under section 214(a)—

(1) would not be allowed unless the couple files a joint return; and

(2) would be reduced dollar for dollar to the extent that the couple's combined adjusted gross income exceeds $4,500.

These conditions, however, were made inapplicable in certain specified situations.

The foregoing provisions of the bill as passed by the House have been approved by your committee and have been combined into one paragraph with an amendment providing that the deduction otherwise allowable under section 214(a) is to be reduced dollar for dollar to the extent that the couple's combined adjusted gross income exceeds $7,000 (rather than $4,500 as provided in the bill as passed by the House).

SECTION 213. MOVING EXPENSES

Section 213 of the bill (sec. 212 of the bill as passed by the House) has been approved by your committee except for a change in the effective date provision in subsection (d). The amendment made by subsection (c) of section 213 (relating to the definition of "wages" for withholding purposes) applied, under the bill as passed by the House, with respect to remuneration paid after December 31, 1963. As amended by your committee, such provision applies with respect to remuneration paid after the seventh day following the date of enactment of the bill.

For the technical explanation of this section of the bill, see page A-57 of the report of the Committee on Ways and Means on the bill.

SECTION 214. DEDUCTION FOR POLITICAL CONTRIBUTIONS

Section 214 of the bill, which is a new section added to the bill as passed by the House, relates to a deduction for certain political contributions in computing taxable income.

(*a*) *Allowance of deduction.*—Subsection (a) of section 214 of the bill amends part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) of the Internal Revenue Code of 1954 by inserting after section 217 (as added by sec. 213(a)(1) of the bill) a new section 218.

SECTION 218. CONTRIBUTIONS TO POLITICAL CANDIDATES AND POLITICAL COMMITTEES

Subsection (a) of section 218 allows an individual a deduction for any political contribution (as defined in subsec. (c)), payment of which is made during the taxable year. The deduction will be allowable only for the taxable year in which the contribution is paid. The method of accounting employed by the taxpayer and the time when the contribution is pledged are immaterial.

Subsection (b)(1) of section 218 limits the deduction under subsection (a) to an aggregate of $50 for any taxable year except that in the case of husband and wife filing a joint return, the deduction for any year is limited to $100. The amount of the deduction in the case of a joint return will not be affected even though the contributions are made by only one spouse.

Subsection (b)(2) of section 218 provides that the deduction under subsection (a) shall be allowed only if the political contribution is verified in accordance with regulations prescribed by the Secretary of the Treasury or his delegate.

The term "political contribution" is defined in subsection (c) of section 218 as a contribution or gift to a political candidate or a political committee for the purpose of furthering the candidacy of one or more individuals in a general, special, or primary election or in a convention of a political party. A contribution to an organization which engages in activities in addition to influencing the election of political candidates, such as general political education, could qualify if such contribution is made to further the candidacy of one or more individuals in a general, special, or primary election or in a convention of a political party and if the funds received from such contributions are segregated from funds for such other activities. The principles applicable under section 170 of the code (relating to charitable contributions) will be followed in determining what constitutes a contribution or gift and the amount thereof. Thus, only that portion of the cost of tickets to fund-raising dinners which represents the excess of the price of the ticket over the amount which would ordinarily be paid for the dinner will qualify as a contribution. In addition, the value of services rendered to a candidate or committee will not qualify as a contribution.

(*b*) *Technical amendment.*—Subsection (b) of section 214 of the bill amends section 642 of the code (relating to special rules for credits and deductions of estates and trusts) by redesignating subsection (i) as subsection (j) and inserting a new subsection (i) which provides that an estate or trust is not allowed the deduction for political contributions provided under section 218.

(*c*) *Effective date.*—Under subsection (c) of section 214 of the bill, only contributions or gifts payment of which is made on or after the date of the enactment of the bill in taxable years ending after such date will be allowable as a deduction under new section 218 of the code.

SECTION 215. 100 PERCENT DIVIDENDS RECEIVED DEDUCTION FOR MEMBERS OF ELECTING AFFILIATED GROUPS

Section 215 of the bill, which is a new section added to the bill as passed by the House, amends section 243 of the code (relating to the deduction for certain dividends received by corporations), and makes conforming technical amendments.

(*a*) *100 percent dividends received deduction.*—Subsection (a) of section 243, as amended, in substance incorporates the provisions of subsections (a) and (b) of existing section 243. Paragraph (1) of subsection (a) corresponds to subsection (a) of existing section 243 and paragraph (2) of subsection (a) corresponds to subsection (b) of existing section 243. Paragraph (3) of subsection (a), which has no counterpart in existing law, provides for a 100 percent deduction in the case of "qualifying dividends."

Qualifying dividends

Subsection (b)(1) of section 243, as amended, defines the term "qualifying dividends" to mean dividends received by a corporation which, at the close of the day the dividends are received, is a member of the same affiliated group of corporations (as defined in par (5) of sec. 243(b)) as the corporation distributing the dividends, provided that the conditions prescribed in subparagraphs (A) and (B) of section 243(b)(1) are met.

Subparagraph (A) of section 243(b)(1) provides that such affiliated group which includes the distributing and recipient corporations must have made an election (under par. (2) of sec. 243(b)) which is effective for the taxable years of its member corporations which include the day of receipt.

Subparagraph (B) of section 243(b)(1) provides that such dividends must have been distributed out of earnings and profits of a taxable year which ends after December 31, 1963, and with respect to which two requirements are satisfied. First, under clause (i) of subparagraph (B), on each day of such taxable year the distributing corporation and the recipient corporation must have been members of such affiliated group. Second, under clause (ii) of subparagraph (B), an election under section 1562 (relating to election of multiple surtax exemptions) must not be effective for such taxable year.

The application of the provisions of section 243(b)(1) may be illustrated by the following examples:

Example (1).—On March 1, 1964, corporation P, a publicly owned corporation, acquires all the stock of corporations S and S–1 and continues to hold such stock throughout the remainder of 1964 and all of 1965. Corporations P, S, and S–1 are domestic corporations which file separate returns on the basis of a calendar year. An election under section 1562 was not effective for their taxable years ending December 31, 1964, and December 31, 1965. Corporation S makes a $5,000 distribution with respect to its stock on February 1, 1965, which is received by corporation P on the same date. Before taking into account this distribution, corporation S had earnings and profits for its taxable years ending December 31, 1964, and December 31, 1965, of $7,000 and $4,000, respectively. An election under section 243(b)(2) is effective for the taxable years of corporations P, S, and S–1 which include February 1, 1965. Accordingly, corporation P will be entitled to a 100 percent dividends received deduction under section 243(a)(3) with respect to $4,000 of the $5,000 distribution received from corporation S on February 1, 1965. Since $1,000 of the $5,000 distribution was made out of earnings and profits of corporation S for its taxable year ending December 31, 1964, and since corporations P and S were not members of the same affiliated group of corporations on each day of such year, $1,000 of the February 1, 1965, distribution would not constitute a qualifying dividend as defined in section 243(b)(1) (but would constitute a dividend entitled to an 85 percent dividends received deduction under sec. 243(a)(1)).

Example (2).—Assume the same facts as in example (1), except that corporation P held all the stock of corporations S and S–1 on each day of 1964 and sold the stock of S on November 1, 1965. Since an election under section 243(b)(2) is effective for the taxable years of corporations P, S, and S–1 which include February 1, 1965, corporation P will be entitled to a 100 percent dividend received deduction under section 243(a)(3) with respect to $1,000 of the $5,000 distribution received from corporation S on February 1, 1965. The $1,000 amount represents the portion of the February 1, 1965, distribution which was made out of the earnings and profits of corporation S for its taxable year ending December 31, 1964, a year for which the requirements of section 243(b)(1) are met. Since $4,000 of the $5,000 distribution was made out of the earnings and profits of corporation S for its taxable year ending December 31, 1965, and since corporations P and S were not members of the same affiliated group of corporations on each day of such year, $4,000 of the February 1, 1965, distribution would not constitute a qualifying dividend as defined in section 243(b)(1) (but would constitute a dividend entitled to an 85 percent dividends received deduction under sec. 243(a)(1)).

Election

Paragraph (2) of section 243(b), as amended, provides that an election (referred to in subpar. (A) of sec. 243(b)(1)) is to be made by the common parent corporation for the affiliated group of corporations. The election is to be made with respect to a particular taxable year of the common parent corporation and is to be made at such time and in such manner as the Secretary of the Treasury or his delegate by regulations prescribes. An election may not be made for an affiliated group for any taxable year of the common parent corporation for which an election under section 1562 (relating to election of multiple surtax exemptions) is effective. A consent is required from each corporation which is a member of the affiliated group at any time during its taxable year which includes the last day of the particular taxable year of the common parent corporation with respect to which the election is made. The consent is to be made at such time and in such manner as the Secretary of the Treasury or his delegate by regulations prescribes.

Under subparagraph (A) of paragraph (2), an election will be effective for the taxable year of each member of the affiliated group which includes the last day of the taxable year of the common parent corporation with respect to which the election is made. However, in the case of a taxable year of a member beginning in 1963 and ending in 1964, if an election is made with respect to a taxable year of the common parent corporation which includes the last day of such taxable year of such member, then the election will be effective with respect to such taxable year of such member if it consents to such election with respect to such taxable year. Under subparagraph (B) of paragraph (2), an election will also be effective (unless terminated under par. (4) of subsec. (b)) for the taxable year of each member which ends after the last day of the taxable year of the common parent corporation with respect to which the election is made but which does not include such last day.

The application of the provisions of section 243(b)(2) may be illustrated by the following example:

Example.—Corporation P is a common parent corporation of an affiliated group of corporations consisting of corporations P and S. Corporation P files its income tax return on the basis of a fiscal year ending June 30 and corporation S uses a calendar year as the basis for its tax return. Corporation P makes an election under section 243(b)(2) with respect to its taxable year ending June 30, 1965. If the election is properly consented to by P and S, the election will be effective with respect to the fiscal year of corporation P ending June 30, 1965, and with respect to the calendar year of corporation S ending December 31, 1965 (the year including June 30, 1965, the last day of the common parent corporation's taxable year with respect to which the election was made). Further, if corporation Y, which has a fiscal year ending September 30, becomes a member of such affiliated group on June 15, 1966, the election will be effective with respect to corporation Y's taxable year ending September 30, 1966, as well as P's taxable year ending June 30, 1966, and S's calendar year ending December 31, 1966, unless the election is terminated under paragraph (4) of section 243(b).

Effect of election

Paragraph (3) of section 243(b), as amended, provides that if an election, made for an affiliated group of corporations under paragraph (2) of section 243(b), is effective with respect to any taxable year of the common parent corporation, then under regulations prescribed by the Secretary of the Treasury or his delegate—

(1) no member of such affiliated group may consent to an election under section 1562 for such taxable year;

(2) the members of such group will be treated as one taxpayer for purposes of making the elections under section 901(a) (relating to allowance of foreign tax credit) and section 904(b)(1) (relating to election of overall limitation); and

(3) the members of such affiliated group will be limited to (i) one $100,000 mimimum accumulated earnings credit under section 535(c) (2) or (3); (ii) one $100,000 limitation for exploration expenditures under section 615 (a) and (b); (iii) one $400,000 limitation for exploration expenditures under section 615(c)(1); (iv) one $25,000 limitation on small business deductions of life insurance companies under sections 804(a)(4) and 809(d)(10); and (v) one $100,000 exemption for purposes of estimated tax filing requirements under section 6016 and the addition to tax under section 6655 for failure to pay estimated tax.

Termination

Paragraph (4) of section 243(b), as amended, provides for the termination of an election under paragraph (2). Such termination, if made, is effective with respect to a taxable year of the common parent corporation and with respect to the taxable years of the members of the affiliated group which includes the last day of such taxable year of the common parent corporation. Under subparagraph (A) of paragraph (4), an election will be terminated if the affiliated group files, with respect to a particular taxable year of the common parent corporation, a termination of such election (at such time and in such manner as the Secretary of the Treasury or his delegate by regulations prescribes). Each corporation which is a member of the affiliated group at any time during its taxable year which includes the last day of such taxable year of the common parent corporation must consent to the termination of the election.

Under subparagraph (B) of paragraph (4), an election will be terminated with respect to a taxable year of the common parent corporation if with respect to such year the affiliated group includes a member which was not a member of such group during such common parent corporation's immediately preceding taxable year, and if such member files a statement that it does not consent to the election at such time and in such manner as the Secretary of the Treasury or his delegate by regulations prescribes.

Definition of affiliated group

Paragraph (5) of section 243(b), as amended, defines the term "affiliated group" for purposes of subsection (b) of section 243. The term is to have the same meaning assigned to it by section 1504(a) except that section 1504(b)(2) and section 1504(c) will not apply. Thus, for purposes of section 243(b), an affiliated group includes those domestic corporations (including a corporation which is treated as a domestic corporation under sec. 1504(d)) which meet the stock-ownership test contained in section 1504(a), and which are "includible corporations" within the meaning of section 1504(b); however, any domestic insurance company subject to taxation under section 802 or 821 will be treated for this purpose as an includible corporation.

Special rules for insurance companies

Paragraph (6) of section 243(b), as amended, provides special rules for certain insurance companies. Subparagraph (A) of paragraph (6) provides that if an election under subsection (b) of section 243 is effective for the taxable year of an insurance company subject to taxation under section 802 or 821 of the code, then part II of subchapter B of chapter 6 of the code (relating to certain controlled corporations) will be applied without regard to section 1563(a)(4) (relating to certain insurance companies) and section 1563(b)(2)(D) (relating to certain excluded members) with respect to such company and the other corporations which are members of the controlled group of corporations (as determined under sec. 1563 without regard to subsecs. (a)(4) and (b)(2)(D)) of which such company is a member. Subparagraph (B) of paragraph (6) provides that if an insurance company subject to taxation under section 802 or 821 distributes a dividend out of earnings and profits of a taxable year with respect to which the company would have been a component member of a controlled group of corporations within the meaning of section 1563 except for subsection (b)(2)(D) thereof, such dividend will not be treated as a qualifying dividend unless an election under subsection (b) of section 243 is effective for such taxable year.

The application of the provisions of paragraph (6) of section 243(b) may be illustrated by the following example:

Example.—Throughout 1965 corporation M owns all the stock of corporations L, X, and Y. Corporation M is a domestic mutual insurance company subject to tax under section 821 of the code, corporation L is a domestic life insurance company subject to tax under section 802 of the code, and corporations X and Y are subject to tax under section 11 of the code. Each corporation uses the calendar year for its taxable year. Corporation L pays a dividend to corporation M in 1965 which is out of the earnings and profits of L's taxable year ending on December 31, 1965. Corporation M makes an election under section 243(b)(2) for 1965 for the affiliated group consisting of corporations M, L, X, and Y which is properly consented to by such corporations. The application of paragraph (6) of section 243(b) results in the following tax consequences:

(1) As a result of applying part II of subchapter B of chapter 6 in the manner described in subparagraph (A) of section 243(b)(6), corporations M, L, X, and Y will be limited to a single $25,000 surtax exemption for their taxable years ending December 31, 1965 (to be apportioned among such corporations in accordance with sec. 1561).

Although M and L are excluded members of the controlled group of corporations consisting of corporations M, L, X, and Y, by reason of the application of the excluded member rule contained in subparagraph (D) of section 1563(b)(2), subparagraph (A) of section 243(b)(6) requires that part II of subchapter B of chapter 6 of the code be applied with respect to M and L and the other members of the controlled group without regard to such rule.

(2) The distribution by corporation L to corporation M is a qualifying dividend within the meaning of paragraph (1) of section 243(b). Since the distribution is out of the earnings and profits of L for its taxable year ending December 31, 1965 (a year in which L would have been a component member of a controlled group of corporations within the meaning of sec. 1563 except for the excluded member rule contained in subsec. (b)(2)(D)), and an election under paragraph (2) of section 243(b) is in effect for such taxable year, the dividend is not disqualified by operation of subparagraph (B) of section 243(b)(6).

Subsection (c) of section 243, as amended, includes a new paragraph (4). New paragraph (4) provides that any dividend received which is described in section 244 (relating to dividends received on preferred stock of a public utility), as amended by subsection (b)(1) of this section of the bill, shall not be treated as a dividend for purposes of section 243, as amended. The corresponding provisions of existing law appear as parenthetical phrases in existing subsections (a) and (b) of section 243.

Subsection (d) of section 243, as amended, is the same as existing section 243(d) except for a conforming change.

(*b*) *Technical amendments.*—Subsection (b) of section 215 of the bill makes technical amendments to several sections of the code to conform them to the amendments made by subsection (a) of this section of the bill.

(*c*) *Effective date.*—Subsection (c) of section 215 of the bill provides that the amendments made by subsections (a) and (b) of such section shall apply with respect to dividends received in taxable years ending after December 31, 1963.

SECTION 216. INTEREST ON LOANS INCURRED TO PURCHASE CERTAIN INSURANCE AND ANNUITY CONTRACTS

Section 216 of the bill (section 213 of the bill as passed by the House) amends section 264 of the code to provide that, under certain circumstances, no deduction is allowed for interest on loans incurred or continued to purchase or carry certain life insurance, endowment, or annuity contracts. For a technical explanation of this section of the bill (other than the amendment made by your committee), see page A–60 of the report of the Committee on Ways and Means on the bill.

Subsection (a)(2) of this section of the bill as passed by the House provided that new paragraph (3) of section 264(a) of the code (added by subsec. (a)(1) of sec. 216 of the bill) would apply only in respect of contracts purchased after August 6, 1963. Under your committee's amendment, new paragraph (3) of section 264(a) of the code applies only in respect of contracts purchased after December 31, 1963.

SECTION 217. INTEREST ON INDEBTEDNESS INCURRED OR CONTINUED TO PURCHASE OR CARRY TAX-EXEMPT BONDS

Section 217 of the bill, which is a new section added to the bill as passed by the House, amends section 265(2) of the code by adding a new sentence at the end thereof.

Section 265(2) presently provides that no deduction shall be allowed for interest on indebtedness incurred or continued to purchase or carry obligations (other than certain obligations of the United States) the interest from which is wholly exempt from the taxes imposed by subtitle A of the code (relating to income taxes).

(*a*) *Application with respect to certain financial institutions.*—Section 217(a) limits the application of section 265(2) in the case of interest expense in respect of face-amount certificates issued by a financial institution (other than a bank) which is subject to the banking laws of the State in which such institution is incorporated. The amendment does not affect the application of section 265(2) in the case of banks.

Under section 265(2), as amended, interest expense incurred by such an institution—

> (1) on face-amount certificates (as defined in sec. 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C. 80a–2)) issued by the institution, and
>
> (2) on amounts received by such institution to be applied toward the purchase of such face-amount certificates to be issued by the institution

is not to be considered as interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from the taxes imposed by subtitle A of the code to the extent that the average amount of such obligations held by such institution during the taxable year does not exceed 25 percent of the average of the total assets of the institution during the taxable year.

The Secretary of the Treasury or his delegate is required to prescribe by regulations the manner of computing the average amount of tax-exempt obligations held by such institution during the taxable year, and the manner of determining the average amount of the total assets held by such institution during the taxable year.

The computation of the average amount of tax-exempt obligations and the average amount of total assets is to be made not more frequently than weekly. Thus, if the Secretary or his delegate prescribes that such averages are to be computed as of the end of each week of the institution's taxable year, the percentage which the average amount of tax-exempt obligations is of the average amount of total assets of the institution for any taxable year shall be computed by dividing—

> (1) the sum of the investments of the institution, as of the end of each week of its taxable year, in obligations the interest on which is wholly tax-exempt, by
>
> (2) the sum of the total assets of the institution as of the end of each week of its taxable year.

If this computation results in a percentage figure in excess of 25 percent, there is interest on indebtedness which is subject to the first sentence of section 265(2). The amount thereof is obtained by multiplying the total interest expense for the taxable year on face-amount certificates and on amounts received for the purchase of such certificates by the percentage equal to the excess of such percentage figure over 25 percent.

In addition, any other interest expense of such institution is subject to the first sentence of section 265(2).

(*b*) *Effective date.*—Section 217(b) provides that the amendment made by section 217(a) shall apply with respect to taxable years ending after the date of enactment of the bill.

SECTION 218. REPEAL OF REQUIREMENT OF ALLOCATION OF CERTAIN TRAVELING EXPENSES

(*a*) *Repeal of section 274(c).*—Subsection (a) of section 218 of the bill, which is a new section added to the bill as passed by the House, amends section 274 of the code by repealing subsection (c) thereof. Section 274(c) provides that in the case of any individual who is traveling away from home in pursuit of a trade or business or in pursuit of an activity described in section 212, no deduction shall be allowed under section 162 or section 212 for that portion of the expenses of such travel otherwise allowable under such section which, under regulations prescribed by the Secretary of the Treasury or his delegate, is not allocable to such trade or business or to such activity. Such provision, however, does not apply to the expenses of any travel away from home which does not exceed 1 week or where the portion of the time away from home which is not attributable to the pursuit of the taxpayer's trade or business or to an activity specified in section 212 is less than 25 percent of the total time away from home on such travel.

(*b*) *Effective date.*—Subsection (b) of section 218 of the bill provides that the repeal made by this section shall apply with respect to taxable years ending after December 31, 1962, but only in respect of periods after such date.

SECTION 219. ACQUISITION OF STOCK IN EXCHANGE FOR STOCK OF CORPORATION WHICH IS IN CONTROL OF ACQUIRING CORPORATION

(*a*) *Definition of reorganization.*—Subsection (a) of section 219 of the bill, which is a new section added by your committee to the bill as passed by the House, amends subparagraph (B) of section 368(a)(1) of the code, relating to definition of a stock-for-stock reorganization. Under the existing section 368(a)(1)(B), the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation qualifies as a "reorganization" if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition).

Subparagraph (B) of section 368(a)(1) of the code, as amended by this section of the bill, allows an acquiring corporation to exchange either its voting stock or the voting stock of a corporation which is in control of the acquiring corporation for the stock of another corporation.

(b) *Technical amendments.*—Paragraph (1) of section 219(b) of the bill, as added by your committee, amends subparagraph (C) of section 368(a)(2) of the code, relating to special rules. Under the existing section 368(a)(2)(C), a transaction otherwise qualifying as a "reorganization" under subparagraph (A) or (C) of section 368(a)(1), which relate respectively to statutory mergers or consolidations and stock-for-property reorganizations, is not disqualified by reason of the fact that part or all of the assets which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets.

Subparagraph (C) of section 368(a)(2) of the code, as amended by this section of the bill, allows a corporation acquiring stock in a transaction otherwise qualifying as a "reorganization" under section 368(a)(1)(B), as amended by this section of the bill, to transfer part or all of such stock to a corporation controlled by the corporation acquiring such stock.

Paragraph (2) of section 219(b) of the bill, as added by your committee, amends the last two sentences of subsection (b) of section 368, relating to definition of a party to a reorganization.

The next to last sentence of section 368(b) of the code, as amended by this section of the bill, provides that in the case of a reorganization qualifying under subparagraph (B) or (C) of section 368(a)(1), if the stock exchanged for the stock or properties is stock of a corporation which is in control of the acquiring corporation, the term "a party to a reorganization" includes the corporation so controlling the acquiring corporation. The last sentence of the amended section 368(b) of the code provides that in the case of a reorganization qualifying under subparagraph (A), (B), or (C) of section 368(a)(1) by reason of subparagraph (C) of section 368(a)(2), the term "a party to a reorganization" includes the corporation controlling the corporation to which the acquired assets or stock are transferred.

(c) *Effective date.*—Subsection (c) of section 219 of the bill, as added by your committee, provides that the amendments made by such section shall apply with respect to transactions after December 31, 1963, in taxable years ending after such date.

SECTION 220. RETROACTIVE QUALIFICATION OF CERTAIN UNION-NEGOTIATED MULTIEMPLOYER PENSION PLANS

(a) *Beginning of period as qualified trust.*—Subsection (a) of section 220 of the bill, which is a new section added by your committee to the bill as passed by the House, amends section 401 of the code by redesignating subsection (i) as (j), and by inserting a new subsection (i). Section 401 relates to qualified pension, profit-sharing, and stock bonus plans.

In general, under existing law, employer contributions to a pension trust are deductible only under the provisions of section 404 of the code. Deductibility under that section in effect requires, if the employees do not have a nonforfeitable right to the contributions at the time they are made, that the trust be part of a pension plan of an employer which qualifies under section 401(a) of the code. One of the requirements for qualification included in the Treasury Department's regulations under that section is that the plan be in the form of "a definite written program and arrangement which is communicated to the employees." However, under a multiemployer collective bargaining agreement, employer contributions are often made to or for a pension trust before a complete schedule of benefits has been adopted, so that such contributions are not made to a qualified trust and, if not vested, are not deductible.

The new subsection (i) applies to a trust forming part of a pension plan which has been determined by the Secretary of the Treasury or his delegate to constitute a qualified trust under section 401(a), and to be exempt from taxation under section 501(a), for a period beginning after contributions were first made to or for such trust. The new subsection (i) provides that where such a trust meets certain conditions, then it shall be considered as having constituted a qualified trust under section 401(a), and as having been exempt from taxation under section 501(a), for the period beginning on the date on which contributions were first made to or for such trust and ending on the date such trust first constituted (without regard to the new subsection) a qualified trust.

The conditions referred to in the preceding paragraph require that it be shown to the satisfaction of the Secretary of the Treasury or his delegate that: (1) such trust was created pursuant to a collective bargaining agreement between employee representatives and two or more employers who are not related (determined under regulations prescribed by the Secretary of the Treasury or his delegate); (2) any disbursements made prior to the period for which the trust was determined to be qualified (without regard to the new subsection) substantially comply with the terms of the trust (and plan) as so qualified; and (3) prior to the period for which the trust was determined to be qualified (without regard to the new subsection) contributions were not used in a manner which jeopardized the interests of the beneficiaries.

In some cases, employer contributions are held in escrow until such time as a trust is created. For purposes of applying the new subsection (i), such employer contributions which are held in escrow and later transferred to a qualified trust are "contributions made to or for such trust."

(*b*) *Effective date.*—Subsection (b) of section 220 of the bill provides that the amendments made by subsection (a) shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954, but only with respect to contributions made after December 31, 1954. However, no provision of this section extends the period of limitations within which a claim for credit or refund may be filed for any taxable year.

SECTION 221. QUALIFIED PENSION, ETC., PLAN COVERAGE FOR EMPLOYEES OF CERTAIN SUBSIDIARY EMPLOYERS

Section 221 of the bill, which is a new section added to the bill as passed by the House, relates to the provision of qualified pension, profit-sharing, etc., plan coverage for certain employees of subsidairy corporations.

(*a*) *Employees of foreign subsidiaries covered by social security agreements.*—Subsection (a) of section 221 of the bill adds a new section 406 to part I of subchapter D of chapter 1 of the Internal Revenue

Code of 1954 (relating to pension, profit-sharing, stock bonus plans, etc.). The new section 406 relates to qualified pension, profit-sharing, etc., plan coverage for certain employees of foreign subsidiaries.

SECTION 406. QUALIFIED PENSION, PROFIT SHARING, ETC., PLAN COVERAGE FOR CERTAIN EMPLOYEES OF FOREIGN SUBSIDIARIES

(*a*) *Treatment as employees of domestic corporation.*—The new section 406(a) sets forth the rules relating to the treatment of certain employees of foreign subsidiaries who are covered under a social security agreement described in section 3121(l) of the code, entered into at the request of the domestic corporation, as employees of such domestic corporation. The new section 406(a) only applies in the case of a plan established and maintained by a domestic corporation which is a pension, profit-sharing, or stock bonus plan described in section 401(a) of the code, an annuity plan described in section 403(a) of the code, or a bond purchase plan described in section 405(a) of the code. The new section 406(a) provides that in the case of such a plan an individual who is a citizen of the United States and who is also an employee of a foreign subsidiary (as defined in section 3121(l)(8) of the code) of the domestic corporation shall be treated as an employee of such domestic corporation if certain requirements are satisfied. Under the new section 406(a), the deemed employer-employee relationship can only exist if the plan of the domestic employer is qualified. However, if the plan of the domestic employer is qualified, then the fact that the trust which forms a part of such plan is not exempt from tax under section 501(a) of the code does not affect such employer-employee relationship.

The first of the requirements of the new section 406(a) is that the domestic corporation has entered into an agreement described in section 3121(l) of the code, relating to agreements entered into by domestic corporations with respect to foreign subsidiaries, and such agreement covers the foreign subsidiary of the domestic corporation in which the individual is employed. Therefore, there is brought into play, as a condition precedent to obtaining the benefits of section 406, the rules set forth in section 3121(l) which relate to the circumstances under which a domestic corporation may enter into an agreement for the purpose of extending the benefits provided by title II of the Social Security Act to certain services performed outside the United States, and to the obligations of the domestic corporation which enters into such an agreement.

The second requirement is that the qualified plan of the domestic employer must expressly provide coverage for the U.S. citizen employees of all foreign subsidiaries which are covered under the agreement described in section 3121(l) of the code which has been entered into by the domestic corporation. However, such requirement does not modify the requirements for qualification set forth in section 401(a) of the code which are applicable to such plan. Thus, such plan must satisfy the requirements of section 401(a) after such plan is amended to cover individuals who are employees within the meaning of section 406(a). The plan need not provide actual benefits for all citizen employees of all such foreign subsidiaries; for example, some such employees may not receive benefits if they are excluded by reason of a nondiscriminatory classification or other provision of the plan.

The third requirement for qualification of an individual as an employee is that contributions under a funded plan of deferred compensation are not provided by any other person with respect to the remuneration paid to such individual by the foreign subsidiary. Contributions are provided under a funded plan of deferred compensation; for example, if contributions are provided for such individual under a plan described in section 401(a) of the code, section 403(a) of the code, or section 405(a) of the code. If any portion of such remuneration is covered under another plan by a person other than the domestic parent, such employee cannot be treated as the employee of the domestic corporation.

(*b*) *Special rules for application of section 401*(*a*).—The new section 406(b) provides certain special rules for the application of section 401(a) of the code in the case of a plan which covers an individual who is treated as an employee of a domestic corporation under the new section 406(a).

Paragraph (1) of such section 406(b) provides certain rules regarding the application of section 401(a) (3)(B) and (4) of the code in the case of a plan which covers such an individual. Paragraph (1)(A) of section 406(b) provides that if such an individual is an officer, shareholder, or person whose principal duties consist in supervising the work of other employees of a foreign subsidiary of such domestic corporation, he shall be treated as having such capacity with respect to the domestic corporation. Thus, for example, if an individual who is an employee within the meaning of section 406(a) is an officer of a foreign subsidiary, he is considered to be an officer of the domestic corporation treated as his employer for the purpose of determining whether the plan of such domestic employer satisfies the nondiscrimination requirements of section 401(a) (3)(B) and (4).

Paragraph (1)(B) of section 406(b) provides that the determination of whether an individual who is treated as an employee under the new section 406(a) is a highly compensated employee for purposes of section 401(a) (3)(B) and (4) of the code is made by treating such individual's total compensation (as computed in accordance with the provisions of par. (2) of sec. 406(b)) as compensation paid by the domestic corporation and by determining such individual's status as a highly compensated employee with regard to such domestic corporation.

Paragraph (2) of the new section 406(b) sets forth the rules regarding determination of the compensation of an individual who is treated as an employee of a domestic corporation under section 406(a) of the code. Such rules are applicable whenever the compensation of such an individual is to be determined for the purpose of determining whether the plan satisfies the requirements for qualification set forth in section 401(a). Paragraph (2)(A) of section 406(b) provides that, for the purpose of applying section 401(a)(5) with respect to such an individual, his total compensation is the remuneration paid to him by the foreign subsidiary which would constitute his total compensation if his services had been performed for the domestic corporation treated as his employer. In addition, such paragraph (2)(A) provides that the portion of the individual's total compensation which constitutes his basic or regular rate of compensation shall be determined under regulations prescribed by the Secretary of the Treasury or his delegate.

Paragraph (2)(B) of section 406(b) provides that an individual who is treated as an employee under section 406(a) shall be treated as having paid the amount paid by such domestic corporation which is equivalent to the tax imposed by section 3101 of the code (relating to the tax imposed on employees) with respect to such individual. Thus, the administrative rules relating to the determination of the contributions or benefits provided by the employer under the Social Security Act apply for purposes of determining whether the plan meets the requirements of section 401.

(c) *Termination of status as deemed employee not to be treated as separation from service for purposes of capital gains provisions.*—The new section 406(c) provides that the termination of status as an employee within the meaning of section 406(a) shall not be treated as separation from service for purposes of sections 402(a)(2) and 403(a)(2) of the code which provide capital gains treatment for certain distributions which take place after an employee's separation from the service. Section 406(c) provides that for purposes of applying section 402(a)(2) and section 403(a)(2) with respect to the distribution of the total amounts payable to an individual who is treated as an employee of a domestic corporation under section 406(a), such individual is not treated as separated from the service of the domestic corporation solely by reason of the occurrence of certain events.

The provisions of section 406(c) are in addition to the rules of existing law regarding the determination as to whether an employee is separated from service. In general, these provisions take into account the deemed employer-employee relationship which is established under the new section 406 of the code and provide that the termination of such deemed relationship does not result in a separation from service.

Section 406(c) provides that for purposes of applying section 402(a)(2) and section 403(a)(2) of the code with respect to an individual who is treated as an employee of a domestic corporation under section 406(a), such individual shall not be treated as separated from the service solely by reason of the fact that—

(1) The agreement entered into by such domestic corporation under section 3121(l) which covers the employment of such individual is terminated under the provisions of such section;

(2) Such individual becomes an employee of a foreign subsidiary (as defined in sec. 3121(l)(8)) with respect to which an agreement described in section 3121(l) does not apply;

(3) Such individual ceases to be an employee within the meaning of section 406(a) and becomes an employee of another corporation controlled by the domestic corporation; or

(4) The provision of the plan described in section 406(a)(2) is terminated.

For purposes of paragraph (3), above, a corporation is considered to be controlled by a domestic corporation if such domestic corporation owns directly or indirectly more than 50 percent of the voting stock of the corporation.

(d) *Deductibility of contributions.*—The new section 406(d) relates to the deductibility of contributions made on behalf of an individual who is treated as an employee of a domestic corporation by reason of the provisions of section 406(a). The new section 406(d) provides that for purposes of applying sections 404 and 405(c) with respect to contributions made to a qualified plan on behalf of an individual who is treated as an employee of a domestic corporation under section 406(a), no domestic corporation is allowed a deduction. The amount which would be deductible under section 404 or 405(c) by the domestic corporation if the individual who is an employee within the meaning of section 406(a) were its own employee is allowed as a deduction to the foreign subsidiary. Thus, the foreign subsidiary is allowed the deduction under section 404(a) or 405(c), but such deduction is available to the foreign corporation only to the extent otherwise allowed under chapter 1 (see, for example, sec. 863 of the code).

Whether contributions on behalf of an individual who is treated as an employee under section 406(a), or forfeitures with regard to such employee, will result in an inclusion in the income of the domestic corporation, or an adjustment in the basis of such corporation's stock in the foreign corporation, will depend upon the rules of existing law. For example, an unreimbursed contribution by the domestic parent corporation to a plan under which each employee's rights to the contributions are nonforfeitable, will be treated as a contribution of capital to the foreign subsidiary to the extent that such contributions are made on behalf of such subsidiary's employees.

Paragraph (3) of the new section 406(d) provides that for the purpose of computing the amount deductible under section 404 or 405(c) any reference to compensation shall be considered to be a reference to the total compensation of such individual determined with the application of the rules set forth in the new section 406(b)(2).

The new section 406(d) also provides that any amount deductible by a foreign subsidiary under this section shall be deductible for its taxable year with or within which the taxable year of the domestic corporation ends.

(e) *Treatment as employee under related provisions.*—The new section 406(e) provides that, for purposes of applying certain related provisions of the code, an individual who is treated as an employee of a domestic corporation under the new section 406(a) is also to be treated as an employee of the domestic corporation with respect to certain related provisions dealing with the tax treatment of qualified plans. This section permits employees of subsidiaries covered under the qualified plan of the domestic corporation and their beneficiaries to receive the same tax treatment afforded other employees of such corporation and their beneficiaries with respect to the taxation of annuities, the death benefit exclusion, the exemption from gross estate of annuities under certain trusts and plans, and the exclusion from gift tax in the case of certain annuities under qualified plans. The provisions specifically designed under subsection (e) are: (1) Section 72(d), relating to employees' annuities; (2) section 72(f), relating to special rules for computing employees' contributions; (3) section 101(b), relating to employees' benefits; (4) section 2039, relating to annuities; and (5) section 2517, relating to certain annuities under qualified plans.

SECTION 221. QUALIFIED PENSION, ETC., PLAN COVERAGE FOR EMPLOYEES OF CERTAIN SUBSIDIARY EMPLOYERS—Continued

(*b*) *Employees of domestic subsidiaries engaged in business outside the United States.*—Subsection (b) of section 221 of the bill amends part I of subchapter D of chapter 1 of the code (relating to pension, profit-sharing, stock bonus plans, etc.) by adding after section 406 of the code a new section 407. The new section 407 relates to certain employees of domestic subsidaries engaged in business outside the United States.

SECTION 407. CERTAIN EMPLOYEES OF DOMESTIC SUBSIDIARIES ENGAGED IN BUSINESS OUTSIDE THE UNITED STATES

(*a*) *Treatment as employees of domestic parent corporation.*—The new section 407(a) sets forth the requirements which must be satisfied for a U.S. citizen who is employed by a domestic subsidiary engaged in business outside the United States to be treated as an employee of the domestic parent corporation. Paragraph (1) of section 407(a) provides that for purposes of applying this part, with respect to a qualified plan described in either section 401(a), 403(a), or 405(a), of a domestic parent corporation, an individual who is a citizen of the United States and an employee of a domestic subsidiary (as defined in paragraph (2) of section 407(a)) of a domestic parent corporation shall be treated as an employee of the domestic parent corporation if two requirements are satisfied.

The first of these requirements is that the plan of the domestic parent corporation must expressly provide coverage for U.S. citizen employees of every domestic subsidiary (as defined in paragraph (2) of section 407(a)). The second requirement is that contributions must not be provided for the employee by any other person under a funded plan of deferred compensation (whether or not such plan is a qualified plan). Contributions are not provided under a funded plan, for example, merely because the domestic subsidiary employer pays the tax imposed by section 3111 with respect to an employee.

Paragraph (2) of the new section 407(a) provides certain definitions for purposes of section 407. Paragraph (2)(A) of section 407(a) defines the term "domestic subsidiary" for purposes of section 407. Such paragraph (2)(A) sets forth three requirements which must be satisfied in order for a domestic corporation to be classified as a "domestic subsidiary." First, the domestic parent corporation must own 80 percent or more of the outstanding voting stock of the subsidiary corporation. Second, 95 percent or more of the subsidiary corporation's gross income for the 3 taxable years of such subsidiary immediately preceding the close of the taxable year of the domestic parent corporation (or for such part of such period during which the corporation was in existence) must be derived from sources without the United States. The third requirement is that 90 percent or more of the subsidiary corporation's gross income for such period (or such part) must be derived from the active conduct of a trade or business.

Paragraph (2)(B) of section 407(a) defines the term "domestic parent corporation" for purposes of section 407. A domestic parent corporation for purposes of such section is the domestic corporation which owns 80 percent or more of the outstanding voting stock of a domestic subsidiary (as defined in paragraph (2)(A)).

(*b*) *Special rules for application of section 401(a).*—The new section 407(b) provides special rules for the application of section 401(a). The rules are substantially the same as those prescribed in the new section 406(b) (1) and (2)(A), except that the provisions of section 407(b) relate to individuals who are employees within the meaning of section 407(a), and the technical explanation of the provisions of section 406(b) (1) and (2)(A) is applicable to the provisions of section 407(b).

(*c*) *Termination of status as deemed employee not to be treated as separation from service for purposes of capital gains provisions.*—The new section 407(c) relates to certain occasions when the termination of the status as an employee within the meaning of section 407 shall not be treated as separation from service for purposes of sections 402(a)(2) and 403(a)(2) of the code. The new section 407(c) provides that an individual who is an employee of a domestic subsidiary but who is treated as an employee of a domestic parent corporation under the new section 407(a) shall not be considered as separated from the service of the domestic parent corporation solely by reason of the fact that the domestic subsidiary ceases, for any taxable year, to be a subsidiary within the meaning of section 407(a)(2)(A). Thus, for example, even though an individual who is an employee of a domestic subsidiary could not be covered under the plan of the domestic parent corporation for any taxable year in which the domestic parent corporation owned only 72 percent of the outstanding voting stock of such domestic subsidiary, such individual would not be treated as separated from service of the domestic corporation for purposes of sections 402(a)(2) and 403(a)(2) of the code.

Section 407(c) also provides that an individual shall not be treated as separated from the service by reason of the fact that—

(1) such individual ceases to be an employee of a domestic subsidiary corporation and becomes an employee of another corporation controlled by the domestic parent corporation; or

(2) the plan no longer contains the provision described in section 407(a)(1)(A).

For purposes of paragraph (1), above, a corporation is considered to be controlled by a domestic parent corporation if such domestic parent corporation owns directly or indirectly more than 50 percent of the voting stock of the corporation.

(*d*) *Deductibility of contributions.*—The new section 407(d) provides rules relating to the deductibility of contributions made on behalf of an individual who is an employee within the meaning of section 407(a). These rules are substantially the same as the rules in the new section 406(d), except that the provisions of section 407 relate to contributions on behalf of employees of domestic subsidiaries.

(*e*) *Treatment as employee under related provisions.*—The substantive provisions of the new section 407(e) are the same as the new section 406(e), except that the provisions of section 407 relate to the tax treatment of employees of domestic subsidiaries.

SECTION 221. QUALIFIED PENSION, ETC., PLAN COVERAGE FOR EMPLOYEES OF CERTAIN SUBSIDIARY EMPLOYERS—Continued

(c) *Technical amendments.*—Subsection (c) of section 221 of the bill sets forth certain technical amendments. Paragraph (1) of section 221(c) amends the table of sections for part I of subchapter D of chapter 1 of the Internal Revenue Code of 1954 to reflect the addition of new sections 406 and 407 of the code. Paragraph (2) of section 221(c) amends section 3121(a)(5) of the code, relating to definition of wages, to conform such definition to the provisions relating to the qualification of plans of deferred compensation which are contained in part I of subchapter D of chapter 1. Paragraph (3) of section 221(c) amends section 209(e) of the Social Security Act, relating to the definition of wages, in order to conform the provisions of this section to the provisions of section 3121(a)(5) of the code, as amended by paragraph (2) of section 221(c) of the bill.

(d) *Effective date.*—Subsection (d) of section 221 of the bill provides that the amendments made by subsections (a), (b), and (c)(1) of section 221 will be applicable to taxable years ending after December 31, 1963, and that the amendments made by subsections (c) (2) and (3) of section 221 shall apply to remuneration paid after December 31, 1962.

SECTION 222. EMPLOYEE STOCK OPTIONS AND PURCHASE PLANS

Section 222 of the bill (sec. 214 of the bill as passed by the House) has been approved by your committee with the amendments explained hereinafter. For the technical explanation of this section of the bill (other than the amendments made by your committee), see page A-63 of the report of the Committee on Ways and Means on the bill.

(a) *In general.*—Subsection (a) of this section of the bill as passed by the House has been amended by your committee as follows:

SECTION 422. QUALIFIED STOCK OPTIONS

(a) *Qualified stock option.*—Under the bill as passed by the House, section 422(b) of the code defined the term "qualified stock option" as an option granted to an individual after June 11, 1963 (other than a restricted stock option granted pursuant to a contract described in sec. 424(c)(4)(A) (sec. 424(c)(3)(A) of the code under the bill as amended by your committee)), for any reason connected with his employment by the corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if the requirements of paragraphs (1) through (7) of section 422(b) are met.

Your committee has amended this provision by changing the date contained therein from June 11, 1963, to December 31, 1963.

(b) *Special rules.*—

Certain options treated as outstanding

Under the bill as passed by the House, section 422(c)(2) of the code provided that, for purposes of section 422(b)(5) (relating to prior outstanding options)—

(A) any restricted stock option which is not terminated before January 1, 1965, and

(B) any qualified stock option granted after June 11, 1963,

shall be treated as outstanding until such option is exercised in full or expires by reason of the lapse of time. The bill as passed by the House further provided that for purposes of the preceding sentence, a restricted stock option granted before June 12, 1963, shall not be treated as outstanding for any period before the first day on which (under the terms of the option) it may be exercised.

Your committee has amended this provision by changing the dates June 11, 1963, and June 12, 1963, contained therein to December 31, 1963, and January 1, 1964, respectively.

Certain disqualifying dispositions where amount realized is less than value at exercise

Under the bill as passed by the House, section 422(c)(4) of the code provided that if an individual who has acquired a share of stock by the exercise of a qualified stock option disposes of such share within 3 years of the transfer of such share to him and if such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to the individual, then the amount includible in the gross income of such individual, and deductible from the income of his employer corporation, as compensation attributable to the exercise of such option cannot exceed the excess, if any, of the amount realized on such sale or exchange over the amount paid for such share.

Your committee has amended this provision in order to provide that the amount of compensation recognized to the individual, or deductible from the income of his employer corporation, is to be limited to the excess, if any, of the amount realized on such sale or exchange over the adjusted basis of such share. Thus, your committee's amendment changes the effect of this provision as passed by the House only if the adjusted basis of the share differs from the amount paid for the share, as might result in the case of the exercise of an option to which section 422(c)(1) (relating to exercise of option when price is less than value of stock) applies.

Exception to application of subsection (b)(5)

Under the bill as passed by the House, paragraphs (1) through (5) of section 422(c) of the code contained five special rules relating to qualified stock options. Your committee has amended section 422(c) by adding a new paragraph (6) at the end thereof. The new section 422(c)(6) (relating to exception to application of subsec. (b)(5)) provides, in effect, that a new qualified stock option being granted to an individual need not contain the limitation on exercise otherwise required by section 422(b)(5), if the new option and all the outstanding qualified (or restricted) stock options previously granted to the individual, are options to purchase stock of the same class in the same corporation, and if the price payable under each such outstanding option (determined as of the date of grant of the new qualified stock option being granted to the individual) is not more than the option price of the option being granted.

The operation of the new paragraph (6) of section 422(c) is illustrated by the following examples:

Example (1).—Assume that on January 2, 1964, A, an employee of M corporation, is granted a qualified stock option entitling him to purchase 100 shares of M stock at a price of $5 per share (the fair market value of M stock on such date). On June 2, 1964, M grants A another qualified stock option with respect to the same class of stock as the January option, entitling him to buy 100 shares of such stock at a price of $6 per share (the fair market value of such stock on such date).

Under the bill as passed by the House, the option granted A in June must contain a provision that such option is not exercisable until the option granted in January has either been exercised in full, or has lapsed. Under the bill as amended by your committee, the June option may be exercisable before the January option since both options are to purchase the same class of stock in the same corporation and the option price of the January option ($5) is not greater than the option price of the June option ($6).

Example (2).—The facts are the same as in example (1) except that the option price of the June option is $4, the fair market value of the stock on June 2, 1964. The new rule of section 422(c)(6) (relating to exception to the application of sec. 422(b)(5)) is not applicable in this case since the price payable for the stock under the January option ($5) is greater than the option price of the June option ($4). Similarly, the exception to the application of section 422(b)(5) provided by the new section 422(c)(6) would not be applicable if the June option were granted with respect to a different class of M stock, or with respect to the stock of a parent or subsidiary of M corporation. In such a situation, the provisions of section 422(b)(5) remain applicable and the outstanding option must either be exercised in full or lapse before the more recently granted option may become exercisable.

SECTION 423. EMPLOYEE STOCK PURCHASE PLANS

(*a*) *General rule.*—Under the bill as passed by the House, section 423(a) of the code provided that the special tax treatment of the new section 421(a) shall apply to a transfer of a share of stock to an individual pursuant to his exercise of an option, if the option is granted after June 11, 1963 (other than a restricted stock option granted pursuant to a plan described in sec. 424(c)(4)(B) (sec. 424(c)(3)(B) of the code under the bill as amended by your committee)), under an employee stock purchase plan (as defined in sec. 423(b)), and if the holding period and employment requirements set forth in paragraphs (1) and (2) of section 423(a) are met.

Your committee has amended this provision by changing the date contained therein from June 11, 1963, to December 31, 1963.

SECTION 424. RESTRICTED STOCK OPTIONS

(*a*) *Restricted stock option.*—Under the bill as passed by the House, section 424(b) of the code continued the definition of the term "restricted stock option" presently contained in section 421(d)(1) for options granted before June 12, 1963 (or after June 11, 1963, if granted in accordance with sec. 424(c)(4) (sec. 424(c)(3) of the code under the bill as amended by your committee)).

Your committee has amended this provision by changing the dates contained therein from June 12, 1963, to January 1, 1964, and from June 11, 1963, to December 31, 1963.

(*b*) *Special rules.*—Under the bill as passed by the House, section 424(c) of the code provided three special rules relating to restricted stock options, all of which are identical to provisions of existing section 421, and a fourth special rule relating to certain options granted after June 11, 1963. Your committee has amended these special rules in the following respects:

Stockholder approval

Under the bill as passed by the House, the applicability of section 424(c)(2) of the code (relating to stockholder approval) was limited to restricted stock options. Your committee has extended the rule contained in section 424(c)(2) to qualified stock options and options granted under employee stock purchase plans by striking paragraph (2) of section 424(c), and by inserting a comparable provision as subsection (i) under section 425 (relating to definitions and special rules). A technical explanation of the new section 425(i) may be found, in place, below.

Certain options granted after December 31, 1963

Under the bill as passed by the House, paragraph (4) of section 424(c) of the code (sec. 424(c)(3) of the code under the bill as amended by your committee) provided the additional requirements that must be met by options granted after June 11, 1963, in order for such options to be treated as restricted stock options. In general, under the bill as passed by the House, an option granted after June 11, 1963, that otherwise meets the requirements of the new section 424(b) of the code is treated as a restricted stock option for purposes of the revised part II of subchapter D if it was granted pursuant to—

(A) a binding written contract entered into before June 12, 1963, or

(B) a written plan adopted and approved before June 12, 1963, which (as of June 12, 1963, and as of the date of the granting of the option) either met the requirements of paragraphs (4) and (5) of section 423(b) or was being administered in a way that did not discriminate in favor of officers, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees.

Your committee has amended this provision by changing the dates contained therein from June 11, 1963, to December 31, 1963, and from June 12, 1963, to January 1, 1964. In determining whether an option is granted pursuant to a plan described in subparagraph (B) of the provision, the terms of any written offering that was made on or before January 1, 1964, will be treated as a part of the plan.

SECTION 425. DEFINITIONS AND SPECIAL RULES

(*a*) *Modification, extension, or renewal of option.*—

Special rules for sections 423 and 424 options

Under the bill as passed by the House, subparagraph (B) of section 425(h)(2) of the code continues the rule of the existing section 421(e)(1) that provides an exception to the rule of section 425(h)(2)(A) if the average fair market value of the stock for the 12 months prior to the modification, extension, or renewal is less than 80 percent of the fair market value at the date of the original granting or any intervening modification, extension, or renewal, whichever is higher. Under the bill as passed by the House, this exception only applies to modifications, extensions, or renewals of restricted stock options made before June 12, 1963 (or made pursuant to a binding written contract entered into before June 12, 1963).

Your committee has amended this provision by changing the date contained therein from June 12, 1963, to January 1, 1964.

Definition of modification

Under the bill as passed by the House, paragraph (3) of section 425(h) of the code defined the term "modification" in the same manner as existing section 421(e). Thus, under the bill as passed by the House, the term "modification" was defined as any change in the terms of the option which gives the employee additional benefits; but such term does not include a change in the terms of the option which is attributable to the issuance or assumption of an option under section 425(a), or to permit the option to qualify under section 422(b)(6), 423(b)(9), or 424(b)(2) if, in the case of a restricted stock option, the period during which the option may be exercised is restricted to 10 years from the date of the grant of the option.

Your committee has amended this provision by adding a new subparagraph (C) to section 425(h)(3) as set forth in the bill as passed by the House. The new subparagraph (C) added by your committee provides an additional exception to the definition of the term "modification." This new exception provides that a change in the terms of an option which is not immediately exercisable in full to accelerate the time at which the option may be exercised is not a modification for purposes of section 425(h). Thus, your committee's amendment allows an option which is exercisable only in installments, or after the expiration of a fixed period of time, or on the happening of an event, to be amended to permit acceleration of the time for exercising any (or all) of the installments, or to permit an acceleration in the time for exercising all or any portion of the option, without treating such amendment as a modification of the option.

(*b*) *Stockholder approval.*—Under the bill as passed by the House, paragraph (2) of section 424(c) of the code provided that for purposes of section 424 (relating to restricted stock options), if the grant of an option is subject to approval by stockholders, the date of grant of the option shall be determined as if the option had not been subject to such approval. Thus, under the bill as passed by the House, the applicability of section 424(c)(2) was limited to restricted stock options.

Your committee has extended the rule of section 424(c)(2) to qualified stock options and options granted under employee stock purchase plans by striking paragraph (2) of section 424(c) as set forth in the bill as passed by the House, by redesignating section 425(i) (relating to cross references) as section 425(j) and by inserting a new section 425(i). The new section 425(i) provides that for purposes of part II of subchapter D of chapter 1 of the code (relating to certain stock options), if the grant of an option is subject to approval by stockholders, the date of grant of the option shall be determined as if the option had not been subject to such approval.

SECTION 222. EMPLOYEE STOCK OPTIONS AND PURCHASE PLANS—Continued

(*b*) *Administrative provisions.*—Subsection (b) of this section of the bill as passed by the House has been amended by your committee as follows:

Penalties for failure to file information returns

Subsection (b)(2) of this section of the bill as passed by the House amends section 6652(a) of the code (relating to failure to file certain information returns) to provide a penalty for the failure to file the return required by section 6039(a). Your committee has revised section 6652 as amended by the bill as passed by the House in order to make clear that the penalty provided under section 6652(a) is imposed for each failure to file the statement referred to in section 6652(a)(1), and for each failure to file a return with respect to a transfer referred to in section 6652(a)(2). Thus a penalty is incurred under section 6652(a)(2) with respect to each transfer described in the new section 6039 which the taxpayer fails to report on the return required by such section. The penalty is $10 for each such failure, not to exceed $25,000 for all failures described in section 6652(a) in any one calendar year.

Your committee has also amended section 6652(a) of the code to provide that the penalty provided by such section shall be imposed in the case of each failure to make a return required by section 6052(a) (relating to reporting payment of wages in the form of group-term life insurance) with respect to group-term life insurance on the life of an employee. (The new sec. 6052 is added to the code by sec. 204 of the bill as reported by your committee.)

(*c*) *Effective date.*—Subsection (e) of this section of the bill as passed by the House provided that the amendments made by this section apply to taxable years ending after June 11, 1963; except that the new section 6039 of the code added by subsection (b) of this section (relating to administrative provisions), and paragraph (2) of section 6652(a) of the code as amended by such subsection, apply only to stock transferred pursuant to options exercised on or after January 1, 1964.

Your committee has amended subsection (e) of this section of the bill as passed by the House by changing the general effective date of the provisions relating to employee stock options and purchase plans as passed by the House from June 11, 1963, to December 31, 1963, and by adding a special rule for certain options granted after December 31, 1963, and before January 1, 1965. The special rule is contained in a new paragraph (3) added to subsection (e) of this section of the bill as passed by the House. The new paragraph provides that paragraphs (1) and (2) of section 422(b) of the code shall not apply to an option granted after December 31, 1963, and before January 1, 1965, and that paragraph (1) of section 425(h) shall not apply to any change in the terms of such an option made before January 1, 1965, to permit the option to qualify under paragraphs (3), (4), and (5) of section 422(b).

Subparagraph (A) of the new paragraph (3) permits the transfer of a share of stock pursuant to an individual's exercise of a stock option granted after December 31, 1963, and before January 1, 1965, to qualify for the special tax treatment provided by the revised section 421 of the code without regard to whether the option is granted pursuant to a plan, as required by section 422(b)(1), or whether the plan was approved by the shareholders. In addition, since the option need not be granted pursuant to a plan at all, the option need not be granted within 10 years from the date such plan is adopted or approved, whichever is earlier, as provided under section 422(b)(2).

Subparagraph (B) of paragraph (3) allows options granted after December 31, 1963, and before January 1, 1965, to be amended at any time before January 1, 1965, to meet the requirements of paragraphs (3), (4), and (5) of section 422(b), without such amendments being treated as a modification under section 425(h). Amendments to options under subparagraph (B) of paragraph (3) are to be retroactive to the date of grant of the option.

SECTION 223. INSTALLMENT SALES BY DEALERS IN PERSONAL PROPERTY

Section 223 of the bill, which was added by your committee to the bill as passed by the House, amends section 453(a) of the code (relating to the reporting of income by dealers in personal property from sales on the installment plan).

(*a*) *Installment plans.*—Subsection (a) of section 223 amends section 453(a) of the code by placing the existing provisions thereof in a new paragraph (1) of such subsection and by adding new paragraphs (2) and (3). The new paragraph (2) provides that for purposes of determining whether a dealer in personal property is selling such property on the installment plan so that he may return on the installment method (as described in par. (1)) the income from such sales, the term "installment plan" includes any plan which provides that the purchaser is to pay for such sales in a series of periodic installments of the debt due such dealer.

Paragraph (3) of revised section 453(a) provides that for purposes of computing the income from sales of personal property to be reported on the installment method by a dealer in personal property under paragraph (1), the term "total contract price" includes all charges relative to such sales including the time price differential which represents the amount paid or payable by the purchaser for the privilege of paying for such property in installments. Charges relative to the sale of personal property do not include charges for service contracts or warranties, or other charges for services unless such services are incidental to and rendered contemporaneously with the sale of the personal property.

(*b*) *Effective date.*—Subsection (b) of section 223 provides that the amendment made by subsection (a) of such section shall apply to taxable years beginning after December 31, 1963.

SECTION 224. TIMING OF DEDUCTIONS AND CREDITS IN CERTAIN CASES WHERE ASSERTED LIABILITIES ARE CONTESTED

Section 224 of the bill, which was added by your committee to the bill as passed by the House, amends section 461 of the 1954 Code (relating to general rule for taxable year of deduction) and section 43 of the 1939 Code (relating to period for which deductions and credits taken), and provides certain transitional rules. No provision of this section of the bill extends the period of limitations within which a claim for credit or refund may be filed for any taxable year.

(*a*) *Taxable year of deduction or credit.*—Paragraph (1) of section 224(a) of the bill, which was added by your committee to the bill as passed by the House, amends section 461 of the 1954 Code, relating to general rule for taxable year of deduction, by adding to such section a new subsection (f). In G.C.M. 25298, 1947-2 C.B. 39, the Internal Revenue Service took the position that a taxpayer may deduct the amount of taxes paid to local authorities not later than for the year of payment even though he contests liability for such taxes. In 1961, the U.S. Supreme Court held that, where an accrual basis taxpayer contested taxes paid to local authorities, the contested amount was deductible for the taxable year in which the contest was settled rather than for the taxable year in which such amount was paid (*U.S.* v. *Consolidated Edison Co.* (1961) 366 U.S. 380). The new subsection (f), in the case of contested taxes, provides that the contested amount is deductible for the year of payment.

The new subsection (f) provides in effect that if (1) a taxpayer contests an asserted liability (such as a tax assessment); (2) such taxpayer transfers money or other property to provide for the satisfaction of the asserted liability; (3) the contest with respect to the asserted liability exists after the time of the transfer; and (4) but for the fact that the asserted liability is contested, a deduction or credit would be allowed for the taxable year of the transfer (or, in the case of an accrual method taxpayer, for an earlier taxable year for which such amount would be accruable), then the deduction or credit shall be allowed for the taxable year of the transfer.

The new subsection (f) is not limited to an asserted liability for taxes, but applies to any asserted liability where the requirements of the new subsection (f) are met. A taxpayer may provide for the satisfaction of an asserted liability by transferring money or other property to the person who is asserting the liability, or by a transfer to an escrow agent provided that the money or other property is beyond the control of the taxpayer. However, purchasing a bond to guarantee payment of the asserted liability, an entry on the taxpayer's books of account, or a transfer to an account which is within the control of the taxpayer is not a transfer to provide for the satisfaction of an asserted liability.

The new subsection (f) applies only if the contest with respect to the asserted liability exists after the time of payment. Thus, the new subsection (f) does not apply to Z corporation in the following example:

Example.—Z corporation uses the accrual method of accounting. In 1964 a $100 liability is asserted against Z. Z contests the asserted liability. In 1967 the contested liability is settled as being $80 which Z accrues and deducts for such year. In 1968 Z pays the $80.

If any portion of the contested amount, which is deducted in the year of payment, is refunded when the contest is settled, such portion is includible in gross income except as provided in section 111 of the 1954 Code, relating to recovery of bad debts, prior taxes, and delinquency amounts.

The new subsection (f) may be illustrated by the following examples:

Example (1).—X corporation, which uses the cash method of accounting, in 1964 contests $20 of a $100 asserted real property tax liability but pays the entire $100 to the taxing authority. In 1968, the contest is settled and X receives a refund of $5. Under the new subsection (f) of section 461 of the 1954 Code, for the taxable year 1964 X deducts $100 and for the taxable year 1968 X includes $5 in gross income (assuming sec. 111 of the 1954 Code does not apply to such amount).

Example (2).—Y corporation, which uses the accrual method of accounting, in 1964 contests $20 of a $100 asserted real property tax liability but pays the entire $100 to the taxing authority. In 1968, the contest is settled and Y receives a refund of $5. Under the new subsection (f) of section 461 of the 1954 Code, for the taxable year 1964 Y deducts $100 and for the taxable year 1968 Y includes $5 in gross income (assuming sec. 111 of the 1954 Code does not apply to such amount).

Paragraph (2) of section 224(a) of the bill, as added by your committee, amends section 43 of the 1939 Code, relating to period for which deductions and credits taken, by adding at the end of such section a new sentence. The new sentence is the same as the new subsection (f) added to section 461 of the 1954 Code by paragraph (1) of section 224(a) of the bill.

(*b*) *Effective dates*.—Subsection (b) of section 224 of the bill, as added by your committee, provides that except as provided in subsections (c) and (d) of section 224 of the bill—

(1) the new subsection (f) of section 461 of the 1954 Code, as added by paragraph (1) of section 224(a) of the bill, shall apply to transfers of money or other property in taxable years beginning after December 31, 1953, and ending after August 16, 1954, and

(2) the new sentence added to section 43 of the 1939 Code by paragraph (2) of section 224(a) of the bill shall apply to transfers of money or other property in taxable years to which the Internal Revenue Code of 1939 applies.

(*c*) *Election as to transfers in taxable years beginning before January 1, 1964*.—Paragraph (1) of section 224(c) of the bill, as added by your committee, provides that the amendments made to section 461 of the 1954 Code and section 43 of the 1939 Code by paragraphs (1) and (2), respectively, of section 224(a) of the bill shall not apply to any transfer of money or other property described in such section 224(a) made in a taxable year beginning before January 1, 1964, if the taxpayer elects, in the manner provided by regulations prescribed by the Secretary of the Treasury or his delegate, to have such paragraph (1) apply. Such an election (1) must be made within 1 year after the date of enactment of the bill, (2) may not be revoked after the expiration of such 1-year period, and (3) shall apply to all transfers of money or other property described in section 224(a) of the bill made in a taxable year beginning before January 1, 1964 (other than transfers described in par. (2) of sec. 224(c) of the bill). In the case of any transfer to which paragraph (1) of section 224(c) of the bill applies, the deduction or credit shall be allowed only for the taxable year in which the contest with respect to such transfer is settled.

Paragraph (2) of section 224(c) of the bill, as added by your committee, provides that paragraph (1) of such section 224(c) shall not apply to any transfer if the assessment of any deficiency which would result from the application of the election in respect of such transfer is, on the date of the election under such paragraph (1), prevented by the operation of any law or rule of law.

Paragraph (3) of section 224(c) of the bill, as added by your committee, provides that if the taxpayer makes an election under paragraph (1) of section 224(c) of the bill, and if, on the date of such election, the assessment of any deficiency which results from the application of the election in respect of any transfer is not prevented by the operation of any law or rule of law, the period within which assessment of such deficiency may be made shall not expire earlier than 2 years after the date of enactment of this bill.

(d) *Certain other transfers in taxable years beginning before January 1, 1964.*—Subsection (d) of section 224 of the bill, as added by your committee, provides that the amendments made to section 461 of the 1954 Code and section 43 of the 1939 Code by paragraphs (1) and (2), respectively, of section 224(a) of the bill shall not apply to any transfer of money or other property described in such section 224(a) made in a taxable year beginning before January 1, 1964, if (1) no deduction or credit has been allowed in respect of such transfer for any taxable year before the taxable year in which the contest with respect to such transfer is settled, and (2) refund or credit of any overpayment which would result from the application of such amendments to such transfer is prevented by the operation of any law or rule of law. In the case of any transfer to which subsection (d) of section 224 of the bill applies, the deduction or credit shall be allowed only for the taxable year in which the contest with respect to such transfer is settled. Thus, if, at any time when a refund or credit of any overpayment, which would result from the application of the new subsection (f) of section 461 of the 1954 Code to a transfer of money or other property described in such new subsection (f) made in a taxable year beginning before January 1, 1964, is prevented by the operation of any law or rule of law, no deduction has been allowed in respect of such transfer for any taxable year before the taxable year in which the contest with respect to such transfer is settled, then a deduction shall be allowed to the taxpayer for the taxable year in which such contest is settled.

SECTION 225. INTEREST ON CERTAIN DEFERRED PAYMENTS

Section 225 of the bill (sec. 215 of the bill as passed by the House) has been approved by your committee with two modifications. For the technical explanation of this section of the bill (other than the amendments made by your committee), see the report of the Committee on Ways and Means starting at page A-84.

Your committee has deleted subsection (c) of this section of the bill as passed by the House, which related to deduction as interest of certain carrying charges on certain sales of services.

Under subsection (c) of this section (subsec. (d) of the bill as passed by the House) relating to effective dates, the amendments made by subsections (a) and (b) of section 225 apply to payments made after December 31, 1963, on account of sales or exchanges of property occurring after June 30, 1963. Your committee's amendment provides that the amendments made by subsections (a) and (b) will not be applicable to payments made on account of a sale or exchange made pursuant to a binding written contract (including an irrevocable written option) entered into before July 1, 1963. Thus, if before such date a taxpayer has committed himself to a sale or exchange of property either by entering into a binding written sales contract or by granting an irrevocable written option entitling another person to purchase the property, any sale or exchange made pursuant to such contract or option will not be affected by the rules of new section 483.

SECTION 226. PERSONAL HOLDING COMPANIES

Section 226 of the bill (sec. 216 of the bill as passed by the House) deals with the treatment of personal holding companies and shareholders of such companies. This section of the bill as passed by the House consisted of 12 subsections, designated (a) through (l). Your committee has adopted the following subsections of this section without change: (a) relating to the personal holding company tax rate, (b) relating to the definition of a personal holding company, (e) relating to foreign personal holding company income and stock ownership, (f) relating to the dividends-paid deduction, and (h) relating to an exception for certain liquidated corporations. Your committee has rejected in its entirety subsection (j), relating to an increase in basis with respect to certain foreign personal holding company holdings, of the bill as passed by the House, has redesignated subsections (k) and (l), respectively, as subsection (j) relating to technical amendments, and subsection (k) relating to effective dates, and has made some technical amendments in redesignated subsection (k) to reflect this elimination.

The changes made by your committee in remaining subsections (c), (d), (g), and (i) of this section are discussed below. For the technical explanation of this section (other than the amendments made by your committee), see page A–88 of the report on the bill by the Committee on Ways and Means.

Section 226(c), relating to excluded corporations

Subsection (c) of section 226 of the bill has been approved by your committee with four modifications. For the technical explanation of subsection (c) of the bill (except for the amendments explained below), see page A–89 of the report on the bill by the Committee on Ways and Means.

Under the bill as passed by the House, a lending or finance company is excluded from the definition of a personal holding company if it meets four requirements: (1) At least 60 percent of its ordinary gross income must be derived directly from the active and regular conduct of a lending or finance business; (2) its personal holding company income (computed (a) without regard to income qualifying under the 60-percent test, (b) by including as personal holding company income the entire amount of the gross income from rents, royalties, produced film rents, and compensation for the use of corporate property by shareholders, and (c) without regard to certain income from domestic subsidiaries described in sec. 542(d)(3) of the code), plus the interest described in section 543(b)(2)(C) of the code, must not exceed 20 percent of ordinary gross income; (3) business deductions directly allocable to the active and regular conduct of its lending or finance business must equal or exceed the sum of (i) 15 percent of its ordinary gross income up to $500,000, plus (ii) 5 percent of its ordinary gross income between $500,000 and $1,000,000; and (4) loans to substantial shareholders must not exceed $5,000 in principal amount.

In applying the 20-percent-of-ordinary-gross-income test of section 542(c)(6)(B), your committee has deleted the provision that interest described in section 543(b)(2)(C) be included with the corporation's personal holding company income. This change conforms the treatment of such interest under section 542(c)(6)(B) to the treatment thereof for all other personal holding company tax purposes.

Under the bill as passed by the House, section 542(d)(3) of the code provides that the lawful income received by a lending company which is in the small loan business (consumer finance business) from domestic subsidiary corporations which are themselves excepted from the definition of a personal holding company under section 542(c)(6), is not included for purposes of the 20-percent-of-ordinary-gross-income test of section 542(c)(6)(B). Your committee has amended this provision in two respects. First, the corporation receiving such income may be any lending or finance company which meets the 60-percent requirement of section 542(c)(6)(A). It does not have to meet the more restrictive requirement of being in the small loan (consumer finance) business. Second, the payor corporation may be any member of the same affiliated group (as defined in sec. 1504) as the corporation receiving such income. Thus the corporation receiving such income is not required to be the parent corporation of the payor corporation. The payor corporation must still meet the requirements of section 542(c)(6).

Under the bill as passed by the House, section 542(d)(1)(A) of the code defines a lending or finance business, generally, as a business of making loans, or purchasing or discounting accounts receivable, notes, or installment obligations.

Your committee has amended the definition of a lending or finance business in section 542(d)(1) to include therein the business of rendering services or making facilities available to another member of the same affiliated group (as defined in sec. 1504) that is also in the lending or finance business.

Under the 60-percent-of-ordinary-gross-income test provided in section 542(c)(6)(A) of the code the corporation's income must be derived "directly" from the active and regular conduct of a lending or finance business. In addition, a reference to this provision is made in section 542(c)(6)(B). The use of the term "directly" is intended to emphasize that the 60-percent test is limited to income "derived from the active and regular conduct" of a lending or finance business, and excludes income that is unrelated to the conduct of the lending or finance business itself. Thus, for example, under section 542(c)(6)(A) as approved by your committee, interest income earned by the lending or finance company from loans to customers would qualify under the 60-percent test, but interest earned from the investment of its idle funds in short-term securities would not qualify under the 60-percent test.

The phrase "directly allocable to the active and regular conduct of its lending or finance business" is used in section 542(c)(6)(C) (business expense test) and, with a minor difference in language, in section 542(d)(2)(B) (relating to deductions for depreciation and real property taxes). As used in these provisions, the term "directly" is intended to exclude expenses unrelated to the conduct of the finance or lending business. It is not intended to exclude completely deductions allocable only in part to such business. Thus, for example, to the extent that general overhead expenses of a corporation are properly allocable to the lending and finance business, they qualify as business deductions under section 542(d)(2).

Section 226(d), relating to personal holding company income

Subsection (d) of section 226 of the bill amends section 543(a) of the code (relating to personal holding company income). It also amends section 543(b) to provide definitions of the new terms "ordinary gross income," "adjusted ordinary gross income," "adjusted income from rents," and "adjusted income from mineral, oil, and gas royalties."

The amended section 543(a) provides that for purposes of subtitle A, the term "personal holding company income" means the portion of the adjusted ordinary gross income (as defined in sec. 543(b)(2)) which consists of the items described in paragraphs (1) through (8) of such section.

Your committee has approved subsection (d) of section 226 of the bill except for changes in paragraph (2) of section 543(a) as amended (relating to rents), in subparagraph (A) of section 543(b)(2) as amended (relating to required adjustments in the amount of gross income from rents includible in adjusted ordinary gross income), and in paragraph (4) of section 543(b) as amended (defining "adjusted income from mineral, oil, and gas royalties").

Rents

Section 543(a)(7) of existing law provides that rents are personal holding company income unless such rents constitute 50 percent or more of gross income.

The bill as passed by the House provides in paragraph (2) of section 543(a) as amended, which corresponds to the existing section 543(a)(7), that only so much of the gross income from rents as is equal to the adjusted income from rents (as defined in sec. 543(b)(3)) is personal holding company income and that the adjusted income from rents shall not be treated as personal holding company income if (A) it constitutes 50 percent or more of the corporation's adjusted ordinary gross income (as defined in sec. 543(b)(2)), and (B) the corporation's personal holding company income for the taxable year, computed without regard to such rents and compensation for the use of the corporation's property by its shareholders, and computed by treating copyright royalties and adjusted income from mineral, oil, and gas royalties as personal holding company income, is not more than 10 percent of the ordinary gross income as defined in section 543(b)(1). Thus, under the bill as passed by the House, even though adjusted income from rents constitutes more than 50 percent of a corporation's adjusted ordinary gross income, this income will still be treated as personal holding company income if the corporation's other income which is classified as personal holding company income exceeds 10 percent of its total ordinary gross income. For examples and the technical explanation of these tests in the bill (except for the amendment made by your committee), see page A-93 of the report on the bill by the Committee on Ways and Means.

Your committee has modified the 10-percent test in subparagraph (B) of section 543(a)(2) in the bill passed by the House to provide that adjusted income from rents which meets the 50-percent requirement of subparagraph (A) thereof shall not be treated as personal holding company income if the sum of the consent dividends (determinded under sec. 565) and the dividends paid or considered as paid (determined under secs. 562 and 563) during the taxable year by the corporation to its shareholders equals or exceeds the amount, if any, by which the corporation's personal holding company income for the taxable year, computed without regard to such rents and compensation for the use of the corporation's property by its shareholders, and computed by treating copyright royalties and adjusted income from mineral, oil, and gas royalties as personal holding company income, exceeds 10 percent of the ordinary gross income as defined in section 543(b)(1).

The effect of this modification in the 10-percent test applicable to rents is that this test shall be deemed to be met if the corporation pays dividends to its shareholders in an amount which is at least equal to its other personal holding company income which is in excess of 10 percent of total ordinary gross income. The difference in this test in the bill as passed by the House and as modified by your committee may be illustrated by the following example:

Example.—Corporation F receives $40 in dividends and $150 of gross income from rents. Corporation F also realizes $10 in capital gain on the sale of securities. Corporation F's deductions for depreciation, interest, and real property taxes allocable to the rents equal $100. Under existing law the rents are not personal holding company income and corporation F is not a personal holding company, since its gross income from rents ($150) constitutes 50 percent or more of its gross income ($200). Under the 50-percent requirement of the new provisions, the adjusted income from rents, $50 ($150 less $100), is 55.5 percent of adjusted ordinary gross income of $90 ($200 less the sum of $100 of adjustments and $10 of capital gains). Accordingly the adjusted income from rents meets the new 50-percent requirement. However, other personal holding company income (the dividend income of $40) is $21 in excess of the allowable 10 percent of ordinary gross income ($190: $200 less $10). Under the bill as passed by the House, the adjusted income from rents is personal holding company income and, therefore, all of corporation F's adjusted ordinary gross income is personal holding company income. However, with the modification in the 10-percent test made by your committee, the adjusted income from rents would not be treated as personal holding company income if corporation F pays a dividend of $21 to its shareholders during the taxable year. On the other hand, if the amount of the dividend paid by corporation F is less than $21, the adjusted income from rents would be personal holding company income as under the bill as passed by the House.

Adjustments to rents included in adjusted ordinary gross income

The bill as passed by the House defines in paragraph (2) of section 543(b) of the code, as amended, the term "adjusted ordinary gross income" as the ordinary gross income adjusted as provided in subparagraphs (A), (B), and (C) of such paragraph. Adjusted ordinary gross income as so defined replaces the concept of gross income of existing law as the denominator in the fraction used in computing certain percentages involved in determining a corporation's status as a personal holding company. With one exception relating to the adjustments required for gross income from rents, your committee has approved proposed section 543(b)(2). For the technical explanation of these provisions of the bill (except the amendment explained below), see page A-100 of the report on the bill by the Committee on Ways and Means.

Subparagraph (A) of section 543(b)(2) provides that from the gross income from rents (as defined in the second sentence of sec. 543(b)(3)) there is to be subtracted the amounts allowable as deductions for exhaustion, wear and tear, obsolescence, and amortization as well as deductions for property taxes, interest, and rent to the extent that such deductions are allocable, under regulations prescribed by the Secretary of the Treasury or his delegate, to the gross income from rents. In no case may the amounts subtracted under subparagraph (A) exceed the gross income from rents.

Your committee has amended subparagraph (A)(i) of section 543(b)(2) to provide that the gross income from rents derived from leases of tangible personal property which is not customarily retained by any one lessee for a period of more than 3 years shall not be reduced by allowable deductions for exhaustion, wear and tear, obsolescence, and amortization of such property. It is the period of customary retention or use by lessees, rather than the term of the lease of the property in any one case, which is determinative of whether the adjustment shall be required.

Adjusted income from mineral, oil, and gas royalties

The bill as passed by the House provides in paragraph (3) of section 543(a) of the code as amended, which corresponds to section 543(a)(8) of existing law, tests for determining whether the "adjusted income from mineral, oil, and gas royalties", as defined in paragraph (4) of section 543(b), is personal holding company income. For the technical explanation of these provisions (except the amendment explained below), see page A-95 of the report on the bill by the Committee on Ways and Means. These provisions have been approved by your committee but an amendment has been added to section 543(b)(4) to specifically include production payments and overriding royalties as mineral, oil, and gas royalties for purposes of classification as personal holding company income under section 543(a).

The Treasury regulations interpreting section 543(a)(8) of existing law currently define the term "mineral, oil, or gas royalties" as including production payments and overriding royalties. (See Reg. § 1.543-1(b)(11)(ii).) However, it has been brought to the attention of your committee that this interpretation of existing section 543(a)(8) is disputed by some taxpayers. Your committee's amendment would make it clear that production payments and overriding royalties are to be treated as mineral, oil, and gas royalties under proposed section 543(b)(4). This amendment is not intended to affect any case involving interpretations of section 543(a)(8) of existing law.

Section 226(g), relating to 1-month liquidations

Subsection (g) of section 226 of the bill adds a new subsection (g) to section 333 of the code. The existing section 333 provides that in certain corporate liquidations gain is recognized to qualified electing shareholders only to the extent of earnings and profits accumulated by the corporation after February 28, 1913, and cash, stock, and securities acquired by the corporation after December 31, 1953, and, with respect to accumulated earnings and profits, is taxable as a dividend to noncorporate shareholders.

Subsection 333(g) as added by the bill as passed by the House consists of three paragraphs. Paragraph (1) provides that if a corporation which is referred to in paragraph (3) of the new subsection is liquidated before January 1, 1966, no gain will be recognized to a qualifying electing shareholder with respect to the distribution of stock and securities acquired by the liquidating corporation before January 1, 1963, and gain realized by a noncorporate shareholder with respect to the corporation's accumulated earnings and profits generally is to be treated as "class B capital gain" rather than as a dividend. Paragraph (2) of subsection (g) provides special rules for liquidations after December 31, 1965, of corporations referred to in paragraph (3) of the new subsection which owe qualified indebtedness (as defined in sec. 545(c)(3)) on August 1, 1963. Paragraph (3) of subsection (g) describes the corporations to which paragraphs (1) and (2) of section 333(g) may apply. Such a corporation in the bill as passed by the House is one which was not a personal holding company under section 542 of existing law for at least one of its two most recent taxable years ending before the date of enactment of section 333(g), but which would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such preceding taxable year.

Your committee has approved in substance the provisions of paragraphs (1), (2), and (3) of section 333(g) as added by the bill as passed by the House but has modified some of the applicable dates therein and has added a new paragraph (4) to new section 333(g) of the code. These modifications and new paragraph (4) of section 333(g) are discussed below. For the technical explanation of section 226(g) of the bill (except for the amendments made by your committee), see page A-107 of the report on the bill by the Committee on Ways and Means.

Your committee has amended paragraph (1) of section 333(g) to provide that it shall be applicable to corporate liquidations occurring before January 1, 1967 (instead of January 1, 1966) and has amended paragraph (2) of section 333(g) to provide that it shall be applicable to liquidations occurring after December 31, 1966 (instead of Dec. 31, 1965) of corporations which owe qualified indebtedness (as defined in sec. 545(c)) on January 1, 1964 (instead of Aug. 1, 1963). Your committee has made conforming amendments in these two paragraphs of section 333(g) to reflect these changes and also changes made in other parts of the bill as approved by your committee.

Your committee has amended paragraph (3) of section 333(g), which describes the corporations to which paragraphs (1) and (2) of the new subsection may apply, to provide that such a corporation is one which was not a personal holding company under section 542 of existing law for at least one of its two most recent taxable years ending before December 31, 1963 (instead of the date of enactment of new subsec. (g)) but which would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such preceding taxable year.

Your committee has added a new paragraph (4) to subsection (g) of section 333 which provides that if an election is made under such section by a qualified electing shareholder (as defined in sec. 333(c)) of a corporation and the shareholder states in such election that it is made on the assumption that the corporation is a corporation referred to in paragraph (3) of subsection (g), the election under section 333 shall have no force or effect if it is determined that the corporation is not a corporation referred to in section 333(g)(3). A qualified electing shareholder who does not include such a statement in an election made and filed under section 333 will be considered to have made an election under the general rule of subsection (a) of such section with respect to recognition of gain on the shares owned by him in the liquidating corporation in the event that the special rule of subsection (g) is inapplicable because the corporation is not a corporation referred to in paragraph (3) thereof.

Section 226(i), relating to deduction for amortization of indebtedness

Subsection (i) of section 226 of the bill adds a new subsection (c) to section 545 of the code which provides a new deduction from taxable income for purposes of determining undistributed personal holding company income (as defined in sec. 545(a)).

Section 545(c) of the code as added by subsection (i) consists of six paragraphs. Paragraph (1) of the new section 545(c) provides the general rule that, except as otherwise provided in such section, there shall be allowed as a deduction (in computing undistributed personal holding company income) amounts used, or amounts irrevocably set aside (to the extent reasonable with reference to the size and terms of the indebtedness), to pay or retire qualified indebtedness (as defined in sec. 545(c)(3)). Paragraph (2) describes the corporations which may qualify for the deduction provided in paragraph (1) of section 545(c). Paragraph (3) defines the term "qualified indebtedness," subject to certain exceptions, as the outstanding indebtedness incurred by the taxpayer after December 31, 1933, and before August 1, 1963, and the outstanding indebtedness (if not otherwise deducted) incurred after July 31, 1963, for the purpose of making a payment or set-aside referred to in section 545(c)(1) in the same taxable year. Paragraph (4) provides that a corporation may elect to treat as nondeductible an amount otherwise deductible under paragraph (1) of section 545(c). Paragraph (5) provides certain limitations on the amount of the deduction otherwise allowed by section 545(c)(1). Paragraph (6) provides that the total amounts of the taxpayer's qualified indebtedness (as defined in sec. 545(c)(3)(A)) are reduced if property (of a character which is subject to the allowance for exhaustion, wear and tear, obsolescence, or amortization) is disposed of after July 31, 1963.

Your committee has approved in substance the provisions of subsection (i) of the bill as passed by the House. For the technical explanation of subsection (i) of the bill, other than the amendments explained below, see page A–113 of the report on the bill by the Committee on Ways and Means. However, your committee has amended paragraph (3) of proposed section 545(c) to provide that the term "qualified indebtedness" shall include the outstanding indebtedness incurred by the taxpayer before January 1, 1964, and has made conforming amendments in the other paragraphs of section 545(c).

Your committee has also amended paragraphs (5) and (6) of section 545(c) to provide that allowable deductions for depletion shall be taken into account to reduce the deduction allowed by section 545(c) and qualified indebtedness under certain circumstances. Your committee has also amended paragraph (2)(A) of section 545(c), which describes a category of corporations to which paragraph (1) of the new subsection may apply, to provide that such a corporation is one which was not a personal holding company under section 542 of existing law for at least one of its two most recent taxable years ending before December 31, 1963 (instead of the date of enactment of this subsection) but which would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such preceding taxable year.

SECTION 227. TREATMENT OF PROPERTY IN CASE OF OIL AND GAS WELLS

Section 227 of the bill (sec. 217 of the bill as passed by the House) has been approved by your committee without change. For the technical explanation of this section of the bill, see page A–122 of the report of the Committee on Ways and Means on the bill.

SECTION 228. TREATMENT OF CERTAIN IRON ORE ROYALTIES

(*a*) *In general.*—Subsection (a) of section 228 of the bill (sec. 218 of the bill as passed by the House) has been approved by your committee except that your committee has (1) restricted its application to iron ore mined in the United States, and (2) provided that the treatment provided by the bill shall not apply to any disposal of iron ore to certain related persons. For the technical explanation of section 228(a) of the bill (other than the amendments made by your committee), see page A133 of the report of the Committee on Ways and Means on the bill.

Under your committee's amendments two types of dispositions of iron ore to related persons will not qualify for treatment under section 631(c) of the code. The first type of such disposition occurs in any disposal to a person whose relationship to the party disposing of such iron ore is such that a loss would be disallowed under section 267 (relating to losses, etc., with respect to transactions between related taxpayers) or section 707(b) (relating to certain sales or exchanges of property with respect to controlled partnerships). Thus, iron ore royalty payments made under a lease between a father and his son would not qualify for treatment under section 631(c). The second type of such disposition occurs in any disposal to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of such iron ore. The test for determining the presence or absence of control is the same test as is presently applied in section 482 of the code (relating to the allocation of income and deductions between taxpayers).

(*b*) *Clerical amendments.*—Subsection (b) of section 228 of the bill contains the various clerical and conforming amendments to the code and to the Social Security Act which are required as a result of the amendments made by subsection (a) of such section.

(c) *Effective date.*—Subsection (c) of this section as passed by the House provided that the amendments made by such section shall apply to iron ore mined in taxable years beginning after December 31, 1963. Your committee has amended this subsection to provide that such amendments shall apply to amounts received or accrued in taxable years beginning after December 31, 1963, attributable to iron ore mined in such taxable years.

SECTION 229. INSURANCE COMPANIES

Section 229 of the bill, which is a new section added to the bill as passed by the House, contains amendments to subchapter L of chapter 1 of the code (relating to insurance companies).

(a) *Certain mutualization distributions made in 1962.*—Subsection (a) of section 229 of the bill relates to stock life insurance companies which adopted a plan of mutualization before January 1, 1958.

Allowance of deduction

Paragraph (1) of section 229(a) of the bill amends section 809(d)(11) of the code (relating to certain mutualization distributions) to allow as a deduction in the computation of gain from operations, distributions made in 1962 to shareholders, in acquisition of stock, pursuant to a plan of mutualizaton adopted by the company before January 1, 1958.

Thus, your committee's amendment allows life insurance companies which adopted a plan of mutualization before January 1, 1958, an additional year (1962) to complete their plan of mutualization by acquiring their stock out of annual earnings, and to receive a deduction for amounts paid for that purpose. The amount deductible is limited to amounts actually paid to shareholders in 1962, and does not include accruals paid in subsequent years. In addition, the deduction allowed by the revised section 809(d)(11) is subject to the limitations of section 809(g) of the code (relating to limitations on deductions for certain mutualization distributions).

Application of section 815

Paragraph (2) of section 229(a) of the bill amends section 809(g)(3) of the code (relating to application of sec. 815) to extend the special rules of section 815(e) to include mutualization distributions deductible under the revised section 809(d)(11).

(b) *Accrual of bond discount.*—Subsection (b) of section 229 of the bill relates to the accrual of bond discount by insurance companies subject to tax under parts I and II of subchapter L of chapter 1 of the code (relating to life insurance companies, and mutual insurace companies (other than life, marine, and certain fire or flood insurance companies) etc., respectively).

Life insurance companies

Paragraph (1) of section 229(b) of the bill amends section 818(b) of the code (relating to amortization of premium and accrual of discount) by adding a new paragraph (3) at the end thereof. The new section 818(b)(3) provides that for taxable years beginning after December 31, 1962, no accrual of discount shall be required under section 818(b)(1) on any bond (as defined in section 171(d)) except as otherwise provided under subparagraphs (A) and (B) of section 818(b)(3).

Subparagraph (A) of the new section 818(b)(3) relates solely to discount on tax-exempt obligations and provides that discount which is interest described in section 103 (relating to interest on certain governmental obligations) must still be accrued. Thus, your committee's amendment makes no change in existing law with respect to issue discount (the difference between issue price and the stated redemption price at maturity) on tax-exempt obligations. Such discount must still be accrued under section 818(b)(1) of the code. On the other hand, your committee's amendment changes existing law with respect to discount on tax-exempt obligations which is not "issue discount." The accrual of such discount will no longer be required.

Subparagraph (B) of the new section 818(b)(3) relates solely to bonds which are not tax-exempt obligations within the meaning of section 103, and provides that orginal issue discount (as defined in sec. 1232(b)) must be accrued under section 818(b)(1).

Under existing law, section 818(b)(1) requires life insurance companies to accrue all discount, regardless of whether it is "issue discount," original issue discount, or "market discount." The new paragraph (3) of section 818(b) of the code changes existing law only with respect to "market discount." Such discount is no longer required to be accrued. Thus, the recognition of gain attributable to market discount is postponed until the disposition of the bond. Upon the disposition of the bond, gain attributable to market discount will ordinarily be taxable as capital gain. The adjustment to basis for the accrual of market discount will no longer be allowed to the extent such discount is not accrued by reason of the new section 818(b)(3).

The new section 818(b)(3) also provides that for purposes of section 805(b)(3)(A), the current earnings rate for any taxable year beginning before January 1, 1963, shall be determined as if the first sentence of the new section 818(b)(3) applied to such taxable year.

Mutual insurance companies

Paragraph (2) of section 229(b) of the bill amends section 822(d)(2) of the code (relating to amortization of premium and accrual of discount) by adding a new sentence at the end thereof. This sentence provides that for taxable years beginning after December 31, 1962, no accrual of discount shall be required under section 822(d)(2) of the code on any bond (as defined in sec. 171(d)). Under the new sentence neither "issue discount," original issue discount, nor "market discount," is required to be accrued under section 822(d)(2). This provision has the effect of postponing until disposition of the bond any recognition of income attributable to bond discount, at which time the provisions of section 1232 may be applicable. No adjustment in the basis of any bond attributable to discount shall be permitted for taxable years beginning after December 31, 1962, to the extent such discount is not accrued by reason of the amended section 822(d)(2).

For taxable years beginning after December 31, 1962, no discount shall be required to be accrued pursuant to section 282(d)(2) regardless of when the bond to which the discount is attributable was acquired.

(c) *Contributions to qualified, etc., plans.*—Subsection (c) of section 229 of the bill amends section 832(c)(10) of the code (relating to deductions allowed in computing taxable income of insurance companies (other than life or mutual), mutual marine insurance companies, and certain mutual fire or flood insurance companies) by adding a new phrase at the end thereof. The new phrase provides that, in computing the taxable income of insurance companies subject to the tax imposed by section 831, there shall be allowed the deduction provided in part I of subchapter D of chapter 1 of the code (sec. 401 and following, relating to pension, profit-sharing, stock bonus plans, etc.). In allowing these companies to deduct their contributions to an employees' trust or annuity plan and compensation under a deferred-payment plan under section 404 of the code, subsection (c) of section 229 of the bill is in accord with existing administrative practice.

(*d*) *Effective dates.*—Subsection (d) of section 229 of the bill provides that the amendment made by subsection (a) of the bill (relating to certain mutualization distributions made in 1962) shall apply to taxable years beginning after December 31, 1961, and that the amendment made by subsection (c) of the bill (relating to contributions to qualified, etc., plans) shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954. No provision of this section extends the period of limitations within which a claim for credit or refund may be filed for any taxable year.

SECTION 230. REGULATED INVESTMENT COMPANIES

Section 230 of the bill, which is a new section added to the bill as passed by the House, relates to regulated investment companies.

(*a*) *Time for mailing certain notices to shareholders.*—Subsection (a) of section 230 of the bill amends several provisions of part I, subchapter M, chapter 1 of the code (relating to regulated investment companies) by increasing from 30 days to 45 days after the close of a taxable year the time within which a regulated investment company must give certain notices to its shareholders.

Under section 852(b)(3)(C) of existing law, a capital gain dividend is defined, in general, as any dividend, or part thereof, which is designated by the company as a capital gain dividend in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year. Under the bill, a 45-day period is substituted for the 30-day period.

Under section 852(b)(3)(D)(i) of existing law, a shareholder of a regulated investment company, in computing his long-term capital gains for his taxable year in which the last day of the regulated investment company's taxable year falls, must include such amount as the company designates as his share of undistributed capital gains in a written notice mailed to its shareholders at any time prior to the expiration of 30 days after the close of the regulated investment company's taxable year. Under the bill, the 30-day period is changed to a 45-day period.

Section 853 of existing law provides that, if certain conditions are met, a regulated investment company may elect to treat as having been distributed to its shareholders any income, war profits, and excess profits taxes paid by it to any foreign country or to any possession of the United States. The shareholders of the company must include the amount of such taxes in gross income and must treat such amount as paid by them for purposes of the deduction under section

164(a) and the foreign tax credit under section 901. Under section 853(c), the amounts to be so treated by the shareholders may not exceed the amounts so designated by the company in a written notice mailed to its shareholders not later than 30 days after the close of its taxable year. The bill changes the 30-day period to a 45-day period.

Section 854(b)(1) of existing law provides limitations to be applied in determining the extent to which any dividend (other than a capital gain dividend) may be taken into account by a shareholder of a regulated investment company for purposes of the credit under section 34, the exclusion under section 116, and the deduction under section 243. Section 854(b)(2) provides that the amount of any distribution which may be taken into account as a dividend for such purposes may not exceed the amount so designated by the regulated investment company in a written notice to its shareholders mailed not later than 30 days after the close of its taxable year. The bill changes the 30-day period to a 45-day period.

Section 855 provides that, if certain conditions are met, a dividend which is paid by a regulated investment company, after the close of a taxable year, may be considered by the company as having been paid during such taxable year. Section 855(c) provides that any notice to shareholders required under part I of subchapter M with respect to such a dividend must be mailed not later than 30 days after the close of the taxable year in which the distribution of such dividend is made. The bill changes the 30-day period to a 45-day period.

(*b*) *Certain redemptions by unit investment trusts.*—Subsection (b) of section 230 of the bill amends section 852 of the code (relating to taxation of regulated investment companies and their shareholders) by adding a new subsection (d) at the end thereof.

Under section 852(b) of existing law, a regulated investment company is allowed a deduction for dividends paid (as defined in sec. 561), other than capital gains dividends, in determining its investment company taxable income, and is allowed a deduction for dividends paid (as defined in sec. 561), determined with reference to capital gains dividends only, in computing that part of the excess of its net long-term capital gain over net short-term capital loss on which it must pay a capital gains tax. Section 561(b) provides that in determining the deduction for dividends paid, the rules provided in section 562 are applicable. Section 562(c) (relating to preferential dividends) provides that the amount of any distribution shall not be considered as a dividend unless such distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled to such preference.

New subsection (d) of section 852 provides that in the case of a unit investment trust—

(1) which is registered under the Investment Company Act of 1940 and issues periodic payment plan certificates (as defined in such act), and

(2) substantially all of the assets of which consist of securities issued by a management company (as defined in such act)—

section 562(c) shall not apply to a distribution by such trust to a holder of an interest in such trust in redemption of part or all of such interest, with respect to the net capital gain of the trust attributable to such redemption. Thus, assume that a holder of an interest in such a trust requests that part or all of such interest be redeemed. In order to obtain the amount of cash required to redeem such interest, the trust liquidates part of its portfolio, represented by shares in a management company, and realizes a long-term capital gain on such liquidation. That amount of the cash distributed to the redeeming interest holder which represents a distribution of such realized long-term capital gain is considered to be a distribution by the trust which qualifies for the deduction for dividends paid with reference to capital gains dividends under section 852(b)(3)(A).

(c) *Effective dates.*—Subsection (c) of section 230 of the bill provides that the amendments made by subsection (a) shall apply to taxable years of regulated investment companies ending on or after the date of the enactment of the bill, and that the amendment made by subsection (b) shall apply to taxable years of regulated investment companies ending after December 31, 1963.

SECTION 231. FOREIGN TAX CREDIT WITH RESPECT TO CERTAIN FOREIGN MINERAL INCOME

Section 231 of the bill, which is a new section added to the bill as passed by the House, amends section 901 (relating to credit for foreign taxes) by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) a new subsection (d) relating to foreign taxes on mineral income.

(a) *Foreign taxes on mineral income.*—Paragraph (1) of new subsection (d) provides that in certain cases the amount of foreign taxes described in section 901(b) (relating to amount of foreign tax allowed as a credit) which are paid or accrued during the taxable year with respect to mineral income to any foreign country (if the per-country limitation applies), or to all foreign countries (if the overall limitation applies), is to be reduced for purposes of computing the foreign tax credit. The reduction, if any, is equal to the amount by which the U.S. tax computed under chapter 1 of the code with respect to the same mineral income and computed before the allowance of any tax credit (such tax hereinafter referred to as the "U.S. tax") is exceeded by the lesser of the following two amounts: (1) The amount of such foreign taxes paid or accrued with respect to such income, or (2) the U.S. tax with respect to such income computed without the deduction for percentage depletion under section 613 but with the deduction for cost depletion determined with reference to the basis for cost depletion under section 612. The computation described in item (2) is made only to determine the amount of foreign taxes to be taken into account in computing the foreign tax credit and does not affect the manner in which a taxpayer actually computes the allowance for depletion under chapter 1 in determining the U.S. tax. In no case will the foreign tax on mineral income under new subsection (d) be reduced to an amount which is less than the U.S. tax on such mineral income. The credit for taxes paid or accrued to possessions of the United States is not affected by this provision.

Paragraph (2) of the new subsection (d) defines the term "mineral income" for purposes of subsection (d). The term means income derived from sources without the United States from mineral activities including dividends received from corporations in which 5 percent or more of the voting stock is owned directly or indirectly by the taxpayer, to the extent such dividends are attributable to mineral activities, and that portion of the taxpayer's distributive share of partnership income attributable to mineral activities. For such purpose the term "mineral activities" includes the extraction of minerals from mines, wells, or other natural deposits, the processing of such minerals into their primary products, and the transportation, distribution, or sale of such minerals or primary products. For example, in the case of oil, mineral activities of a taxpayer would include the extraction of the crude oil from the ground, transportation of the crude oil by pipeline or ship to a refinery, refining of the crude oil to obtain gasoline and other products resulting from such refining, and the sale of such products. However, the manufacture of chemical products from oil would not be considered the processing of oil into its primary products, and thus would not be considered a mineral activity. Similarly, the transportation, distribution, or sale of the chemical products would not be considered a mineral activity. If primary products of oil, such as gasoline, are sold through outlets of the taxpayer which also sell other products, only the sale of the primary products would be a mineral activity.

(*b*) *Effective date.*—The amendments made by section 231 of the bill are applicable to taxable years beginning after December 31, 1963.

SECTION 232. AMOUNTS RECEIVED FROM EMPLOYER ON SALE OF RESIDENCE OF EMPLOYEE IN CONNECTION WITH TRANSFER TO NEW PLACE OF WORK

(*a*) *Treatment of certain amounts received from employer on sale of residence of employee in connection with transfer to new place of work.*—Subsection (a)(1) of section 232 of the bill, which is a new section added to the bill as passed by the House, adds a new section 1003 to part I of subchapter O of chapter 1 of the code (relating to determination of amount of and recognition of gain or loss).

It has been held that an amount received by an employee from his employer, in respect of the sale of the employee's residence in connection with his transfer to a new place of work, is taxable as compensation. (*Harris W. Bradley*, 39 T.C. 652 (1963), aff'd 324 F. 2d 610 (4th Cir. 1963); *Arthur J. Kobacker*, 37 T.C. 882 (1962).)

SECTION 1003. AMOUNTS RECEIVED FROM EMPLOYER ON SALE OF RESIDENCE OF EMPLOYEE IN CONNECTION WITH TRANSFER TO NEW PLACE OF WORK

(a) *General rule.*—Subsection (a) of new section 1003 provides the general rule that if, in connection with the transfer of the taxpayer as as an employee to a new place of work, the taxpayer or his spouse sells property used as his principal residence "old residence" pursuant to a sales contract entered into within the forced sale period, and within 1 year after the date of such contract his employer pays part or all of the "sale differential," then the amount so paid shall be treated by the taxpayer or his spouse as an additional amount realized on the sale of the old residence to the extent that it does not exceed the lesser of (A) the "sale differential," or (B) 15 percent of the gross sales price of the old residence.

Section 1003 is applicable only with respect to the sale of a taxpayer's principal residence. Whether or not property is used by the taxpayer as his residence, and whether or not property is used by the taxpayer as his principal residence (in the case of a taxpayer using more than one property as a residence), depends upon all the facts and circumstances in each individual case. Property which qualifies as a principal residence for purposes of section 1034 will be considered a principal residence for purposes of section 1003.

Where property is used by the taxpayer partially as his principa residence and partially for business purposes or in the production of income (as in the case where a part of the building in which the taxpayer resides is used as an office or is rented), then only that portion of the reimbursement, appraised value, gross sales price, and selling expenses attributable to that part of the property used as the taxpayer's principal residence shall be considered for purposes of section 1003.

The gross sales price of the old residence is the total consideration received upon the sale by the taxpayer, and includes the amount of any mortgage, trust deed, or other indebtedness to which the property is subject in the hands of the purchaser whether or not the purchaser assum.., such indebtedness. It also includes the face amount of any liabilities of the purchaser which are part of the consideration for the sale. Commissions, and other selling or fixing up expenses paid or incurred by the taxpayer in connection with the sale of the old residence, are not to be deducted or taken into account in determining the gross sales price of the old residence.

(b) *Limitations.*—Subsection (b) of new section 1003 provides certain limitations on the applicability of section 1003.

Period of employment

Paragraph (1) of subsection (b) limits the application of section 1003 to those cases where the taxpayer was employed for the 6-month period ending on the day on which he commences work at the new principal place of work by the employer who makes the reimbursement.

Location of new place of work

Paragraph (2) of subsection (b) provides that section 1003 shall not apply unless the distance between the taxpayer's new principal place of work and his old residence exceeds by at least 20 miles the distance between the taxpayer's former principal place of work and his old residence. If the taxpayer, prior to his transfer, had no principal place of work, section 1003 shall not apply unless the distance between his new principal place of work and his old residence is at least 20 miles. For purposes of measuring distances under section 1003(b)(2), all computations are to be made on the basis of a straight-line measurement.

(c) *Definitions; special rules.*—Subsection (c) of new section 1003 provides definitions and special rules for the application of section 1003.

Forced sale period

The term "forced sale period," as defined in paragraph (1) of subsection (c), is the period which begins 90 days before, and ends 180 days after, the date on which the taxpayer commences work as an employee at the new principal place of work. The term has reference only to a period of time, and not to the nature of, or reason for, the sale.

Sale differential

The term "sale differential" is defined in paragraph (2) of subsection (c) as the amount by which (A) the appraised value of the old residence exceeds (B) the gross sales price of the old residence reduced by the selling commissions, legal fees, and other expenses incident to the transfer of ownership of the old residence. Expenses incident to the transfer of ownership refer to direct transfer costs borne by the employee. For example, such expenses do not include fixing-up expenses or traveling expenses of the employee or members of his family from or to the location of the old residence for purposes of its sale. In order for section 1003 to apply, the payment must be made by the employer to the employee as a sale differential. Thus, if an employer pays an employee a lump sum for miscellaneous costs relating to a transfer to a new place of work, only so much of such sum as is related to the sale of the old residence qualifies for treatment under section 1003.

Appraised value

The term "appraised value of the old residence", as defined in paragraph (3) of subsection (c), is the average of two or more appraisals of fair market value made, on or after the valuation date and on or before the date on which the sales contract is entered into, by independent real estate appraisers selected by the employer. Such paragraph (3) provides that the appraised value shall not exceed the fair market value of the old residence. The appraisals shall be made as of the valuation date.

Valuation date

The term "valuation date" is defined in paragraph (4) of subsection (c) as the date selected by the employer for purposes of determining the amount to be paid with respect to the sale differential. The date selected by the employer shall be a date which occurs (1) on or before the date the sales contract is entered into and (2) within the forced sale period.

Employer

The term "employer," as defined in paragraph (5) of subsection (c), means the person who employs the taxpayer as an employee at the new principal place of work. The term also includes any predecessor or successor corporation and any parent or subsidiary corporation. The determination of whether a corporation is a parent corporation or a subsidiary corporation shall be made under subsections (e) and (f) of section 425 of the code (added by sec. 222(a) of the bill) but by reference to the date on which the taxpayer commences work as an employee at the new principal place of work rather than as of the time of the granting of the option to which such section 425 relates. Thus, where a 50-percent voting stock relationship exists between the corporation for which the employee worked prior to his transfer and the corporation for which he works after his transfer, he is considered as having been employed by the same employer.

Exchanges

Paragraph (6) of subsection (c) provides that an exchange by the taxpayer or his spouse of an old residence for other property shall be treated as a sale.

Tenant-stockholder in a cooperative housing corporation

Paragraph (7) of subsection (c) provides that "property used by the taxpayer as his principal residence" includes stock held by a tenant-stockholder in a cooperative housing corporation, as those terms are defined in section 216 of the code, but only if the house or apartment which the taxpayer was entitled to occupy by reason of such stockownership was used by the taxpayer as his principal residence.

(d) *Regulations.*—Subsection (d) of new section 1003 provides that the Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of section 1003.

SECTION 232. AMOUNTS RECEIVED FROM EMPLOYER ON SALE OF RESIDENCE OF EMPLOYEE IN CONNECTION WITH TRANSFER TO NEW PLACE OF WORK—Con.

Subsection (a)(2) of section 232 of the bill amends the table of sections of part I of subchapter O of chapter 1 of the code to reflect the addition of section 1003 added by the bill.

(b) *Effective date.*—Subsection (b) of section 232 of the bill provides that the amendments made by subsection (a) shall apply to amounts paid with respect to sales contracts entered into after December 31, 1963, in taxable years ending after such date.

SECTION 233. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY

Section 233 of the bill (sec. 220 of the bill as passed by the House) was approved by your committee without change. For the technical explanation of this section of the bill, see page A–148 of the report of the Committee on Ways and Means on the bill.

SECTION 234. AVERAGING

Section 234 of the bill (sec. 221 of the bill as passed by the House) has been approved by your committee with three exceptions. For the technical explanation of this section of the bill (other than the amendments made by your committee), see page A–168 of the report of the Committee on Ways and Means on the bill.

First, your committee has made technical changes in the definition of the term "capital gain net income" and in the provisions relating to the computation of the alternative tax to reflect the elimination of section 219 (relating to capital gains and losses) of the bill as passed by the House.

Second, your committee has added a provision to the bill as passed by the House to allow an individual whose adjusted gross income for the computation year is under $5,000 and who chooses the benefits of income averaging to elect the standard deduction under section 144 of the code.

Third, your committee has added a provision to the bill as passed by the House restricting, in certain cases, the application of section 170(b)(5) of the code as added by section 209(c) of the bill (relating to 5-year carryover of certain excess charitable contributions by individuals).

Capital gain net income

Paragraph (1) of section 1302(d) of the code, as amended by your committee, provides that the term "capital gain net income" means the amount which is equal to 50 percent of the excess of the net long-term capital gain over the net short-term capital loss. An individual's capital gain net income for any taxable year cannot be less than zero.

Computation of alternative tax

Paragraph (2) of section 1304(e) deals with the method by which an individual computes his alternative tax under section 1201 of the code for any computation year. Paragraph (2), as amended by your committee, provides that if an individual has capital gain net income for the computation year, then section 1201(b) of the code is treated as imposing a tax on the individual's income which is equal to the tax imposed by section 1 of the code, reduced by the amount (if any) by which the amount of the tax imposed by section 1 of the code which is attributable to an individual's capital gain net income for such year (as determined under paragraph (1) of section 1304(e)) exceeds the amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss.

Amendment of section 144.—Subsection (c) of section 234 of the bill, as approved by your committee, amends section 144 of the code (relating to election of standard deduction) by adding after section 144(c) (as added by sec. 112(c)(2) of the bill) a new subsection (d).

Individuals electing income averaging

Subsection (d) of section 144 provides that if a taxpayer chooses to have the benefits of part I of subchapter Q (relating to income averaging) for a taxable year, section 144(a) of the code (relating to method and effect of election of standard deduction) shall not apply for such taxable year and the standard deduction under section 141 of the code shall be allowed if the taxpayer so elects in his return for such taxable year. The Secretary of the Treasury or his delegate shall prescribe by regulations the manner of signifying such election in the return. If the taxpayer on making his return fails to signify, in the manner prescribed by regulations, his election to take the standard deduction, such failure shall be considered his election not to take the standard deduction.

Effective date.—Subsection (g)(2) of section 234 of the bill, as approved by your committee, provides, in effect, that, in a taxable year beginning after December 31, 1963, if a taxpayer elects to apply both sections 1301 and 1307(e) of the code, as such sections were in effect immediately before the enactment of the bill, then section 170(b)(5) of the code as added by section 209(c) of the bill shall not apply to charitable contributions paid in such taxable year.

SECTION 235. SMALL BUSINESS CORPORATIONS

Section 235 of the bill, which is a new section added to the bill as passed by the House, relates to small business corporations.

(*a*) *Ownership of certain stock disregarded.*—Subsection (a) of section 235 of the bill amends section 1371 of the code (relating to the definition of a small business corporation) by adding a new subsection (d) to permit a corporation to be a small business corporation while owning the stock of certain inactive subsidiary corporations.

Under section 1371(a) of existing law, a small business corporation is not permitted to be a member of an affiliated group. New subsection (d) provides that, for purposes of section 1371(a), a corporation shall not be considered to be a member of an affiliated group at any time during any taxable year by reason of the ownership of stock in another corporation if such other corporation meets the requirements provided in new paragraphs (1) and (2) of section 1371(d).

Paragraph (1) provides that the subsidiary corporation must not have begun business at any time on or after the date of its incorporation and before the close of the parent corporation's taxable year with respect to which status as a small business corporation is being sought. An example of a corporation which "has not begun business" is a corporation which is incorporated for the sole purpose of reserving a corporate name in a State or States in which the parent corporation is not doing business.

Paragraph (2) of section 1371(d) provides, in effect, that the subsidiary corporation must not have taxable income for the portions of any of its taxable years which are included within the taxable year of the parent corporation with respect to which status as a small business corporation is being sought.

Thus, for example, assume that corporation P wishes to elect to be treated under the provisions of sections 1371 through 1377 of the code for its calendar year 1964 and subsequent years. Corporation P owns all of the stock of corporation S, which is on a June 30 taxable year. Corporation P would not be precluded from making an election under section 1372 if corporation S had not begun business before January 1, 1965, and had no taxable income for either the period January 1, 1964, through June 30, 1964, or the period July 1, 1964, through December 31, 1964. Assuming that corporation P so elected with respect to its calendar year 1964, it would cease to be a small business corporation for any subsequent taxable year if corporation S either begins business before the close of such subsequent year, or has taxable income for any period included within such subsequent year.

The enactment of section 1371(d) does not relax or otherwise change the requirements of any of the provisions of subchapter S other than with respect to the requirement that a small business corporation may not be a member of an affiliated group. Thus, in the above example, the election made by corporation P under section 1372 must have been made either during the month of December 1963 or January 1964.

(*b*) *Certain distributions of money after close of taxable year.*—Subsection (b) of section 235 of the bill amends section 1375 of the code (relating to special rules applicable to distributions of electing small business corporations) by adding a new subsection (e).

Paragraph (1) of new section 1375(e) provides that, for purposes of chapter 1 of the code, a corporation which sold capital assets or property described in section 1231(b) of the code during a taxable year with respect to which it was an electing small business corporation may elect to treat as a distribution of money made on the last day of such taxable year, a distribution of money representing all or part of the proceeds of such sales of assets or property which such corporation makes to its shareholders on or before the 15th day of the third month following the close of such year, if such distribution is made pursuant to a resolution of its board of directors adopted before the close of such taxable year. Thus, if a corporation makes such an election, such distribution will be treated as actually distributed and received on the last day of such taxable year and will be taken into account in computing undistributed taxable income (as defined in sec. 1373(c)) for such taxable year to the extent that such distribution is a distribution out of earnings and profits of such taxable year as specified in section 316(a)(2).

Paragraph (2) of new section 1375(e) provides, in effect, that in order for a corporation to make an election under paragraph (1) of new section 1375(e) with respect to any distribution, each person who is a shareholder on the day the distribution is received must own as of the close of such day the same proportion of stock of such corporation as he owned as of the close of the last day of the taxable year of such corporation preceding the taxable year of the distribution, and each such shareholder must consent to such election at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe by regulations.

Paragraph (3) of new section 1375(e) provides that the election under paragraph (1) of new section 1375(e) shall be made in such manner as the Secretary of the Treasury or his delegate shall prescribe by regulations. Such election shall be made not later than the time prescribed by law for filing the return for the taxable year during which the sale was made (including extensions thereof), except that, with respect to any taxable year ending on or before the date of enactment of the bill, such election shall be made within 120 days after such date.

(c) *Effective dates.*—Subsection (c) of section 235 of the bill provides that the amendment made by subsection (a) of such section shall apply with respect to taxable years of corporations beginning after December 31, 1962, and that the amendment made by subsection (b) of such section shall apply with respect to taxable years of corporations beginning after December 31, 1957. No provision of this section of the bill extends the period of limitations within which a claim for credit or refund may be filed for any taxable year.

SECTION 236. REPEAL OF ADDITIONAL 2-PERCENT TAX FOR CORPORATIONS FILING CONSOLIDATED RETURNS

Section 236 of the bill (sec. 222 of the bill as passed by the House) was approved by your committee without change. For the technical explanation of this section of the bill, see page A–186 of the report of the Committee on Ways and Means on the bill.

SECTION 237. REDUCTION OF SURTAX EXEMPTION IN CASE OF CERTAIN CONTROLLED CORPORATIONS, ETC.

Section 237 of the bill (sec. 223 of the bill as passed by the House) was approved by your committee with minor technical changes. For the technical explanation of this section (except for the amendments made by your committee), see page A–187 of the report of the Committee on Ways and Means on the bill.

(*a*) *In general.*—Subsection (a) of section 237 adds a new part II (relating to certain controlled corporations) to subchapter B of chapter 6 of the code.

SECTION 1562. PRIVILEGE OF GROUPS TO ELECT MULTIPLE SURTAX EXEMPTIONS

Additional tax imposed

The bill as passed by the House provides certain exceptions to the general rule that a corporation which is a component member of a controlled group of corporations which has made an election under new section 1562(a) of the code is subject to the additional tax imposed by section 1562(b):

1. New section 1562(b)(1) provided that the additional tax is not to apply to the taxable year of the corporation if such corporation is the only member of the controlled group which has taxable income for the taxable year.
2. Subsection (c) of section 1551 of the code (relating to disallowance of surtax exemption and accumulated earnings credit), as amended by the bill as passed by the House, provided that if the surtax exemption is disallowed to a transferee corporation under section 1551(a) for any taxable year the additional tax is not to apply with respect to such transferee for such taxable year.
3. The bill as passed by the House added a new subsection (d) to section 269 of the code (relating to acquisitions made to evade or avoid income tax) to provide that if the surtax exemption is disallowed under section 269(a) to an acquired corporation for any taxable year the additional tax is not to apply with respect to such acquired corporation for such taxable year.

Your committee has stricken out the provisions referred to in paragraphs (2) and (3), and has added to the provision referred to in paragraph (1) a general rule that the additional tax is not to apply to the taxable year of a corporation if its surtax exemption is disallowed under any provision of subtitle A of the code for such taxable year.

Tolling of statute of limitations

Your committee has made a change in subsection (g) of new section 1562 in order to make it clear that neither the Secretary of the Treasury nor his delegate nor the taxpayer may invoke such subsection for the purpose of overturning closing or compromise agreements. Thus, paragraph (2) of new section 1562(g) relating to the tolling of the statute of limitations for allowing or making claim for credit or refund of any overpayment of tax has been changed by your committee to conform to the provisions of paragraph (1) of such section, relating to the tolling of the statute of limitations for assessment of deficiencies.

SECTION 1563. DEFINITIONS AND SPECIAL RULES

Special rules

Your committee has adopted a new special rule by adding a new subparagraph (C) to new section 1563(f)(3). By reason of this addition, your committee has deleted as unnecessary a provision contained in the first parenthetical expression of section 1563(c)(2)(A)(ii). The new subparagraph (C) of section 1563(f)(3) provides that if stock is owned by a person within the meaning of section 1563(d) and such ownership results in the corporation being a component member of a controlled group, such stock shall not be treated as excluded stock under section 1563(c)(2) if by reason of treating such stock as excluded stock the result is that such corporation is not a component member of a controlled group. Thus, for example, assume corporation P owns directly 50 of the 100 shares of the only class of stock of corporation S. Also assume that O, an officer of corporation P, owns directly 30 shares of such stock and corporation P owns an option to acquire such 30 shares from O. The remaining shares of corporation S (20) are owned by unrelated persons. In the absence of the new special rule adopted by your committee, one possible construction of the applicable provisions of the House bill is that the 30 shares of stock of corporation S owned by O would be treated as excluded stock under section 1563(c)(2)(A)(ii), and corporation P would be treated as owning only 71 percent (50 divided by 70) of the stock of corporation S. Thus, corporation S would not be a component member of a controlled group of corporations within the meaning of section 1563(b). The special rule added by your committee insures, however, that the stock ownership rules contained in section 1563(d) take precedence over the excluded stock rules contained in section 1563(c)(2) when the result is to include a corporation as a component member of a controlled group of corporations which, in the absence of the new special rule, would not be the case. Thus, in the preceding example, O's stock would not be treated as excluded stock with the result that P is treated as owning 80 percent of the stock of corporation S (50 percent directly, and 30 percent constructively under sec. 1563(e)(1)) and corporation S would be a component member of a controlled group of corporations consisting of corporations P and S.

Your committee has also made minor conforming and clarifying changes in new section 1563.

(*b*) *Disallowance of surtax exemption and accumulated earnings credit.*—Subsection (b) of the bill contains amendments to section 1551 of existing law. Subsection (b)(2) of section 1551 as amended by the bill, defines the term "control" in the case of a transferee corporation described in subsection (a)(3) of such section. Subparagraph (B) of section 1551(b)(2) provides, in part, that with respect to voting stock, five or fewer individuals must own stock possessing *more than* 50 percent of the total combined voting power of all classes of stock entitled to vote. However, a slightly different test is provided with respect to the ownership requirements relating to the value of the outstanding stock. The test is that the five or fewer individuals must own stock possessing *at least* 50 percent of the total value of shares of all classes of stock. Your committee has made the voting stock and the value stock tests identical by requiring that in each case the individuals must own more than 50 percent of the particular stock in question.

(c) *Technical amendments.*—Subsection (c) of the bill as reported is the same as subsection (c) of the bill as passed by the House except for a conforming change.

(d) *Effective date.*—Subsection (d) of the bill as reported is the same as subsection (d) of the bill as passed by the House.

SECTION 238. VALIDITY OF TAX LIENS AGAINST MORTGAGEES, PLEDGEES, AND PURCHASERS OF MOTOR VEHICLES

Section 238 of the bill, which is a new section added to the bill as passed by the House, relates to the validity of tax liens on certain motor vehicles.

(a) *Mortgagees, pledgees, and purchasers without actual notice or knowledge of lein.*—Subsection (a) of section 238 of the bill amends section 6323(c) of the code (relating to exception in case of securities) to grant, in the case of the mortgage, pledge, or purchase of a motor vehicle, the same treatment which is now available in the case of the mortgage, pledge, or purchase of a security after notice of a tax lien has been filed. Thus, even though notice of a tax lien imposed by section 6321 has been filed, such lien will not be valid with respect to any mortgagee, pledgee, or purchaser of a motor vehicle, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser was without notice or knowledge of the existence of such lien.

Paragraph (1) of section 238(a) of the bill amends the heading of section 6323(c) of the code to reflect the extension of the exception contained in such subsection to cover motor vehicles.

Paragraphs (2) and (3) of section 238(a) of the bill amend paragraph (1) of section 6323(c) of the code to extend the exception contained in paragraph (1) to any mortgagee, pledgee, or purchaser of a motor vehicle without notice or knowledge of the existence of a tax lien.

Paragraph (4) of section 238(a) of the bill adds a new paragraph (3) to section 6323(c) of the code. Paragraph (3) defines the term "motor vehicle", as used in section 6323(c), as a vehicle (other than a house trailer) which is registered for highway use under the laws of any State or foreign country.

(b) *Liens for estate and gift taxes.*—Subsection (b) of section 238 of the bill amends section 6324 of the code (relating to special liens for estate and gift taxes) to grant, in the case of the mortgage, pledge, or purchase of a motor vehicle, the same treatment which is now available in the case of the mortgage, pledge, or purchase of a security after a lien for estate or gift tax has arisen. Thus, even though a special lien for estate or gift tax has arisen, such lien will not be valid with respect to any mortgagee, pledgee, or purchaser of a motor vehicle, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser was without notice or knowledge of the existence of such lien.

Paragraph (1) of section 238(b) of the bill amends section 6324(a) of the code (relating to liens for estate tax) and section 6324(b) of the code (relating to lien for gift tax) to extend the exception for securities now contained in those subsections to motor vehicles.

Paragraph (2) of section 238(b) of the bill amends section 6324(c) of the code (relating to exception in case of securities) by revising such subsection to cover both securities and motor vehicles.

(c) *Effective date.*—Subsection (c) of section 238 of the bill provides that the amendments made by this section apply only with respect to mortgages, pledges, and purchases made after the date of the enactment of the bill.

TITLE III—OPTIONAL TAX ON INDIVIDUALS; COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 301. OPTIONAL TAX IF ADJUSTED GROSS INCOME IS LESS THAN $5,000

This section has been approved by your committee without change. For the technical explanation of this section of the bill see page A–214 of the report of the Committee on Ways and Means on the bill.

SECTION 302. INCOME TAX COLLECTED AT SOURCE

Section 302 of the bill amends section 3402 of the code (relating to income tax collected at source) and section 1441 of the code (relating to withholding of tax on nonresident aliens).

(a) *Percentage method of withholding.*—Subsection (a) of section 302 of the bill amends section 3402(a) of the code (relating to income tax collected at source). Under the bill as passed by the House, section 3402(a) of the code provided for a 15-percent withholding rate in the case of wages paid during the calendar year 1964 and a 14-percent withholding rate in the case of wages paid after December 31, 1964. Your committee has amended section 3042(a) to provide for a 14-percent withholding rate in the case of wages paid after the seventh day following the date of the enactment of the bill.

(b) *Wage bracket withholding.*—Subsection (b) of section 302 of the bill amends section 3402(c)(1) of the code (relating to wage bracket withholding). Under the bill as passed by the House, section 3402(c)(1) of the code provided new withholding tables for wages paid during the calendar year 1964, and new tables for wages paid after December 31, 1964. Your committee has amended section 3402(c)(1) to provide that the new withholding tables which would have become effective for wages paid after December 31, 1964, under the bill as passed by the House will become effective for wages paid after the seventh day following the date of the enactment of the bill.

(c) *Withholding of tax on certain nonresident aliens.*—Subsection (c) of section 302 of the bill amends sections 1441 (a) and (b) of the code (relating to withholding of tax on nonresident aliens). Under the bill as passed by the House, section 1441(a) of the code provided a 15-percent withholding rate in the case of certain payments made during the calendar year 1964 and a 14-percent withholding rate in the case of certain payments made after December 31, 1964. Your committee has amended section 1441(a) to provide a 14-percent withholding rate in the case of these payments made after the seventh day following the date of the enactment of the bill.

Under the bill as passed by the House, section 1441(b) of the code referred to the rates of 15 percent or 14 percent provided by the amended section 1441(a). Your committee has amended section 1441(b) to refer to the new 14-percent rate which is provided by amended section 1441(a).

(*d*) *Effective dates.*—Subsection (d) of section 302 of the bill as passed by the House provided that the amendments made by subsections (a) and (b) of such section apply with respect to remuneration paid after December 31, 1963, and that the amendment made by subsection (c) applies with respect to payments made after December 31, 1963. Your committee's amendment provides that the amendments made by subsections (a) and (b) of such section apply with respect to remuneration paid after the seventh day following the date of the enactment of the bill, and that the amendment made by subsection (c) of such section applies with respect to payments made after the seventh day following the date of the enactment of the bill.

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88TH CONGRESS 2d Session } HOUSE OF REPRESENTATIVES { REPORT No. 1149

1565

REVENUE ACT OF 1964

FEBRUARY 24, 1964.—Ordered to be printed

Mr. MILLS, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H.R. 8363]

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 8363) to amend the Internal Revenue Code of 1954 to reduce individual and corporate income taxes, to make certain structural changes with respect to the income tax, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its amendments numbered 1, 2, 53, 56, 129, 132, 135, 142, 143, 144, 146, 164, 165, 195, 199, 200, 201, 202, and 203.

That the House recede from its disagreement to the amendments of the Senate numbered 3, 4, 5, 6, 7, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 21, 22, 23, 24, 25, 28, 29, 30, 33, 34, 35, 37, 38, 39, 40, 41, 44, 45, 48, 49, 51, 52, 63, 64, 65, 66, 67, 68, 69, 71, 72, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89, 90, 91, 92, 93, 94, 95, 102, 103, 107, 108, 109, 110, 111, 112, 113, 114, 115, 116, 117, 118, 119, 120, 121, 122, 123, 124, 125, 126, 127, 128, 130, 131, 133, 134, 136, 137, 138, 139, 140, 148, 150, 151, 152, 153, 154, 155, 156, 157, 158, 159, 160, 161, 169, 170, 171, 172, 173, 174, 175, 176, 180, 181, 182, 183, 184, 186, 187, 188, 189, 190, 191, 192, 204, 205, 206, 207, and 208, and agree to the same.

Amendment numbered 8:

That the House recede from its disagreement to the amendment of the Senate numbered 8, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

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SEC. 202. RETIREMENT INCOME CREDIT OF CERTAIN MARRIED INDIVIDUALS.

(a) DETERMINATION OF RETIREMENT INCOME.—Section 37 (relating to retirement income) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) SPECIAL RULES FOR CERTAIN MARRIED COUPLES.—

"(1) ELECTION.—A husband and wife who make a joint return for the taxable year and both of whom have attained the age of 65 before the close of the taxable year may elect (at such time and in such manner as the Secretary or his delegate by regulations prescribes) to determine the amount of the credit allowed by subsection (a) by applying the provisions of paragraph (2).

"(2) SPECIAL RULES.—If an election is made under paragraph (1) for the taxable year, for purposes of subsection (a)—

"(A) if either spouse is an individual who has received earned income within the meaning of subsection (b), the other spouse shall be considered to be an individual who has received earned income within the meaning of such subsection; and

"(B) subsection (d) shall be considered as providing that the amount of the combined retirement income of both spouses shall not exceed $2,286, less the sum of the amounts specified in paragraphs (1) and (2) of subsection (d) for each spouse."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1963.

And the Senate agree to the same.

Amendment numbered 20:

That the House recede from its disagreement to the amendment of the Senate numbered 20, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following:

"(1) the cost of $50,000 of such insurance, and

And the Senate agree to the same.

Amendment numbered 26:

That the House recede from its disagreement to the amendment of the Senate numbered 26, and agree to the same with an amendment, as follows:

Page 7, in the last line of the matter following line 3, of the Senate engrossed amendments, strike out "222" and insert: *221*; and the Senate agree to the same.

Amendment numbered 27:

That the House recede from its disagreement to the amendment of the Senate numbered 27, and agree to the same with an amendment, as follows:

Page 7, line 6, of the Senate engrossed amendments, strike out "222" and insert: *221*; and the Senate agree to the same.

Amendment numbered 31:

That the House recede from its disagreement to the amendment of the Senate numbered 31, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following:

period, if such amounts are at a rate which exceeds 75 percent of the regular weekly rate of wages of the employee (as determined under regulations prescribed by the Secretary or his delegate). If amounts attributable to the first 30 calendar days in such period are at a rate which does not exceed 75 percent of the regular weekly rate of wages of the employee, the first sentence of this subsection (1) shall not apply to the extent that such amounts exceed a weekly rate of $75, and (2) shall not apply to amounts attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of personal injuries or sickness for at least one day during such period."

And the Senate agree to the same.

Amendment numbered 32:

That the House recede from its disagreement to the amendment of the Senate numbered 32, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

"*(5) State and local taxes on the sale of gasoline, diesel fuel, and other motor fuels.*

And the Senate agree to the same.

Amendment numbered 36:

That the House recede from its disagreement to the amendment of the Senate numbered 36, and agree to the same with amendments as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

(b) UNLIMITED CHARITABLE CONTRIBUTION DEDUCTION.—Section 170 (relating to charitable, etc., contributions and gifts) is amended by inserting after subsection (f) (added by subsection (e) of this section) the following new subsection:

"*(g) APPLICATION OF UNLIMITED CHARITABLE CONTRIBUTION DEDUCTION.—*

"*(1) ALLOWANCE OF DEDUCTION FOR TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1963.—If the taxable year begins after December 31, 1963—*

"*(A) subsection (b)(1)(C) shall apply only if the taxpayer so elects (at such time and in such manner as the Secretary or his delegate by regulations prescribes); and*

"*(B) for purposes of subsection (b)(1)(C), the amount of the charitable contributions for the taxable year (and for all prior taxable years beginning after December 31, 1963) shall be determined without the application of subsection (b)(5) and solely by reference to charitable contributions described in paragraph (2).*

If the taxpayer elects to have subsection (b)(1)(C) apply for the taxable year, then for such taxable year subsection (a) shall apply *only with respect to charitable contributions described in paragraph (2), and no amount of charitable contributions made in the taxable year or any prior taxable year may be treated under subsection (b)(5) as having been made in the taxable year or in any succeeding taxable year.*

"(2) QUALIFIED CONTRIBUTIONS.—*The charitable contributions referred to in paragraph (1) are—*

"(A) *any charitable contribution described in subsection (b)(1)(A);*

"(B) *any charitable contribution, not described in subsection (b)(1)(A), to an organization described in subsection (c)(2) substantially more than half of the assets of which is devoted directly to, and substantially all of the income of which is expended directly for, the active conduct of the activities constituting the purpose or function for which it is organized and operated;*

"(C) *any charitable contribution, not described in subsection (b)(1)(A), to an organization described in subsection (c)(2) which meets the requirements of paragraph (3) with respect to such charitable contribution; and*

"(D) *any charitable contribution payment of which is made on or before the date of the enactment of the Revenue Act of 1964.*

"(3) ORGANIZATIONS EXPENDING AT LEAST 50 PERCENT OF DONOR'S CONTRIBUTIONS.—*An organization shall be an organization referred to in paragraph (2)(C), with respect to any charitable contribution, only if—*

"(A) *not later than the close of the third year after the organization's taxable year in which the contribution is received (or before such later time as the Secretary or his delegate may allow upon good cause shown by such organization), such organization expends an amount equal to at least 50 percent of such contribution for—*

"(i) *the active conduct of the activities constituting the purpose or function for which it is organized and operated,*

"(ii) *assets which are directly devoted to such active conduct,*

"(iii) *contributions to organizations which are described in subsection (b)(1)(A) or in paragraph (2)(B) of this subsection, or*

"(iv) *any combination of the foregoing; and*

"(B) *for the period beginning with the taxable year in which such contribution is received and ending with the taxable year in which subparagraph (A) is satisfied with respect to such contribution, such organization expends all of its net income (determined without regard to capital gains and losses) for the purposes described in clauses (i), (ii), (iii), and (iv) of subparagraph (A).*

If the taxpayer so elects (at such time and in such manner as the Secretary or his delegate by regulations prescribes) with respect to contributions made by him to any organization, then, in applying subparagraph (B) with respect to contributions made by him to such organization during his taxable year for which such election is made *and during all his subsequent taxable years, amounts expended by the organization after the close of any of its taxable years and on or before the 15th day of the third month following the close of such taxable year shall be treated as expended during such taxable year.*

"(4) *DISQUALIFYING TRANSACTIONS.—An organization shall be an organization referred to in subparagraph (B) or (C) of paragraph (2) only if at no time during the period consisting of the organization's taxable year in which the contribution is received, its 3 preceding taxable years, and its 3 succeeding taxable years, such organization—*

"(A) *lends any part of its income or corpus to,*

"(B) *pays compensation (other than reasonable compensation for personal services actually rendered) to,*

"(C) *makes any of its services available on a preferential basis to,*

"(D) *purchases more than a minimal amount of securities or other property from, or*

"(E) *sells more than a minimal amount of securities or other property to,*

the donor of such contribution, any member of his family (as defined in section 267(c)(4)), any employee of the donor, any officer or employee of a corporation in which he owns (directly or indirectly) 50 percent or more in value of the outstanding stock, or any partner or employee of a partnership in which he owns (directly or indirectly) 50 percent or more of the capital interest or profits interest. This paragraph shall not apply to transactions occurring on or before the date of the enactment of the Revenue Act of 1964."

Page 62, line 3, of the House engrossed bill, strike out "(g) and (h)," and insert: *(h) and (i),*

And the Senate agree to the same.

Amendment numbered 42:

That the House recede from its disagreement to the amendment of the Senate numbered 42, and agree to the same with an amendment as follows:

Page 14, line 8, of the Senate engrossed amendments, strike out the period and insert:

, except that such amendments shall not apply to any transfer of a future interest made before July 1, 1964, where—

(A) the sole intervening interest or right is a nontransferable life interest reserved by the donor, or

(B) in the case of a joint gift by husband and wife, the sole intervening interest or right is a nontransferable life interest reserved by the donors which expires not later than the death of whichever of such donors dies later.

For purposes of the exception contained in the preceding sentence, a right to make a transfer of the reserved life interest to the donee of the future interest shall not be treated as making a life interest transferable.

And the Senate agree to the same.

Amendment numbered 43:

That the House recede from its disagreement to the amendment of the Senate numbered 43, and agree to the same with an amendment as follows:

Page 16, lines 1 and 2, of the Senate engrossed amendments, strike out "may be prescribed by the Secretary or his delegate" and insert: *the Secretary or his delegate by regulations prescribes*

And the Senate agree to the same.

Amendment numbered 46:

That the House recede from its disagreement to the amendment of the Senate numbered 46, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following:

> "*(B) The $600 limit of subparagraph (A) shall be increased (to an amount not above $900) by the amount of expenses incurred by the taxpayer for any period during which the taxpayer had 2 or more dependents.*

And the Senate agree to the same.

Amendment numbered 47:

That the House recede from its disagreement to the amendment of the Senate numbered 47, and agree to the same with an amendment as follows:

Page 19, line 21, of the Senate engrossed amendments, strike out "$7,000" and insert: *$6,000*

And the Senate agree to the same.

Amendment numbered 50:

That the House recede from its disagreement to the amendment of the Senate numbered 50, and agree to the same with amendments as follows:

Strike out the matter proposed to be stricken out and omit the matter proposed to be inserted by the Senate amendment.

Page 68, line 8, of the House engrossed bill, strike out "219" and insert: *218*

Page 71 of the House engrossed bill, in the matter following line 14, strike out " 'Sec. 219. Cross references.' " and insert: "*Sec. 218. Cross references.*"

And the Senate agree to the same.

Amendment numbered 54:

That the House recede from its disagreement to the amendment of the Senate numbered 54, and agree to the same with an amendment as follows:

Page 22, line 18, of the Senate engrossed amendments, strike out "215" and insert: *214*; and the Senate agree to the same.

Amendment numbered 55:

That the House recede from its disagreement to the amendment of the Senate numbered 55, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *215*; and the Senate agree to the same.

Amendment numbered 57:

That the House recede from its disagreement to the amendment of the Senate numbered 57, and agree to the same with amendments as follows:

Page 31, line 18, of the Senate engrossed amendments, strike out "217" and insert: *216*

Page 32, line 1, of the Senate engrossed amendments, beginning with "which" strike out all through "80a-2))" in line 5 and insert: *which is a face-amount certificate company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 and following) and which is subject to the banking laws of the State in which such institution is incorporated, interest on face-amount certificates (as defined in section 2(a)(15) of such Act)*

Page 32, line 13, of the Senate engrossed amendments, strike out "25 percent" and insert: *15 percent*

And the Senate agree to the same.

Amendment numbered 58:

That the House recede from its disagreement to the amendment of the Senate numbered 58, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 217. LIMITATION OF TRAVEL ALLOCATION REQUIREMENT TO FOREIGN TRAVEL.

(a) LIMITATION OF APPLICATION OF SECTION 274(c).—Section 274(c) (relating to traveling) is amended to read as follows:

"(c) CERTAIN FOREIGN TRAVEL.—

"(1) IN GENERAL.—In the case of any individual who travels outside the United States away from home in pursuit of a trade or business or in pursuit of an activity described in section 212, no deduction shall be allowed under section 162 or section 212 for that portion of the expenses of such travel otherwise allowable under such section which, under regulations prescribed by the Secretary or his delegate, is not allocable to such trade or business or to such activity.

"(2) EXCEPTION.—Paragraph (1) shall not apply to the expenses of any travel outside the United States away from home if—

"(A) such travel does not exceed one week, or

"(B) the portion of the time of travel outside the United States away from home which is not attributable to the pursuit of the taxpayer's trade or business or an activity described in section 212 is less than 25 percent of the total time on such travel.

"(3) DOMESTIC TRAVEL EXCLUDED.—For purposes of this subsection, travel outside the United States does not include any travel from one point in the United States to another point in the United States."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to taxable years ending after December 31, 1962, but only in respect of periods after such date.

And the Senate agree to the same.

Amendment numbered 59:

That the House recede from its disagreement to the amendment of the Senate numbered 59, and agree to the same with an amendment as follows:

Page 33, line 6, of the Senate engrossed amendments, strike out "219" and insert: *218*; and the Senate agree to the same.

Amendment numbered 60:

That the House recede from its disagreement to the amendment of the Senate numbered 60, and agree to the same with an amendment as follows:

Page 35, line 2, of the Senate engrossed amendments, strike out "220" and insert: *219*; and the Senate agree to the same.

Amendment numbered 61:

That the House recede from its disagreement to the amendment of the Senate numbered 61, and agree to the same with amendments as follows:

Page 37, line 2, of the Senate engrossed amendments, strike out "221" and insert: *220*

Page 44 of the Senate engrossed amendments, after line 22, insert:

> *If for the period (or part thereof) referred to in clauses (ii) and (iii) such corporation has no gross income, the provisions of clauses (ii) and (iii) shall be treated as satisfied if it is reasonable to anticipate that, with respect to the first taxable year thereafter for which such corporation has gross income, the provisions of such clauses will be satisfied.*

And the Senate agree to the same.

Amendment numbered 62:

That the House recede from its disagreement to the amendment of the Senate numbered 62, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *221*; and the Senate agree to the same.

Amendment numbered 70:

That the House recede from its disagreement to the amendment of the Senate numbered 70, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

> "*(6)* *APPLICATION OF SUBSECTION (b)(5) WHERE OPTIONS ARE FOR STOCK OF SAME CLASS IN SAME CORPORATION.—The requirement of subsection (b)(5) shall be considered to have been met in the case of any option (referred to in this paragraph as 'new option') granted to an individual if—*
>
> "*(A) the new option and all outstanding options referred to in subsection (b)(5) are to purchase stock of the same class in the same corporation, and*
>
> "*(B) the new option by its terms is not exercisable while there is outstanding (within the meaning of paragraph (2)) any qualified stock option (or restricted stock option) which was granted, before the granting of the new option, to such individual*

to purchase stock in such corporation at a price (determined as of the date of grant of the new option) higher than the option price of the new option.

And the Senate agree to the same.

Amendment numbered 96:

That the House recede from its disagreement to the amendment of the Senate numbered 96, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 222. SALES AT RETAIL UNDER REVOLVING CREDIT PLANS.

(a) TREATMENT UNDER INSTALLMENT METHOD.—Section 453 (relating to installment method of accounting) is amended by adding at the end thereof the following new subsection:

"(e) REVOLVING CREDIT TYPE PLANS.—For purposes of subsection (a), the term 'installment plan' includes a revolving credit type plan which provides that the purchaser of personal property at retail may pay for such property in a series of periodic payments of an agreed portion of the amounts due the seller under the plan, except that such term does not include any such plan with respect to a purchaser who uses his account primarily as an ordinary charge account."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply in respect of sales made during taxable years beginning after December 31, 1963.

And the Senate agree to the same.

Amendment numbered 97:

That the House recede from its disagreement to the amendment of the Senate numbered 97, and agree to the same with amendments as follows:

Page 57, line 14, of the Senate engrossed amendments, strike out "224" and insert: *223*

Page 57, line 14, of the Senate engrossed amendments, strike out **"AND CREDITS"**

Page 57, line 17, of the Senate engrossed amendments, strike out "OR CREDIT"

Page 58, line 4, of the Senate engrossed amendments, strike out "or credit"

Page 58, line 6, of the Senate engrossed amendments, strike out "or credit"

Page 58, line 7, of the Senate engrossed amendments, after the period and before the quotation marks insert: *This subsection shall not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States.*

Page 58, line 11, of the Senate engrossed amendments, strike out "sentence" and insert: *sentences*

Page 58, line 19, of the Senate engrossed amendments, strike out "or credit"

Page 58, line 22, of the Senate engrossed amendments, strike out "or credit"

Page 58, line 23, of the Senate engrossed amendments, after the period and before the quotation marks insert: *The preceding sentence* *shall not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States.*

Page 60, line 4, of the Senate engrossed amendments, strike out "or credit"

Page 61, line 3, of the Senate engrossed amendments, strike out "or credit"

Page 61, line 12, of the Senate engrossed amendments, strike out "or credit"

And the Senate agree to the same.

Amendment numbered 98:

That the House recede from its disagreement to the amendment of the Senate numbered 98, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *224*; and the Senate agree to the same.

Amendment numbered 99:

That the House recede from its disagreement to the amendment of the Senate numbered 99, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out by the Senate amendment and in lieu thereof insert the following:

(c) CERTAIN CARRYING CHARGES.—Section 163(b)(1) (relating to installment purchases where interest charge is not separately stated) is amended—

(1) by striking out "personal property is purchased" and inserting in lieu thereof "personal property or educational services are purchased"; and

(2) by adding at the end thereof the following new sentence: "For purposes of this paragraph, the term 'educational services' means any service (including lodging) which is purchased from an educational institution (as defined in section 151(e)(4)) and which is provided for a student of such institution."

And the Senate agree to the same.

Amendment numbered 100:

That the House recede from its disagreement to the amendment of the Senate numbered 100, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following:

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to payments made after December 31, 1963, on account of sales or exchanges of property occurring after June 30, 1963, other than any sale or exchange made pursuant to a binding written contract (including an irrevocable written option) entered into before July 1, 1963. The amendments made by subsection (c) shall apply to payments made during taxable years beginning after December 31, 1963.

And the Senate agree to the same.

Amendment numbered 101:

That the House recede from its disagreement to the amendment of the Senate numbered 101, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *225*; and the Senate agree to the same.

Amendment numbered 104:

That the House recede from its disagreement to the amendment of the Senate numbered 104, and agree to the same with an amendment, as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *obligations,*; and the Senate agree to the same.

Amendment numbered 105:

That the House recede from its disagreement to the amendment of the Senate numbered 105, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

> "*(iii) rendering services or making facilities available in connection with activities described in clauses (i) and (ii) carried on by the corporation rendering services or making facilities available, or*
>
> "*(iv) rendering services or making facilities available to another corporation which is engaged in the lending or finance business (within the meaning of this paragraph), if such services or facilities are related to the lending or finance business (within such meaning) of such other corporation and such other corporation and the corporation rendering services or making facilities available are members of the same affiliated group (as defined in section 1504).*

And the Senate agree to the same.

Amendment numbered 106:

That the House recede from its disagreement to the amendment of the Senate numbered 106, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following:

> *unless the loans, notes, or installment obligations are evidenced or secured by contracts of conditional sale, chattel mortgages, or chattel lease agreements arising out of the sale of goods or services in the course of the borrower's or transferor's trade or business, or*

And the Senate agree to the same.

Amendment numbered 141:

That the House recede from its disagreement to the amendment of the Senate numbered 141, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out by the Senate amendment and in lieu thereof insert:

(j) INCREASE IN BASIS WITH RESPECT TO CERTAIN FOREIGN PERSONAL HOLDING COMPANY STOCK OR SECURITIES.—

(1) IN GENERAL.—Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by redesignating section 1022 as section 1023 and by inserting after section 1021 the following new section:

"SEC. 1022. INCREASE IN BASIS WITH RESPECT TO CERTAIN FOREIGN PERSONAL HOLDING COMPANY STOCK OR SECURITIES.

"(a) GENERAL RULE.—The basis (determined under section 1014(b)(5), relating to basis of stock or securities in a foreign personal holding company) of a share of stock or a security, acquired from a decedent dying after December 31, 1963, of a corporation which was a foreign personal holding company for its most recent taxable year ending before the date of the decedent's death shall be increased by its proportionate share of any Federal estate tax attributable to the net appreciation in value of all of such shares and securities determined as provided in this section.

"(b) PROPORTIONATE SHARE.—For purposes of subsection (a), the proportionate share of a share of stock or of a security is that amount which bears the same ratio to the aggregate increase determined under subsection (c)(2) as the appreciation in value of such share or security bears to the aggregate appreciation in value of all such shares and securities having appreciation in value.

"(c) SPECIAL RULES AND DEFINITIONS.—For purposes of this section—

"(1) FEDERAL ESTATE TAX.—The term 'Federal estate tax' means only the tax imposed by section 2001 or 2101, reduced by any credit allowable with respect to a tax on prior transfers by section 2013 or 2102.

"(2) FEDERAL ESTATE TAX ATTRIBUTABLE TO NET APPRECIATION IN VALUE.—The Federal estate tax attributable to the net appreciation in value of all shares of stock and securities to which subsection (a) applies is that amount which bears the same ratio to the Federal estate tax as the net appreciation in value of all of such shares and securities bears to the value of the gross estate as determined under chapter 11 (including section 2032, relating to alternate valuation).

"(3) NET APPRECIATION.—The net appreciation in value of all shares and securities to which subsection (a) applies is the amount by which the fair market value of all such shares and securities exceeds the adjusted basis of such property in the hands of the decedent.

"(4) FAIR MARKET VALUE.—For purposes of this section, the term 'fair market value' means fair market value determined under chapter 11 (including section 2032, relating to alternate valuation).

"(d) LIMITATIONS.—This section shall not apply to any foreign personal holding company referred to in section 342(a)(2)."

(2) Amendment of section 1016(a).—Section 1016(a) (relating to adjustments to basis) is amended by striking out the period at the end thereof and by inserting in lieu thereof a semicolon and by adding at the end thereof the following new paragraph:

"(21) to the extent provided in section 1022, relating to increase in basis for certain foreign personal holding company stock or securities."

(3) Clerical amendment.—The table of sections for part II of subchapter O of chapter 1 is amended by striking out

"Sec. 1022. Cross references."

and inserting in lieu thereof the following:

"Sec. 1022. Increase in basis with respect to certain foreign personal holding company stock or securities.
"Sec. 1023. Cross references."

And the Senate agree to the same.

Amendment numbered 145:

That the House recede from its disagreement to the amendment of the Senate numbered 145, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out by the Senate amendment and in lieu thereof insert:

(4) The amendments made by subsection (j) shall apply in respect of decedents dying after December 31, 1963.

And the Senate agree to the same.

Amendment numbered 147:

That the House recede from its disagreement to the amendment of the Senate numbered 147, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *226*; and the Senate agree to the same.

Amendment numbered 149:

That the House recede from its disagreement to the amendment of the Senate numbered 149, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *227*; and the Senate agree to the same.

Amendment numbered 162:

That the House recede from its disagreement to the amendment of the Senate numbered 162, and agree to the same with an amendment as follows:

Page 68, line 22, of the Senate engrossed amendments, strike out "229" and insert: *228*; and the Senate agree to the same.

Amendment numbered 163:

That the House recede from its disagreement to the amendment of the Senate numbered 163, and agree to the same with an amendment as follows:

Page 70, line 22, of the Senate engrossed amendments, strike out "230" and insert: *229*; and the Senate agree to the same.

Amendment numbered 166:

That the House recede from its disagreement to the amendment of the Senate numbered 166, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out by the Senate amendment and in lieu thereof insert the following:

SEC. 230. CAPITAL LOSS CARRYOVERS FOR TAXPAYERS OTHER THAN CORPORATIONS.

(a) IN GENERAL.—Section 1212 (relating to capital loss carryover) is amended—

(1) by striking out "If for any taxable year the taxpayer" and inserting in lieu thereof:

"(a) CORPORATIONS.—If for any taxable year a corporation"; and

(2) by adding at the end thereof the following new subsection:

"(b) OTHER TAXPAYERS.—

"(1) IN GENERAL.—If a taxpayer other than a corporation has a net capital loss for any taxable year beginning after December 31, 1963—

"(A) the excess of the net short-term capital loss over the net long-term capital gain for such year shall be a short-term capital loss in the succeeding taxable year, and

"(B) the excess of the net long-term capital loss over the net short-term capital gain for such year shall be a long-term capital loss in the succeeding taxable year.

For purposes of this paragraph, in determining such excesses an amount equal to the excess of the sum allowed for the taxable year under section 1211(b) over the gains from sales or exchanges of capital assets (determined without regard to this sentence) shall be treated as a short-term capital gain in such year.

"(2) TRANSITIONAL RULE.—In the case of a taxpayer other than a corporation, there shall be treated as a short-term capital loss in the first taxable year beginning after December 31, 1963, any amount which is treated as a short-term capital loss in such year under this subchapter as in effect immediately before the enactment of the Revenue Act of 1964."

(b) TECHNICAL AMENDMENTS.—

(1) Section 1222(9) (relating to net capital gain) is amended to read as follows:

"(9) NET CAPITAL GAIN.—In the case of a corporation, the term 'net capital gain' means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges."

(2) The second sentence of section 1222(10) (relating to net capital loss) is amended by striking out "For the purpose" and inserting in lieu thereof "In the case of a corporation, for the purpose".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1963.

And the Senate agree to the same.

Amendment numbered 167:

That the House recede from its disagreement to the amendment of the Senate numbered 167, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *231*; and the Senate agree to the same.

Amendment numbered 168:

That the House recede from its disagreement to the amendment of the Senate numbered 168, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *232*; and the Senate agree to the same.

Amendment numbered 177:

That the House recede from its disagreement to the amendment of the Senate numbered 177, and agree to the same with an amendment as follows:

Page 81, line 11, of the Senate engrossed amendments, strike out "235" and insert: *233*; and the Senate agree to the same.

Amendment numbered 178:

That the House recede from its disagreement to the amendment of the Senate numbered 178, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *234*; and the Senate agree to the same.

Amendment numbered 179:

That the House recede from its disagreement to the amendment of the Senate numbered 179, and agree to the same with an amendment as follows:

Strike out the matter proposed to be stricken out and in lieu of the matter proposed to be inserted by the Senate amendment insert the following: *235*; and the Senate agree to the same.

Amendment numbered 185:

That the House recede from its disagreement to the amendment of the Senate numbered 185, and agree to the same with an amendment, as follows:

Strike out the matter proposed to be stricken out and insert the matter proposed to be inserted by the Senate amendment and on page 268 of the House engrossed bill strike out lines 20, 21, and 22, and insert:

> *(C) Adopted Child—For purposes of this section, a legally adopted child of an individual shall be treated as a child of such individual by blood.*

And the Senate agree to the same.

Amendment numbered 193:

That the House recede from its disagreement to the amendment of the Senate numbered 193, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 236. VALIDITY OF TAX LIENS AGAINST PURCHASERS OF MOTOR VEHICLES.

(a) PURCHASERS WITHOUT ACTUAL NOTICE OR KNOWLEDGE OF LIEN.—Section 6323 (relating to validity of liens for Federal taxes) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) EXCEPTION IN CASE OF MOTOR VEHICLES.—

"(1) EXCEPTION.—Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a motor vehicle, as defined in paragraph (2) of this subsection, as against any purchaser of such motor vehicle for an adequate and full consideration in money or money's worth if—

"(A) at the time of the purchase the purchaser is without notice or knowledge of the existence of such lien, and

"(B) before the purchaser obtains such notice or knowledge, he has acquired possession of such motor vehicle and has not thereafter relinquished possession of such motor vehicle to the seller or his agent.

"(2) DEFINITION OF MOTOR VEHICLE.—As used in this subsection, the term 'motor vehicle' means a self-propelled vehicle which is registered for highway use under the laws of any State or foreign country."

(b) LIENS FOR ESTATE AND GIFT TAXES.—Section 6324 (relating to special lien for estate and gift taxes) is amended by adding at the end thereof the following new subsection:

"(d) EXCEPTION IN CASE OF MOTOR VEHICLES.—The lien imposed by subsection (a) or (b) shall not be valid with respect to a motor vehicle, as defined in section 6323(d)(2), as against any purchaser of such motor vehicle for an adequate and full consideration in money or money's worth if—

"(1) at the time of the purchase the purchaser is without notice or knowledge of the existence of such lien, and

"(2) before the purchaser obtains such notice or knowledge, he has acquired possession of such motor vehicle and has not thereafter relinquished possession of such motor vehicle to the seller or his agent."

(c) CLERICAL AMENDMENTS.—

(1) Section 6323(a) is amended by striking out "subsection (c)" and inserting in lieu thereof "subsections (c) and (d)".

(2) Section 6324 is amended by inserting after "subsection (c) (relating to transfers of securities)" in subsections (a) and (b) the following: "and subsection (d) (relating to purchases of motor vehicles)".

(d) EFFECTIVE DATES.—The amendments made by this section shall apply only with respect to purchases made after the date of the enactment of this Act.

And the Senate agree to the same.

Amendment numbered 194:

That the House recede from its disagreement to the amendment of the Senate numbered 194, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 237. EXCLUSION OF EARNED INCOME OF CERTAIN UNITED STATES CITIZENS WHO ARE RESIDENTS OF FOREIGN COUNTRIES.

(a) REDUCTION OF LIMITATION.—Subparagraph (B) of section 911(c)(1) (relating to limitations on amount of exclusion) is amended by striking out "$35,000" and inserting in lieu thereof "$25,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1964.

And the Senate agree to the same.

Amendment numbered 196:

That the House recede from its disagreement to the amendment of the Senate numbered 196, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 238. LOSSES ARISING FROM CONFISCATION OF PROPERTY BY CUBA.

Section 165 (relating to losses) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) CERTAIN PROPERTY CONFISCATED BY CUBA.—For purposes of this chapter, any loss of tangible property, if such loss arises from expropriation, intervention, seizure, or similar taking by the government of Cuba, any political subdivision thereof, or any agency or instrumentality of the foregoing, shall be treated as a loss from a casualty within the meaning of subsection (c)(3)."

And the Senate agree to the same.

Amendment numbered 197:

That the House recede from its disagreement to the amendment of the Senate numbered 197, and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SEC. 239. CREDIT OR REFUND OF SELF-EMPLOYMENT TAX.

Section 6511 (relating to limitations on credit or refund) is amended by adding at the end of subsection (d) the following new paragraph:

> *"(5) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO SELF-EMPLOYMENT TAX IN CERTAIN CASES.—If the claim for credit or refund relates to an overpayment of the tax imposed by chapter 2 (relating to the tax on self-employment income) attributable to an agreement, or modification of an agreement, made pursuant to section 218 of the Social Security Act (relating to coverage of State and local employees), and if the allowance of a credit or refund of such overpayment is otherwise prevented by the operation of any law or rule*

of law other than section 7122 (relating to compromises), such credit or refund may be allowed or made if claim therefor is filed on or before the later of the following dates: (A) the last day of the second year after the calendar year in which such agreement (or modification) is agreed to by the State and the Secretary of Health, Education, and Welfare, or (B) December 31, 1965."

And the Senate agree to the same.

Amendment numbered 198:

That the House recede from its disagreement to the amendment of the Senate numbered 198, and agree to the same with amendments as follows:

Page 92, line 2, of the Senate engrossed amendments, strike out "243" and insert: *240*

Page 93, line 3, of the Senate engrossed amendments, after "1939" insert: *attributable to such interest, including any extensions thereof,*

And the Senate agree to the same.

W. D. MILLS,
CECIL R. KING,
THOS. J. O'BRIEN,
HALE BOGGS,
JOHN W. BYRNES,
VICTOR A. KNOX,
Managers on the Part of the House.

HARRY F. BYRD,
RUSSELL B. LONG,
GEORGE SMATHERS,
CLINTON P. ANDERSON,
JOHN J. WILLIAMS,
FRANK CARLSON,
WALLACE F. BENNETT,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 8363) to amend the Internal Revenue Code of 1954 to reduce individual and corporate income taxes, to make certain structural changes with respect to the income tax, and for other purposes, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

The following Senate amendments made technical, clerical, clarifying, or conforming changes: 2, 3, 5, 6, 7, 9, 14, 15, 19, 22, 24, 27, 28, 33, 34, 38, 39, 40, 44, 45, 48, 49, 50, 51, 52, 55, 62, 63, 65, 68, 69, 72, 73, 75, 77, 78, 79, 80, 89, 90, 92, 93, 94, 98, 101, 103, 104, 110, 112, 113, 115, 118, 120, 121, 122, 123, 125, 126, 127, 128, 130, 134, 135, 136, 138, 140, 142, 143, 144, 145, 146, 147, 148, 149, 150, 152, 154, 155, 156, 157, 158, 159, 160, 161, 167, 168, 169, 170, 172, 173, 174, 175, 176, 178, 179, 180, 181, 182, 183, 184, 185, 186, 187, 188, 189, 190, 191, and 192. With respect to these amendments (1) the House either recedes or recedes with amendments which are technical, clerical, clarifying, or conforming in nature; or (2) the Senate recedes in order to conform to other action agreed upon by the committee of conference.

DECLARATION BY CONGRESS

Amendment No. 1: Section 1 of the bill as passed by the House provided that it is the sense of Congress that the tax reduction provided by the bill, through stimulation of the economy, will, after a brief transitional period, raise (rather than lower) revenues and that such revenue increases should first be used to eliminate the deficits in the administrative budgets and then to reduce the public debt. Such section also provided that, to further the objective of obtaining balanced budgets in the near future, Congress by this action recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective. Senate amendment No. 1 strikes out this section of the bill.

The Senate recedes.

REDUCTION OF TAX RATES—RETIREMENT INCOME CREDIT

Amendment No. 4: Section 37(a) of the code provides the general rule that the credit against tax for retirement income shall be determined by multiplying the retirement income (as defined in and limited by sec. 37) by the rate provided in section 1 of the code (relating to tax imposed on individuals) for the first $2,000 of taxable income. The bill as passed by the House provided that the credit shall be equal to 15 percent of such retirement income. Senate amendment

No. 4 retains the change made by the bill as passed by the House except that in the case of a taxable year beginning in 1964 the amendment provides that the credit shall be equal to 17 percent of such retirement income.

The House recedes.

RETIREMENT INCOME CREDIT IN CASE OF CERTAIN JOINT RETURNS

Amendment No. 8: Section 37 of the code provides a credit against tax for retirement income. To be eligible for the credit, an individual must have received earned income in excess of $600 in each of 10 calendar years before the taxable year and (except in the case of pensions and annuities under a public retirement system) must have attained the age of 65 before the close of the taxable year. Under section 37(d) of the code the amount of retirement income taken into account in the case of any individual may not exceed $1,524 less (1) amounts received in the taxable year as pensions and annuities (including social security and railroad retirement benefits) which are excluded from gross income, and (2) if the individual has not attained the age of 72, adjustments for earned income received in the taxable year.

Senate amendment No. 8 adds a new subsection (i) to section 37 of the code. The new subsection provides an increase in the $1,524 amount in the case of certain joint returns where both the husband and wife have attained age 65 before the close of the taxable year. If both spouses meet the 10-year earned income requirement and if in the case of either spouse the sum of the retirement income and of the amounts described in paragraphs (1) and (2) of section 37(d) of the code which reduce the $1,524 amount is less than $762, then the $1,524 amount is to be increased with respect to the other spouse by an amount equal to the excess of $762 over such sum. If either spouse does not meet the 10-year earned income requirement, the $1,524 amount is to be increased with respect to the other spouse by an amount equal to the excess of $762 over the amounts described in paragraphs (1) and (2) of section 37(d) of the code received by his spouse.

The House recedes with an amendment. Under the conference agreement, a husband and wife who make a joint return for the taxable year and both of whom have attained the age of 65 before the close of the taxable year may elect to determine the amount of the credit allowed by section 37(a) of the code by applying the special rules of the new section 37(i)(2). These special rules provide that (1) if either spouse meets the 10-year earned income requirement the other spouse shall be considered as also meeting that requirement, and (2) section 37(d) (relating to limitation on retirement income) shall be considered as providing that the amount of the combined retirement income of both spouses is not to exceed $2,286 less the sum of the amounts for each spouse specified in paragraphs (1) and (2) of section 37(d) (that is, amounts received in the taxable year as pensions and annuities which are excluded from gross income, and amounts representing adjustments for certain earned income received during the taxable year). Under the conference agreement, this new provision will apply to taxable years beginning after December 31, 1963.

EFFECTIVE DATE FOR REPEAL OF REQUIREMENT THAT BASIS OF SECTION 38 PROPERTY BE REDUCED BY 7 PERCENT

Amendments Nos. 10, 11, 12, 13, 16, 17, and 18: Section 48(g) of the code requires the basis of any section 38 property (that is, property with respect to which an investment credit is allowable) to be reduced by an amount equal to 7 percent of the qualified investment with respect to such property. The bill as passed by the House repealed section 48(g) of the code, provided special rules to increase the basis of property placed in service before July 1, 1963 (the effective date of the repeal), and made conforming changes in the code. The repeal and conforming changes apply (1) in the case of property placed in service after June 30, 1963, with respect to taxable years ending after such date, and (2) in the case of property placed in service before July 1, 1963, with respect to taxable years beginning after June 30, 1963.

Senate amendments Nos. 10, 11, 12, 13, 16, 17, and 18 change the "June 30, 1963" and "July 1, 1963" dates to "December 31, 1963" and "January 1, 1964", respectively, for purposes of both the effective date provisions and the special rules relating to property placed in service before the effective date.

The House recedes.

GROUP-TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES

Amendment No. 20: The bill as passed by the House added a new section 79 to the code. In general, the new section 79 requires an employee to include in gross income for the taxable year an amount equal to the cost of group-term life insurance on his life under policies carried by his employers, but only to the extent that such cost exceeds the sum of (1) the cost of so much of such insurance as does not exceed $30,000 of such protection, and (2) the amount (if any) paid by the employee toward the purchase of the insurance.

Senate amendment No. 20 in effect increases the $30,000 amount referred to above to $70,000.

The House recedes with an amendment. Under the conference agreement the new section 79 of the code requires an employee to include in gross income for the taxable year an amount equal to the cost of group-term life insurance on his life under policies carried by his employers, but only to the extent that such cost exceeds the sum of (1) the cost of $50,000 of such insurance, and (2) the amount (if any) paid by the employee toward the purchase of such insurance. In providing for the inclusion, to the extent specified, in a taxpayer's income of certain amounts representing the cost of group-term life insurance, it is not intended that such insurance include the death benefits in so-called travel insurance or accident and health policies where such policies do not provide general death benefits.

Amendment No. 21: Under the bill as passed by the House the cost of group-term life insurance on the life of an employee provided during any period was to be determined on the basis of uniform premiums (computed on the basis of 5-year age brackets); except that, at the election of the employer with respect to any employee, the cost was to be determined on the basis of the actual average premium cost under the policy for the ages included within the age bracket which would be applicable to the employee but for the election.

Senate amendment No. 21 deletes the election (policy cost method) so that the cost is to be determined in all cases under the uniform premium method.

The House recedes. It is the understanding of the conferees that the Treasury Department will study the table of premiums at attained ages contained in the committee reports on the bill to see whether this table should not be replaced by a table which reflects the most recent mortality experience and which may possibly make some allowance for expense factors.

Amendment No. 23: The bill as passed by the House added a new section 218 to the code to provide a deduction in the case of certain employees where group-term life insurance in excess of $30,000 is provided under policies carried by his employers. The deduction in the case of any employee was to be an amount equal to the excess (if any) of (1) the amount paid by the employee toward the purchase of such insurance in excess of $30,000, over (2) the cost of such insurance in excess of $30,000 (such cost to be determined in a specified manner).

Senate amendment No. 23 strikes out this provision.

The House recedes.

Amendments Nos. 25 and 26: Under the bill as passed by the House, the cost of group-term life insurance included in the income of the employee under the new section 79 was not excluded from income tax withholding. Under Senate amendment No. 25, no part of the cost of group-term life insurance is to be subject to income tax withholding. Senate amendment No. 26 adds a new section 6052 to the code (1) to require the employer to file an information return setting forth the cost of such insurance, to the extent such cost is includible in the gross income of the employee, and (2) to furnish a statement to the employee showing the cost shown on the return. This amendment also makes conforming changes in section 6678 of the code, relating to penalty for failure to furnish statements.

The House recedes with a clerical amendment.

Amendment No. 29: The new section 79(b) of the code provides exceptions to the general rule of section 79(a) which requires an employee to include in gross income a portion of the cost of certain group-term life insurance. Under section 79(b)(2)(B), the general rule is not to apply to the cost of any portion of the group-term life insurance on the life of an employee provided during part or all of the taxable year of the employee under which a person described in section 170(c) of the code (relating to definition of charitable contributions) is the sole beneficiary. The effect of Senate amendment No. 29 is to treat the insurance contract as satisfying this condition for the period beginning January 1, 1964, and ending April 30, 1964, in the case of a taxable year beginning before May 1, 1964, if the condition is satisfied for the portion after April 30, 1964, of the employee's first taxable year ending after such date.

The House recedes.

INCLUSION IN GROSS INCOME OF REIMBURSED MEDICAL EXPENSES TO THE EXTENT THAT THE REIMBURSEMENT EXCEEDS THE EXPENSES

Amendment No. 30: Section 204 of the bill as passed by the House added a new section 80 to the code. The new section 80 required that amounts received through accident or health insurance for medical expenses be included in gross income to the extent the aggregate of such amounts received for any personal injury or sickness exceeds the aggregate amount of the medical expenses incurred by the taxpayer for such injury or sickness.

Senate amendment No. 30 strikes out this section of the bill.

The House recedes.

AMOUNTS RECEIVED UNDER WAGE CONTINUATION PLANS

Amendment No. 31: Section 105(d) of the code (relating to wage continuation plans) provides (subject to a $100 weekly rate limitation) that gross income does not include amounts received as accident or health insurance if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injury or sickness. Under existing law, in the case of a period during which the employee is absent from work on account of sickness, the exclusion from gross income does not apply to amounts (sick pay) attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of sickness for at least 1 day during such period.

Under the bill as passed by the House, the exclusion from gross income was not to apply to amounts (sick pay) attributable to the first 30 calendar days in any period of absence from work on account of personal injury or sickness. Senate amendment No. 31 has the same effect as the bill as passed by the House where the amounts (sick pay) received exceed 75 percent of the regular weekly rate of wages of the employee. Under the Senate amendment, if the amounts (sick pay) received are less than 75 percent of the regular weekly rate of wages of the employee, the exclusion from gross income is not to apply to amounts attributable to the first 7 calendar days in the period of absence from work unless the employee is hospitalized on account of sickness for at least 1 day during such period.

The House recedes with an amendment which provides that if the amounts (sick pay) received are at a rate not exceeding 75 percent of the employee's regular weekly rate of wages, the exclusion from gross income is to apply to amounts attributable to the first 30 calendar days of the period of absence to the extent of a weekly rate of $75, but is not to apply to amounts attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of personal injuries or sickness for at least 1 day during such period.

DENIAL OF DEDUCTIONS FOR CERTAIN STATE, LOCAL, AND FOREIGN TAXES

Amendment No. 32: Section 207 of the bill as passed by the House amended section 164 of the code (relating to deduction of taxes) to provide for the allowance of a deduction for those State, local, and foreign taxes listed in the bill. Senate amendment No. 32 adds to the list:

(1) State and local taxes on the sale of gasoline, diesel fuel, and other motor fuels; and

(2) State and local taxes on the registration or licensing of highway motor vehicles and on licenses for the operation of highway motor vehicles.

The House recedes with an amendment. Under the conference action, State and local taxes on the sale of gasoline, diesel fuel, and other motor fuels will remain deductible. However, State and local taxes on the registration or licensing of highway motor vehicles and on licenses for the operation of highway motor vehicles will no longer be deductible (unless paid or accrued in carrying on a trade or business or an activity described in sec. 212 of the code).

Amendment No. 35: In amending section 164 of the code, the bill as passed by the House eliminated the deduction permitted by existing section 164(b)(5)(B) of the code for certain taxes assessed against local benefits levied by special taxing districts described in such section. The effect of Senate amendment No. 35 is to continue the allowance of the deduction for such taxes if the special taxing district was in existence on December 31, 1963, and the taxes are levied for the purpose of retiring indebtedness existing on such date.

The House recedes.

CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS

Amendment No. 36: Under existing section 170(b)(1)(C) of the code, an individual is allowed an unlimited charitable contribution deduction if in the taxable year, and in 8 of the 10 preceding taxable years, the charitable contributions and the income taxes paid by the taxpayer during such year exceed 90 percent of his taxable income computed without deduction for charitable contributions, personal exemptions, and net operating loss carrybacks. Under existing law, the unlimited charitable contribution deduction is computed by reference to charitable contributions to those organizations to which the general 20-percent limitation applies, whether or not those organizations are ones to which the additional 10-percent limitation also applies.

This amendment redesignates subparagraph (D) of section 170(b)(1) of the code as subparagraph (E) and inserts a new subparagraph (D) which provides, in effect, that if the taxable year begins after December 31, 1963—

(1) section 170(b)(1)(C) shall apply only at the election of the taxpayer; and

(2) in determining whether the 90-percent requirement is satisfied in the taxable year and in 8 of the 10 preceding taxable years, the amount of the charitable contributions for the taxable year (and for all prior taxable years beginning after December 31, 1963) is to be determined without the application of section 170(b)(5) of the code (carryover of certain excess contributions by individuals, added by Senate amendment No. 37) and solely by reference to charitable contributions described in section 170(b)(1)(A) of the code, as amended by section 209(a) of the bill (i.e., contributions to those organizations to which the additional 10-percent limitation applies).

If the taxpayer elects to have section 170(b)(1)(C) apply for the taxable year, then for such taxable year the deduction under section 170(a) of the code applies only with respect to charitable contributions to those organizations to which the additional 10-percent limitation applies. In addition, no amount of charitable contributions made in the taxable year or any prior taxable year may be treated under the new section 170(b)(5) as having been made in the taxable year or in any succeeding taxable year.

The House recedes with amendments. Under the conference agreement, section 170 of the code is amended by inserting after subsection (f) (added by subsec. (e) of sec. 209 of the bill) a new subsection (g).

Paragraph (1) of such new subsection (g) provides that if the taxable year begins after December 31, 1963—

(A) section 170(b)(1)(C) shall apply only at the election of the taxpayer; and

(B) in determining whether the 90-percent requirement is satisfied in the taxable year and in 8 of the 10 preceding taxable years, the amount of the charitable contributions for the taxable year (and for all prior taxable years beginning after December 31, 1963) is to be determined without the application of section 170(b)(5) of the code (carryover of certain excess contributions by individuals, added by Senate amendment No. 37) and solely by reference to the charitable contributions which are described in paragraph (2) of new subsection (g).

If the taxpayer elects to have section 170(b)(1)(C) apply for the taxable year, then for such taxable year, the deduction under section 170(a) of the code applies only with respect to charitable contributions which are described in paragraph (2) of new subsection (g). In addition, no amount of charitable contributions made in the taxable year or any prior taxable year may be treated under section 170(b)(5) as having been made in the taxable year or in any succeeding taxable year.

Under the conference agreement, the charitable contributions, which are referred to in paragraph (1) and described in paragraph (2) of new subsection (g), which qualify for application of the unlimited charitable contribution deduction are—

(A) any charitable contribution described in section 170(b)(1)(A) of the code;

(B) any charitable contribution, not described in section 170(b)(1)(A) of the code, to an organization described in section 170(c)(2) of the code (certain organizations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals) substantially more than half of the assets of which is devoted directly to, and substantially all of the income of which is expended directly for, the active conduct of the activities constituting the purpose or function for which it is organized and operated (as distinguished from making contributions to other organizations organized and operated for such purpose or function);

(C) any charitable contribution, not described in section 170(b)(1)(A) of the code, to an organization described in section 170(c)(2) of the code which meets the requirements of new subsection (g)(3) with respect to such charitable contribution; and

(D) any charitable contribution taken into account under existing section 170(b)(1)(C) of the code payment of which is made on or before the date of the enactment of the bill.

Under the conference agreement, a contribution to an organization which is referred to in new subsection (g)(2)(C) qualifies only if such organization meets the two requirements described in new subsection (g)(3) with respect to such contribution. The first of such requirements is that—

(A) not later than the close of the third year after the organization's taxable year in which the contribution is received (or before such later time as the Secretary of the Treasury or his delegate may allow upon good cause shown by such organization), such organization expends an amount equal to at least 50 percent of such contribution for—

(i) the active conduct of the activities constituting the purpose or function for which it is organized and operated (as distinguished from making contributions to other organizations organized and operated for such purpose or function),

(ii) assets which are directly devoted to such active conduct,

(iii) contributions to organizations which are described in section 170(b)(1)(A) of the code or in paragraph (2)(B) of the new subsection (g), or

(iv) any combination of the foregoing.

If an amount expended as provided in subparagraph (A) is used to qualify any contribution under this 50-percent test, to the extent so used such amount may not be used as an expenditure for purposes of qualifying another contribution under subparagraph (A), whether such other contribution was made by the same donor or by another donor.

The second of such requirements with respect to such contribution is that—

(B) for the period beginning with the beginning of the taxable year in which such contribution is received and ending with the close of the taxable year in which the 50-percent test is satisfied with respect to such contribution, such organization expends all of its net income (determined without regard to capital gains and losses) for the purposes described in clauses (i), (ii), (iii), and (iv) of paragraph (3)(A).

If the organization has shown, to the satisfaction of the Secretary of the Treasury or his delegate, that good cause exists for extending the period during which the organization must expend an amount equal to 50 percent of the contribution in question, and the Secretary or his delegate allows such an extension, the requirement that the organization must expend all of its net income applies with respect to the organization's net income for the period beginning with the beginning of the taxable year in which such contribution is received and ending with the close of the taxable year in which it expends an amount equal to 50 percent of such contribution. Thus, for example, if the Secretary of the Treasury or his delegate extends the time within which an organization may expend an amount equal to at least 50 percent of a contribution until the close of the fifth taxable year after the organization's taxable year in which the contribution is received and the 50-percent test is satisfied during such fifth year, the requirement of subparagraph (B) is satisfied only if the net income for the 6-year period is expended as required by subparagraph (B). On the other hand, if the 50-percent test is satisfied during the taxable year in which the contribution is received, the requirement of subparagraph

(B) is satisfied if the net income for such taxable year is expended as required by subparagraph (B).

Under the conference agreement, subsection (g)(3) also provides the taxpayer with an election (to be exercised in accordance with regulations prescribed by the Secretary of the Treasury or his delegate) with respect to contributions made by him to an organization referred to in subsection (g)(2)(C). If the taxpayer so elects with respect to contributions made by him to such an organization, then, in applying the expenditure of income requirement with respect to contributions made by him to such organization during his taxable year for which such election is made and during all his subsequent taxable years, amounts expended by the organization after the close of any of its taxable years and on or before the 15th day of the third month following the close of such taxable year shall be treated as expended during such taxable year.

Under the conference agreement, for the contribution to qualify under section 170(b)(1)(C) of the code an additional requirement, as described in new subsection (g)(4) (disqualifying transactions), must be met by an organization referred to in new subsection (g)(2) (B) or (C). An organization shall be an organization referred to in new subsection (g)(2) (B) or (C) only if at no time during the period consisting of the organization's taxable year in which the contribution is received, its 3 preceding taxable years, and its 3 succeeding taxable years, such organization—

(A) lends any part of its income or corpus to;

(B) pays compensation (other than reasonable compensation for personal services actually rendered) to;

(C) makes any of its services available on a preferential basis to;

(D) purchases more than a minimal amount of securities or other property from; or

(E) sells more than a minimal amount of securities or other property to,

the donor of such contribution, any member of his family (as defined in section 267(c)(4) of the code), any employee of the donor, any officer or employee of a corporation in which he owns (directly or indirectly) 50 percent or more in value of the outstanding stock, or any partner or employee of a partnership in which he owns (directly or indirectly) 50 percent or more of the capital interest or profits interest. An exception to this provision makes it inapplicable to transactions which occurred on or before the date of the enactment of the bill.

Amendment No. 37: This amendment adds a new paragraph (5) to section 170(b) of the code to provide a 5-year carryover of certain charitable contributions made by individuals in taxable years beginning after December 31, 1963, where the amount of the contributions exceeds 30 percent of the taxpayer's adjusted gross income (computed without regard to net operating loss carrybacks). Under the amendment, the amount carried from a taxable year (and the amount thereof treated as paid in a succeeding taxable year) is determined solely by reference to charitable contributions to those organizations to which the additional 10-percent limitation applies.

The House recedes.

Amendment No. 41: The bill as passed by the House added a new subsection (f) to section 170 of the code to provide, in general, that payment of a charitable contribution which consists of a future interest in tangible personal property shall be treated as made only when all intervening interests in (and rights to the actual possession or enjoyment of) the property have expired or are held by persons other than the taxpayer (or certain related parties). The bill as passed by the House excepted from this rule any charitable contribution where the sole intervening interest or right is a nontransferable life interest reserved by the donor (or donors in the case of a joint gift by husband and wife). Senate amendment No. 41 strikes out this exception.

The House recedes on this amendment, but under the conference action on Senate amendment No. 42, the exception in the bill as passed by the House is restored with respect to transfers of future interests before July 1, 1964.

Amendment No. 42: Senate amendment No. 42 relates to the effective dates for the amendments made by the bill to section 170 of the code. In the case of individuals, the effective dates are the same as provided by the bill as passed by the House.

Under the bill as passed by the House, the amendments providing a 5-year carryover of charitable contributions made by corporations applied with respect to contributions which are paid (or treated as paid under sec. 170(a)(2) of the code) in taxable years beginning after December 31, 1963. Under Senate amendment No. 42, the amendments are to apply to taxable years beginning after December 31, 1963, with respect to contributions which are paid (or treated as paid under sec. 170(a)(2) of the code) in taxable years beginning after December 31, 1961.

The House recedes with an amendment (see discussion of Senate amendment No. 41).

LOSSES ARISING FROM EXPROPRIATION OF PROPERTY BY GOVERNMENTS OF FOREIGN COUNTRIES

Amendment No. 43: In general, the effect of this amendment is to permit a taxpayer to elect (for any taxable year ending after December 31, 1958) a 10-year carryover under section 172 of the code (relating to net operating loss deduction) of the portion of the net operating loss for such year attributable to a foreign expropriation loss for such year in lieu of the existing 3-year carryback and 5-year carryover. The 10-year carryover is not to apply unless the foreign expropriation loss equals or exceeds 50 percent of the net operating loss. The term "foreign expropriation loss" is defined to mean, for any taxable year, the sum of the losses sustained by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing. For this purpose, a debt which becomes worthless is to be treated as a loss to the extent of any deduction allowed under section 166(a) of the code.

The amount of any loss taken into account in determining a foreign expropriation loss may not exceed the taxpayer's adjusted basis for the property or bad debt in question since the foreign expropriation loss must arise from a loss described in section 165 of the code or a bad debt described in section 166; in both of these cases the deduction allowed may not exceed the adjusted basis for purposes of the sale or other disposition of the property.

If a taxpayer makes the election for a taxable year ending before January 1, 1964, special rules are provided (with respect to any year affected by the election) to extend to the close of December 31, 1965, the time for making or changing any choice or election under sections 901 through 905 of the code (relating to foreign tax credit) and to extend to the close of December 31, 1968, the time for assessing deficiencies and filing claims for refund or credit of overpayments.

The House recedes with a technical amendment.

CARE OF DEPENDENTS

Amendment No. 46: The bill as passed by both the House and the Senate amends section 214 of the code (relating to deduction for expenses for care of certain dependents). Under the bill as passed by the House, section 214(b)(1) limited the deduction under section 214(a) for any taxable year to $600, except that the $600 limit was to be increased (to an amount not above $900) by the amount of expenses incurred by the taxpayer for any period during which the taxpayer had two or more dependents (within the meaning of amended sec. 214(d)(1) of the code). In the case of a woman who is married, the increase in the limitation applied only for a period during which her husband is incapable of self-support because mentally or physically defective.

The effect of Senate amendment No. 46 is to retain the $900 amount for a period during which the taxpayer had two dependents, to increase the $900 amount to $1,000 for a period during which the taxpayer had three or more dependents, and to omit the provision which would limit the application of these new amounts in the case of married women.

The House recedes with an amendment which retains the $900 amount for a period during which the taxpayer had two or more dependents and omits the provision which would limit the application of this new amount in the case of married women.

Amendment No. 47: Under the bill as passed by the House, section 214(b) further provided, in the case of a woman who is married and in the case of a husband whose wife is incapacitated, that the deduction otherwise allowable under section 214(a)—

(1) would not be allowed unless the couple files a joint return; and

(2) would be reduced dollar for dollar to the extent that the couple's combined adjusted gross income exceeds $4,500.

These conditions did not apply in certain specified situations. The effect of the Senate amendment No. 47 is to retain these conditions and exceptions, except that the Senate amendment substitutes $7,000 for the $4,500 amount.

The House recedes with an amendment which provides that this amount will be $6,000.

DEDUCTION FOR POLITICAL CONTRIBUTIONS

Amendment No. 53: This amendment adds a new section 218 to the code. Section 218(a) provides that in the case of an individual, there shall be allowed as a deduction any political contribution payment of which is made by the taxpayer within the taxable year. Section 218(b) limits the deduction to $50 for any taxable year, except that in the case of a joint return of a husband and wife the limit is $100.

The Senate recedes.

100-PERCENT DIVIDENDS-RECEIVED DEDUCTION FOR MEMBERS OF ELECTING AFFILIATED GROUPS

Amendment No. 54: This amendment adds a new section to the bill which amends section 243 of the code (relating to the deduction for certain dividends received by corporations) to provide a 100-percent deduction in the case of "qualifying dividends", and makes conforming technical amendments.

As amended, section 243(b)(1) defines the term "qualifying dividends" to mean dividends received by a corporation which (at the close of the day the dividends are received) is a member of the same affiliated group of corporations (as defined in sec. 243(b)(5)) as the corporation distributing the dividends, if (1) such affiliated group has made an election under section 243(b)(2) which is effective for the taxable years of its members which include such day; and (2) the dividends are distributed out of earnings and profits of a taxable year of the distributing corporation ending after December 31, 1963, with respect to which two requirements are satisfied. First, the distributing corporation and the recipient corporation must have been members of such affiliated group on each day of such taxable year. Second, an election under section 1562 (relating to election of multiple surtax exemptions) must not be effective for such taxable year.

Section 243(b)(2) prescribes rules for the making of an election and the taxable years to which it applies. Under section 243(b)(3), if an election by an affiliated group is effective with respect to a taxable year of the common parent corporation, then under regulations prescribed by the Secretary of the Treasury or his delegate—

(1) no member of such affiliated group may consent to an election under section 1562 for such taxable year;

(2) the members of such group will be treated as one taxpayer for purposes of making the elections under section 901(a) (relating to allowance of foreign tax credit) and section 904(b)(1) (relating to election of overall limitation); and

(3) the members of such affiliated group will be limited to (i) one $100,000 minimum accumulated earnings credit under section 535(c) (2) or (3); (ii) one $100,000 limitation for exploration expenditures under section 615 (a) and (b); (iii) one $400,000 limitation for exploration expenditures under section 615(c)(1); (iv) one $25,000 limitation on small business deductions of life insurance companies under sections 804(a)(4) and 809(d)(10); and (v) one $100,000 exemption for purposes of estimated tax filing requirements under section 6016 and the addition to tax under section 6655 for failure to pay estimated tax.

Section 243(b)(4) provides for the termination of an election under section 243(b)(2) either by the filing by the group of a termination of the election or by the filing of a statement by a new member of the group that it does not consent to the election.

Section 243(b)(5) provides that the term "affiliated group" has the meaning assigned to it by section 1504(a) of the code except that for purposes of the 100-percent dividends received deduction insurance companies subject to taxation under section 802 or 821 of the code are not to be excluded by section 1504(b)(2) from a group and are not to be considered under section 1504(c) as a separate group. Section 243(b)(6) provides special rules for insurance companies.

The amendments providing for the 100-percent dividends received deduction are to apply with respect to dividends received in taxable years ending after December 31, 1963.

The House recedes with a clerical amendment.

INTEREST ON LOANS INCURRED TO PURCHASE CERTAIN INSURANCE AND ANNUITY CONTRACTS

Amendment No. 56: The bill as passed by the House amended section 264 of the code to provide that, under certain circumstances, no deduction is allowed for interest on loans incurred or continued to purchase or carry certain life insurance, endowment, or annuity contracts. This new provision was to apply only in respect of contracts purchased after August 6, 1963. Under the Senate amendment No. 56 this new provision applies only in respect of contracts purchased after December 31, 1963.

The Senate recedes.

INTEREST ON INDEBTEDNESS INCURRED OR CONTINUED TO PURCHASE OR CARRY TAX-EXEMPT BONDS

Amendment No. 57: Section 265(2) of the code provides that no deduction shall be allowed for interest on indebtedness incurred or continued to purchase or carry obligations (other than certain obligations of the United States) the interest on which is wholly exempt from income tax. Under Senate amendment No. 57, a new sentence is added to section 265(2) to provide that, in applying the preceding sentence to a financial institution (other than a bank) which is subject to the banking laws of the State in which such institution is incorporated, interest—

(1) on face-amount certificates (as defined in sec. 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C. 80a–2)) issued by the institution; and

(2) on amounts received by such institution to be applied toward the purchase of such face-amount certificates to be issued by the institution—

is not to be considered as interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from income tax to the extent that the average amount of such obligations held by such institution during the taxable year (as determined under regulations prescribed by the Secretary of the Treasury or his delegate) does not exceed 25 percent of the average of the total assets of the institution during the taxable year (as so determined). The new provision is to apply with respect to taxable years ending after the date of the enactment of the bill.

The House recedes with amendments. Under the conference agreement, the new sentence added to section 265(2) of the code by the Senate amendment is to apply only with respect to interest on face-amount certificates, and on amounts received toward the purchase of such certificates, issued by a face-amount certificate company (registered under the Investment Company Act of 1940), and the percentage contained in the new sentence is reduced to 15 percent. In providing that the financial institutions specified in this provision are not to be denied interest deductions under section 265(2) of the code to the extent that the average amount invested by such an institution in tax-free obligations does not exceed 15 percent of the average of its total assets, it is not intended to imply that an interest deduction is to be denied because of investments in excess of the specified 15-percent level if the taxpayer establishes that indebtedness was not "incurred or continued to purchase or carry" these excess obligations. Nor is it intended that any inference with respect to years before the effective date of this provision be drawn from the enactment of this provision.

ALLOCATION OF CERTAIN TRAVELING EXPENSES

Amendment No. 58: Section 274(c) of the code provides that in the case of any individual who is traveling away from home in pursuit of a trade or business or in pursuit of an activity described in section 212, no deduction shall be allowed under section 162 or section 212 for that portion of the expenses of such travel otherwise allowable under such section which, under regulations prescribed by the Secretary of the Treasury or his delegate, is not allocable to such trade or business or to such activity. Such provision, however, does not apply to the expenses of any travel away from home which does not exceed 1 week or where the portion of the time away from home which is not attributable to the pursuit of the taxpayer's trade or business or to an activity specified in section 212 is less than 25 percent of the total time away from home on such travel. Senate amendment No. 58 strikes out subsection (c) of section 274 of the code, effective with respect to taxable years ending after December 31, 1962, but only in respect of periods after such date.

The House recedes with an amendment which, in effect, retains section 274(c) of the code but limits its application to foreign travel. Under the conference agreement, section 274(c) will only apply to an individual's travel outside the United States away from home. Travel from one point in the United States to another point in the United States is not to be considered travel outside the United States, even though it may constitute a portion of the trip in which the taxpayer travels to a point outside the United States. Section 274(c), as amended, will not apply to the expenses of any travel outside the United States away from home, if such travel does not exceed 1 week, or if the portion of the time of travel outside the United States away from home which is not attributable to the pursuit of the taxpayer's trade or business or an activity described in section 212 is less than 25 percent of the total time on such travel. Section 274(c), as amended, will apply with respect to taxable years ending after December 31, 1962, but only in respect of periods after such date.

ACQUISITION OF STOCK IN EXCHANGE FOR STOCK OF CORPORATION WHICH IS IN CONTROL OF ACQUIRING CORPORATION

Amendment No. 59: Under existing section 368(a)(1)(B) of the code, the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation qualifies as a "reorganization" if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition). Under Senate amendment No. 59, section 368(a)(1)(B) is amended to permit an acquiring corporation to exchange either its voting stock or the voting stock of a corporation which is in control of the acquiring corporation for the stock of another corporation. The amendment also makes technical and conforming changes. The amendments apply with respect to transactions after December 31, 1963, in taxable years ending after such date.

The House recedes with a clerical amendment.

RETROACTIVE QUALIFICATION OF CERTAIN UNION-NEGOTIATED MULTIEMPLOYER PENSION PLANS

Amendment No. 60: Section 401 of the code relates to qualified pension, profit-sharing, and stock bonus plans. Senate amendment No. 60 inserts a new subsection (i) in section 401.

The new subsection (i) applies to a trust forming part of a pension plan which has been determined by the Secretary of the Treasury or his delegate to constitute a qualified trust under section 401(a), and to be exempt from taxation under section 501(a), for a period beginning after contributions were first made to or for such trust. The new subsection (i) provides that where such a trust meets certain conditions, then it shall be considered as having constituted a qualified trust under section 401(a), and as having been exempt from taxation under section 501(a), for the period beginning on the date on which contributions were first made to or for such trust and ending on the date such trust first constituted (without regard to the new subsection) a qualified trust.

The conditions referred to in the preceding paragraph require that it be shown to the satisfaction of the Secretary of the Treasury or his delegate that: (1) Such trust was created pursuant to a collective bargaining agreement between employee representatives and two or more employers who are not related (determined under regulations prescribed by the Secretary of the Treasury or his delegate); (2) any disbursements made prior to the period for which the trust was determined to be qualified (without regard to the new subsection) substantially comply with the terms of the trust (and plan) as so qualified; and (3) prior to the period for which the trust was determined to be qualified (without regard to the new subsection) contributions were not used in a manner which would jeopardize the interests of the beneficiaries.

The new subsection (i) is to apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954, but only with respect to contributions made after December 31, 1954.

The House recedes with a clerical amendment.

QUALIFIED PENSION, ETC., PLAN COVERAGE FOR EMPLOYEES OF CERTAIN SUBSIDIARY EMPLOYERS

Amendment No. 61: This amendment adds a new section to the bill, relating to qualified pension, etc., plan coverage for employees of certain subsidiary employers.

Employees of foreign subsidiaries covered by social security agreements

Subsection (a) of the new section adds a new section 406 to part I of subchapter D of chapter 1 of the code.

(*a*) *Treatment as employees of domestic corporation.*—The new section 406(a) sets forth the rules relating to the treatment of certain employees of foreign subsidiaries who are covered under a social security agreement described in section 3121(l) of the code, entered into at the request of the domestic corporation, as employees of such domestic corporation. The new section 406(a) only applies in the case of a plan established and maintained by a domestic corporation which is a pension, profit-sharing, or stock bonus plan described in section 401(a) of the code, an annuity plan described in section 403(a) of the code, or a bond purchase plan described in section 405(a) of the code. The new section 406(a) provides that in the case of such a plan an individual who is a citizen of the United States and who is also an employee of a foreign subsidiary (as defined in sec. 3121(l)(8) of the code) of the domestic corporation shall be treated as an employee of such domestic corporation if certain requirements are satisfied.

The first of the requirements of the new section 406(a) is that the domestic corporation has entered into an agreement described in section 3121(l) of the code, relating to agreements entered into by domestic corporations with respect to foreign subsidiaries, and such agreement covers the foreign subsidiary of the domestic corporation in which the individual is employed.

The second requirement is that the qualified plan of the domestic employer must expressly provide coverage for the U.S. citizen employees of all foreign subsidiaries which are covered under the agreement described in section 3121(l) of the code which has been entered into by the domestic corporation.

The third requirement for qualification of an individual as an employee is that contributions under a funded plan of deferred compensation (whether or not such plan is a qualified plan) are not provided by any other person with respect to the remuneration paid to such individual by the foreign subsidiary.

(*b*) *Special rules for application of section 401(a).*—The new section 406(b) provides certain special rules for the application of section 401(a) of the code in the case of a plan which covers an individual who is treated as an employee of a domestic corporation under the new section 406(a).

Paragraph (1) of such section 406(b) provides certain rules regarding the application of section 401(a) (3)(B) and (4) of the code in the case of a plan which covers such an individual. Paragraph (1)(A) of section 406(b) provides that if such an individual is an officer, shareholder, or person whose principal duties consist in supervising the work of other employees of a foreign subsidiary of such domestic corporation, he shall be treated as having such capacity with respect to the domestic corporation. Paragraph (1)(B) of section 406(b) provides that the determination of whether an individual who is treated as an employee under the new section 406(a) is a highly compensated employee for purposes of section 401(a) (3)(B) and (4) of the code is made by treating such individual's total compensation (as computed in accordance with the provisions of par. (2) of sec. 406(b)) as compensation paid by the domestic corporation and by determining such individual's status as a highly compensated employee with regard to such domestic corporation.

Paragraph (2) of the new section 406(b) sets forth the rules regarding determination of the compensation of an individual who is treated as an employee of a domestic corporation under section 406(a) of the code. Such rules are applicable whenever the compensation of such an individual is to be determined for the purpose of determining whether the plan satisfies the requirements for qualification set forth in section 401(a). Paragraph (2)(A) of section 406(b) provides that, for the purpose of applying section 401(a)(5) with respect to such an individual, his total compensation is the remuneration paid to him by the foreign subsidiary which would constitute his total compensation if his services had been performed for the domestic corporation treated as his employer. In addition, such paragraph (2)(A) provides that the portion of the individual's total compensation which constitutes his basic or regular rate of compensation shall be determined under regulations prescribed by the Secretary of the Treasury or his delegate.

Paragraph (2)(B) of section 406(b) provides that an individual who is treated as an employee under section 406(a) shall be treated as having paid the amount paid by such domestic corporation which is equivalent to the tax imposed by section 3101 of the code (relating to the tax imposed on employees) with respect to such individual.

(*c*) *Termination of status as deemed employee not to be treated as separation from service for purposes of capital gains provisions.*—Existing sections 402(a)(2) and 403(a)(2) of the code provide capital gains treatment for certain distributions after an employee's separation from service. The new section 406(c) provides that for purposes of applying section 402(a)(2) and section 403(a)(2) of the code with respect to an individual who is treated as an employee of a domestic corporation under section 406(a), such individual shall not be treated as separated from the service solely by reason of the fact that—

(1) the agreement entered into by such domestic corporation under section 3121(l) which covers the employment of such individual is terminated under the provisions of such section;

(2) such individual becomes an employee of a foreign subsidiary (as defined in sec. 3121(l)(8)) with respect to which an agreement described in section 3121(l) does not apply;

(3) such individual ceases to be an employee within the meaning of section 406(a) and becomes an employee of another corporation controlled by the domestic corporation; or

(4) the provision of the plan described in section 406(a)(2) is terminated.

(*d*) *Deductibility of contributions.*—The new section 406(d) relates to the deductibility of contributions made on behalf of an individual who is treated as an employee of a domestic corporation by reason of the provisions of section 406(a).

Paragraph (1) of the new section 406(d) provides that, for purposes of applying sections 404 and 405(c) with respect to contributions made to a qualified plan on behalf of an individual who is treated as an employee of a domestic corporation under section 406(a), no domestic corporation is allowed a deduction.

Paragraph (2) of the new section 406(d) provides that the amount which would be deductible under section 404 or 405(c) by the domestic corporation if the individual who is an employee within the meaning of section 406(a) were its own employee is to be allowed as a deduction to the foreign subsidiary.

Paragraph (3) of the new section 406(d) provides that for the purpose of computing the amount deductible under section 404 or 405(c) any reference to compensation shall be considered to be a reference to the total compensation of such individual determined with the application of the rules set forth in the new section 406(b)(2).

The new section 406(d) also provides that any amount deductible by a foreign subsidiary under this section shall be deductible for its taxable year with or within which the taxable year of the domestic corporation ends.

(e) *Treatment as employee under related provisions.*—The new section 406(e) provides that an individual who is treated as an employee of a domestic corporation under the new section 406(a) is also to be treated as an employee of the domestic corporation with respect to certain related provisions dealing with the tax treatment of employees under the qualified plan.

Employees of domestic subsidiaries engaged in business outside the United States

Subsection (b) of the new section added by the Senate amendment adds a new section 407 to part I of subchapter D of chapter 1 of the code.

(a) *Treatment as employees of domestic parent corporation.*—The new section 407(a) sets forth the requirements which must be satisfied for a U.S. citizen who is employed by a domestic subsidiary engaged in business outside the United States to be treated as an employee of the domestic parent corporation.

Paragraph (1) of section 407(a) provides that for purposes of applying part I of subchapter D of chapter 1 of the code, with respect to a qualified plan described in either section 401(a), 403(a), or 405(a), of a domestic parent corporation, an individual who is a citizen of the United States and an employee of a domestic subsidiary (as defined in par. (2) of sec. 407(a)) of a domestic parent corporation shall be treated as an employee of the domestic parent corporation if two requirements are satisfied. The first of these requirements is that the plan of the domestic parent corporation must expressly provide coverage for U.S.-citizen employees of every domestic subsidiary (as defined in par. (2) of sec. 407(a)). The second requirement is that contributions must not be provided for the employee by any other person under a funded plan of deferred compensation (whether or not such plan is a qualified plan).

Paragraph (2) of the new section 407(a) provides certain definitions for purposes of section 407. Paragraph (2)(A) of section 407(a) defines the term "domestic subsidiary" for purposes of section 407. Such paragraph (2)(A) sets forth three requirements which must be satisfied in order for a domestic corporation to be classified as a "domestic subsidiary". First, the domestic parent corporation must own 80 percent or more of the outstanding voting stock of the subsidiary corporation. Second, 95 percent or more of the subsidiary corporation's gross income for the 3-year period immediately preceding the close of the taxable year of such subsidiary which ends on or before the close of the taxable year of the domestic parent corporation (or for such part of such period during which the corporation was in existence) must be derived from sources without the United States. The third requirement is that 90 percent or more of the subsidiary corporation's gross income for such period (or such part) must be derived from the active conduct of a trade or business.

Paragraph (2)(B) of section 407(a) defines the term "domestic parent corporation" for purposes of section 407. A domestic parent corporation for purposes of such section is the domestic corporation which owns 80 percent or more of the outstanding voting stock of a domestic subsidiary (as defined in paragraph (2)(A)).

(*b*) *Special rules for application of section 401(a).*—The new section 407(b) provides special rules for the application of section 401(a). The rules are substantially the same as those prescribed in the new section 406 (b)(1) and (2)(A), except that the provisions of section 407(b) relate to individuals who are employees within the meaning of section 407(a).

(*c*) *Termination of status as deemed employee not to be treated as separation from service for purposes of capital gains provisions.*—The new section 407(c) relates to certain occasions when the termination of the status as an employee within the meaning of section 407 shall not be treated as separation from service for purposes of sections 402(a)(2) and 403(a)(2) of the code. The new section 407(c) provides that an individual who is an employee of a domestic subsidiary but who is treated as an employee of a domestic parent corporation under the new section 407(a) shall not be considered as separated from the service of the domestic parent corporation solely by reason of the fact that—

(1) the domestic subsidiary ceases, for any taxable year, to be a subsidiary within the meaning of section 407(a)(2)(A);

(2) such individual ceases to be an employee of a domestic subsidiary corporation and becomes an employee of another corporation controlled by the domestic parent corporation; or

(3) the plan no longer contains the provision described in section 407(a)(1)(A).

(*d*) *Deductibility of contributions.*—The new section 407(d) provides rules relating to the deductibility of contributions made on behalf of an individual who is an employee within the meaning of section 407(a). These rules are substantially the same as the rules in the new section 406(d), except that the provisions of section 407 relate to contributions on behalf of employees of domestic subsidiaries.

(*e*) *Treatment as employee under related provisions.*—The substantive provisions of the new section 407(e) are the same as the new section 406(e), except that the provisions of section 407 relate to the tax treatment of employees of domestic subsidiaries.

Technical amendments

Subsection (c) of the new section added to the bill makes a conforming change in a table of sections and amends section 3121(a)(5) of the code (relating to definition of wages) and section 209(e) of the Social Security Act (relating to definition of wages) to conform these definitions to the Internal Revenue Code of 1954, as amended by the Self-Employed Individuals Tax Retirement Act of 1962.

the personal property to be paid for by the purchaser in installments over a period of time.

The amendment to section 453(a) is to apply to taxable years beginning after December 31, 1963.

The House recedes with an amendment. Under the conference agreement, a new subsection (e) is added to section 453. New section 453(e) provides that, for purposes of section 453(a) of the code (which in effect allows a dealer in personal property to return on the installment basis income from sales of personal property on the installment plan), the term "installment plan" includes a revolving credit type plan which provides that the purchaser of personal property at retail may pay for such property in a series of periodic payments of an agreed portion of the amounts due the dealer under the plan, except that such term does not include any such plan with respect to a purchaser who uses his account primarily as an ordinary charge account. The new section 453(e) is to apply in respect of sales made during taxable years beginning after December 31, 1963.

TIMING OF DEDUCTIONS AND CREDITS IN CERTAIN CASES WHERE ASSERTED LIABILITIES ARE CONTESTED

Amendment No. 97: This amendment adds a new section to the bill, relating to the timing of deductions and credits in certain cases where asserted liabilities are contested.

(*a*) *Taxable year of deduction or credit.*—Subsection (a) of the new section amends section 461 of the 1954 code (relating to general rule for taxable year of deduction) and section 43 of the 1939 code (relating to period for which deductions and credits taken) to provide that if—

(1) the taxpayer contests an asserted liability;

(2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability;

(3) the contest with respect to the asserted liability exists after the time of the transfer; and

(4) but for the fact that the asserted liability is contested, a deduction or credit would be allowed for the taxable year of the transfer (or for an earlier taxable year);

then the deduction or credit shall be allowed for the taxable year of the transfer.

(*b*) *Effective dates.*—Subsection (b) of the new section provides that except as provided by subsections (c) and (d) of the new section, the amendment to the 1954 code is to apply to taxable years to which the 1954 code applies and the amendment to the 1939 code is to apply to taxable years to which the 1939 code applies.

(*c*) *Election as to transfers in taxable years beginning before January 1, 1964.*—Paragraph (1) of subsection (c) of the new section added to the bill provides that the amendments made to section 461 of the 1954 code and section 43 of the 1939 code by subsection (a) shall not apply to any transfer of money or other property described in subsection (a) made in a taxable year beginning before January 1, 1964, if the taxpayer elects, in the manner provided by regulations prescribed by the Secretary of the Treasury or his delegate, to have such paragraph (1) apply. Such an election (1) must be made within 1 year after the date of enactment of the bill, (2) may not be revoked after the expiration of such 1-year period, and (3) shall apply to all transfers of money or other property described in subsection (a) made in a taxable year beginning before January 1, 1964 (other than transfers described in par. (2) of subsec. (c)). In the case of any transfer to which paragraph (1) applies, the deduction or credit shall be allowed only for the taxable year in which the contest with respect to such transfer is settled.

Paragraph (2) of subsection (c) provides that paragraph (1) of subsection (c) shall not apply to any transfer if the assessment of any deficiency which would result from the application of the election in respect of such transfer is, on the date of the election under such paragraph (1), prevented by the operation of any law or rule of law.

Paragraph (3) of subsection (c) provides that if the taxpayer makes an election under paragraph (1) of subsection (c), and if, on the date of such election, the assessment of any deficiency which results from the application of the election in respect of any transfer is not prevented by the operation of any law or rule of law, the period within which assessment of such deficiency may be made shall not expire earlier than 2 years after the date of enactment of the bill.

(d) Certain other transfers in taxable years beginning before January 1, 1964.—Subsection (d) of the new section added to the bill provides that the amendments made to section 461 of the 1954 code and section 43 of the 1939 code by paragraphs (1) and (2), respectively, of subsection (a) shall not apply to any transfer of money or other property described in subsection (a) made in a taxable year beginning before January 1, 1964, if (1) no deduction or credit has been allowed in respect of such transfer for any taxable year before the taxable year in which the contest with respect to such transfer is settled, and (2) refund or credit of any overpayment which would result from the application of such amendments to such transfer is prevented by the operation of any law or rule of law. In the case of any transfer to which subsection (d) applies, the deduction or credit shall be allowed for the taxable year in which the contest with respect to such transfer is settled.

The House recedes with amendments. Under the conference agreement, the amendments to section 461 of the 1954 code (relating to general rule for taxable year of deduction) and section 43 of the 1939 code (relating to period for which deductions and credits taken) do not apply in respect of any credit against tax, and do not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States.

It is the understanding of the conferees that the new provisions relating to the timing of deductions in certain cases where asserted liabilities are contested do not affect the taxable year in which the taxpayer may deduct items of a nature which are properly accruable in a year before the year of payment.

INTEREST ON CERTAIN DEFERRED PAYMENTS

Amendment No. 99: Subsection (c) of section 215 of the bill as passed by the House amended section 163(b) of the code to provide that if personal services are purchased under a contract providing for installment payments of part or all of the purchase price and if the contract provides for carrying charges but the portion thereof which constitutes interest cannot be ascertained, then the payments under the contract are treated, for purposes of the interest deduction, as if they included interest equal to 6 percent of the average unpaid balance. Senate amendment No. 99 strikes this provision from the bill.

The House recedes with an amendment. Under the conference agreement, this provision is restored to the bill but is made applicable only with respect to educational services. For this purpose, the term "educational services" is defined as meaning any service (including lodging) which is purchased from an educational institution (as defined in section 151(e)(4) of the code) and which is provided for a student of such institution.

Amendment No. 100: Under the bill as passed by the House the new provisions relating to the treatment of interest on certain deferred payments (subsec. (a) of this section of the bill) were to apply to payments made after December 31, 1963, on account of sales or exchanges of property occurring after June 30, 1963. Senate amendment No. 100 provides, in addition, that the new provisions will not apply to a sale or exchange made pursuant to a binding written contract (including an irrevocable written option) entered into before July 1, 1963.

The House recedes with an amendment providing that the amendments made to section 163(b)(1) of the code with respect to certain payments for educational services are to apply to payments made during taxable years beginning after December 31, 1963.

PERSONAL HOLDING COMPANIES

Amendments Nos. 102, 105, 106, and 107:

Excluded lending and finance companies.—Under the bill as passed by the House, a lending or finance company was excluded from the definition of a personal holding company if it met four requirements: (1) At least 60 percent of its ordinary gross income must be derived directly from the active and regular conduct of a lending or finance business; (2) its personal holding company income (computed without regard to income qualifying under the 60-percent test; computed by including as personal holding company income the entire amount of the gross income from rents, royalties, produced film rents, and compensation for the use of corporate property by shareholders; and computed without regard to certain income from domestic subsidiaries described in sec. 542(d)(3) of the code), plus the interest described in section 543(b)(2)(C) of the code, must not exceed 20 percent of the ordinary gross income; (3) business deductions directly allocable to the active and regular conduct of its lending or finance business must equal or exceed the sum of 15 percent of its ordinary gross income up to $500,000 plus 5 percent of its ordinary gross income between $500,000 and $1,000,000; and (4) loans to substantial shareholders must not exceed $5,000 in principal amount. Senate amendment No. 102 deletes the provision that interest described in section 543(b)(2)(C) be included with the corporation's personal holding company income in applying the 20-percent-of-ordinary-gross-income test of section 542(c)(6)(B) which is described in clause (2) of the preceding sentence.

The House recedes on Senate Amendment No. 102.

Under the bill as passed by the House, section 542(d)(1)(A) of the code defined a lending or finance business, generally, as a business of making loans, or purchasing or discounting accounts receivable, notes, or installment obligations. Senate amendment No. 105 amends the definition of a lending or finance business in section 542(d)(1) to include therein the business of rendering services or making facilities available to another member of the same affiliated group (as defined in sec. 1504) which is also in the lending or finance business. The House recedes with an amendment to Senate amendment No. 105. Under the conference agreement, the definition of a lending or finance business in section 542(d)(1) includes (1) rendering services or making facilities available in connection with the activities of making loans, or purchasing or discounting accounts receivable, notes, or installment obligations where such activities are carried on by the corporation rendering the services or making the facilities available, and (2) rendering services or making facilities available to another corporation which is a member of the same affiliated group and is engaged in the lending or finance business, if such services or facilities are related to the lending or finance business of such other corporation.

Under the bill as passed by the House, section 542(d)(1)(B)(i) provided that the term "lending or finance business" does not include the business of making loans, or purchasing or discounting notes or installment obligations, if the remaining maturity exceeds 60 months. Senate amendment No. 106 excepts from this exclusion loans, notes, and installment obligations evidenced or secured by contracts of conditional sale, chattel mortgages, or lease agreements, arising out of the sale of goods or services in the course of the transferor's or borrower's trade or business. The House recedes with a clarifying amendment.

Under the bill as passed by the House, section 542(d)(3) of the code provided that the lawful income received by a lending company which is in the small loan business (consumer finance business) from domestic subsidiary corporations which are themselves excepted from the definition of a personal holding company under section 542(c)(6) is not included for purposes of the 20-percent-of-ordinary-gross-income test of section 542(c)(6)(B). Senate amendment No. 107 changes this provision in two respects. First, the corporation receiving such income may be any lending or finance company which meets the 60-percent requirement of section 542(c)(6)(A). It does not have to meet the requirement of being in the small loan (consumer finance) business. Second, the payor corporation may be any member of the same affiliated group (as defined in sec. 1504 of the code) as the corporation receiving such income. Thus, the corporation receiving such income is not required to be the parent corporation of the payor corporation. However, the payor corporation must still meet the requirements of section 542(c)(6). The House recedes.

Amendments Nos. 108, 109, and 111:

Personal holding company income.—Subsection (d) of this section of the bill amends section 543(a) of the code (relating to personal holding company income). It also amends section 543(b) to provide definitions of the new terms "ordinary gross income," "adjusted ordinary gross income," "adjusted income from rents," and "adjusted income from mineral, oil, and gas royalties." Subsections (a) and (b) of section 543 are the same under the bill as passed by the House and under the Senate amendments except for changes in section 543(a)(2) (relating to rents), section 543(b)(2)(A) (relating to required adjustments in the amount of gross income from rents includible in adjusted ordinary gross income), and section 543(b)(4) (defining "adjusted income from mineral, oil, and gas royalties").

Rents.—Senate amendment No. 108 modifies the 10-percent test in section 543(a)(2)(B) in the bill as passed by the House to provide that adjusted income from rents which meets the 50-percent requirement of section 543(a)(2)(A) shall not be treated as personal holding company income if the sum of the consent dividends (determined under sec. 565) and the dividends paid or considered as paid (determined under secs. 562 and 563) during the taxable year by the corporation to its shareholders equals or exceeds the amount, if any, by which the corporation's personal holding company income for the taxable year (computed without regard to such rents and compensation for the use of the corporation's property by its shareholders, and computed by treating copyright royalties and adjusted income from mineral, oil, and gas royalties as personal holding company income) exceeds 10 percent of the ordinary gross income as defined in section 543(b)(1). The effect of this modification in the 10-percent test applicable to rents is that this test shall be deemed to be met if the shareholders are required to include in their income as dividends an amount which is at least equal to the corporation's other personal holding company income which is in excess of 10 percent of total ordinary gross income. The House recedes.

Adjustment to rents included in adjusted ordinary gross income.—The bill as passed by the House defines, in paragraph (2) of section 543(b) of the code, the term "adjusted ordinary gross income" as the ordinary gross income adjusted as provided in subparagraphs (A), (B), and (C) of such paragraph. Senate amendment No. 109 amends subparagraph (A)(i) of section 543(b)(2) to provide that the gross income from rents derived from leases of tangible personal property which is not customarily retained by any one lessee for a period of more than 3 years shall not be reduced by allowable deductions for exhaustion, wear and tear, obsolescence, and amortization of such property. The House recedes.

Adjusted income from mineral, oil, and gas royalties.—Senate amendment No. 111 amends section 543(b)(4) of the code to specifically include production payments and overriding royalties as mineral, oil, and gas royalties for purposes of classification as personal holding company income under section 543(a). The House recedes.

Amendments Nos. 114, 116, 117, 119, 124, 129, and 131:

One-month liquidations.—The bill as passed by the House added a new subsection (g) to section 333 of the code to provide a special rule for 1-month liquidations of certain corporations. Senate amendment No. 114 amends paragraph (1) of section 333(g) to provide that it shall be applicable to corporate liquidations occurring before January 1, 1967 (instead of January 1, 1966, as in the bill as passed by the House). Senate amendments Nos. 116 and 117 provide that the capital gain treatment under section 333(g)(1)(B) shall not apply to certain earnings and profits to which the corporation succeeds after December 31, 1963 (instead of August 1, 1963). Senate amendments Nos. 119 and 124 amend paragraph (2) of section 333(g) to provide that it shall be applicable to liquidations occurring after December 31, 1966 (instead of December 31, 1965), of corporations which owe qualified indebtedness (as defined in sec. 545(c)) on January 1, 1964 (instead of on August 1, 1963). The House recedes.

Senate amendment No. 129 amends paragraph (3) of section 333(g), which describes the corporations to which paragraphs (1) and (2) of section 333(g) may apply, to provide that such a corporation is one which was not a personal holding company under section 542 of existing law for at least 1 of its 2 most recent taxable years ending before December 31, 1963 (instead of the date of the enactment of the bill) but which would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such preceding taxable year. The Senate recedes.

Senate amendment No. 131 adds a new paragraph (4) to section 333(g) providing that if an election is made under section 333 by a qualified electing shareholder (as defined in sec. 333(c)) of a corporation and the shareholder states in such election that it is made on the assumption that the corporation is a corporation referred to in paragraph (3) of section 333(g), the election under section 333 shall have no force or effect if it is determined that the corporation is not a corporation referred to in section 333(g)(3). The House recedes.

Amendments Nos. 132, 133, 137, and 139:

Deduction for amortization of indebtedness.—The bill as passed by the House added a new subsection (c) to section 545 of the code which provides that, under certain circumstances, there shall be allowed as a deduction (in computing undistributed personal holding company income) amounts used, or amounts irrevocably set aside, to pay or retire qualified indebtedness. Senate amendment No. 133 amends proposed section 545(c)(3) to provide that the term "qualified indebtedness" includes outstanding indebtedness incurred by the taxpayer before January 1, 1964 (instead of before August 1, 1963, as in the bill as passed by the House). The House recedes.

Senate amendments Nos. 137 and 139 amend proposed paragraphs (5) and (6) of section 545(c) to provide that allowable deductions for depletion shall be taken into account to reduce the deduction allowed by section 545(c) and to reduce the qualified indebtedness under certain circumstances. The House recedes.

Senate amendment No. 132 amends proposed paragraph (2)(A) of section 545(c), which describes a category of corporations to which paragraph (1) of section 545(c) may apply, to provide that such a corporation is one which was not a personal holding company under section 542 of existing law for at least one of its two most recent taxable years ending before December 31, 1963 (instead of the date of the enactment of the bill, as in the bill as passed by the House) but which would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such preceding taxable year. The Senate recedes.

Amendment No. 141:

Increase in basis with respect to certain foreign personal holding company stock or securities.—Subsection (j) of section 216 of the bill as passed by the House amended the code to provide for an increase in basis with respect to certain foreign personal holding company holdings. Such subsection (j) also contained provisions relating to the liquidation of certain foreign personal holding companies. Senate amendment No. 141 strikes out this subsection.

Under the conference agreement, the provisions of subsection (j) relating to an increase in basis with respect to certain foreign personal holding company holdings are restored to the bill (with modifications) and the provisions relating to liquidation of foreign personal holding companies are omitted. Paragraph (1) of subsection (j) redesignates section 1022 of the code as section 1023 and inserts a new section 1022 (relating to increase in basis with respect to certain foreign personal holding company stock or securities).

Section 1014(b)(5) of the code provides that the basis of a share of stock or of a security in a foreign personal holding company, in the hands of a person acquiring it from a decedent by bequest, devise, or inheritance, or acquired by the decedent's estate from the decedent, is the lower of the fair market value of such share or security at the date of the decedent's death or the basis in the hands of the decedent. The new section 1022(a) provides that the basis determined under section 1014(b)(5) of a share of stock or a security, acquired from a decedent dying after December 31, 1963, of a corporation which was a foreign personal holding company for its most recent taxable year ending before the date of the decedent's death is to be increased by such share's or security's proportionate share of any Federal estate tax attributable to the net appreciation in value of all of such shares and securities.

The new section 1022(b) provides that a share's or security's proportionate share of the tax referred to in section 1022(a) is an amount which bears the same ratio to the amount of tax determined under section 1022(c)(2) as the appreciation in value of the share or security bears to the aggregate appreciation in value of all such shares and securities having appreciation in value.

The new section 1022(c) provides special rules and definitions to be used in determining the increase in basis provided in section 1022(a).

Paragraph (1) of section 1022(c) defines the term "Federal estate tax" to mean the tax imposed by section 2001 or 2101 of the code, reduced by any credit allowable with respect to a tax on prior transfers by section 2013 or 2102 of the code.

Paragraph (2) of section 1022(c) provides that the Federal estate tax attributable to the net appreciation in value of all shares of stock and securities to which section 1022(a) applies is the amount which bears the same ratio to the Federal estate tax as the net appreciation in value of all of such shares and securities bears to the value of the gross estate as determined under chapter 11 of the code. If, for estate tax purposes, alternate valuation is elected under section 2032 of the code, the value of the gross estate is to be determined under the provisions of such section.

Paragraph (3) of section 1022(c) provides that the net appreciation in value of all shares and securities to which section 1022(a) applies is the amount by which the fair market value of all shares and securities exceeds the adjusted basis of such property in the hands of the decedent.

Paragraph (4) of section 1022(c) defines "fair market value", for purposes of section 1022, to mean such value determined under chapter 11 of the code. If, for estate tax purposes, alternate valuation is elected under section 2032 of the code, fair market value is to be determined as of the appropriate date provided in such section.

The new section 1022(d) provides that section 1022 is not to apply to any stock or securities of a foreign personal holding company referred to in section 342(a)(2) of the code (relating to foreign corporations which were foreign personal holding companies in 1937).

Paragraph (2) of the new subsection (j) of the bill adds a new paragraph (21) to section 1016(a) of the code providing, in effect, that an increase in basis under section 1022 of the code is to be taken into account in determining the adjusted basis of property to which such provisions apply. Paragraph (3) of the new subsection (j) makes a clerical amendment to the table of sections to part II of subchapter O of chapter 1 of the code.

TREATMENT OF CERTAIN IRON ORE ROYALTIES

Amendments Nos. 151 and 153: The bill as passed by the House amended sections 631(c), 1231(b)(2), and 272 of the code to grant, in the case of certain disposals of iron ore with a retained economic interest, the same treatment which is now available in the case of certain disposals of coal with a retained economic interest. Under such treatment, the gain or loss attributable to such disposals of iron ore is treated as gain or loss from the sale of property used in the trade or business (as defined in sec. 1231(b) of the code).

Under the Senate amendments, this treatment of these disposals of iron ore with a retained economic interest provided by the bill as passed by the House is retained with two exceptions. First, the treatment is to be available only in the case of iron ore mined in the United States. Second, the treatment is not to apply to disposals of iron ore to certain related persons. One of these is where the disposal is to a person whose relationship to the party disposing of the iron ore is such that a loss would be disallowed under section 267 of the code (relating to losses, etc., with respect to transactions between related taxpayers) or section 707(b) (relating to certain sales or exchanges of property with respect to controlled partnerships). The other of these is where the disposal is to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of the iron ore.

The House recedes.

INSURANCE COMPANIES

Amendment No. 162:

(*a*) *Certain mutualization distributions made in 1962.*—Subsection (a) of the section added to the bill by this amendment amends section 809(d)(11) of the code (relating to certain mutualization distributions) to allow, as a deduction in the computation of gain from operations, distributions made in 1962, in acquisition of stock, pursuant to a plan of mutualization adopted by a stock life insurance company before January 1, 1958. Existing law permits a deduction for such mutualization distributions made in 1958, 1959, 1960, or 1961.

(*b*) *Accrual of bond discount.*—Subsection (b) of the section added to the bill by Senate amendment No. 162 relates to the accrual of bond discount by insurance companies subject to tax under part I or II of subchapter L of chapter 1 of the code (relating to life insurance companies and certain mutual insurance companies).

Paragraph (1) of this subsection (b) amends section 818(b) of the code (relating to amortization of premium and accrual of discount) to add a new paragraph at the end thereof. The new section 818(b)(3) provides that for taxable years beginning after December 31, 1962, no accrual of discount shall be required under section 818(b)(1) on any bond (as defined in sec. 171(d) of the code) except in the case of discount which is interest to which section 103 of the code applies or is original issue discount (as defined in sec. 1232(b) of the code). The new section 818(b)(3) also provides that for purposes of section 805(b)(3)(A) of the code, the current earnings rate for any taxable year beginning before January 1, 1963, is to be determined as if the first sentence of the new section 818(b)(3) applied to such taxable year.

Paragraph (2) of subsection (b) of the section added to the bill by Senate amendment No. 162 amends section 822(d)(2) of the code (relating to the amortization of premium and accrual of discount in the case of mutual insurance companies other than life and other than certain fire, flood, and marine insurance companies) by adding a new sentence. This sentence provides that for taxable years beginning after December 31, 1962, no accrual of discount shall be required under section 822(d)(2) of the code on any bond (as defined in sec. 171(d) of the code).

(c) *Contributions to qualified pension, etc., plans.*—Subsection (c) of the section added to the bill by Senate amendment No. 162 amends section 832(c)(10) of the code (relating to deductions allowed in computing taxable income of certain insurance companies) to make it clear that in computing the taxable income of insurance companies subject to the tax imposed by section 831 of the code, there shall be allowed the deduction provided in part I of subchapter D of chapter 1 of the code (sec. 401 and following, relating to pension, profit-sharing, stock bonus plans, etc.). Under subsection (d) of this section of the bill, this clarification is to apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

The House recedes on Senate amendment No. 162 with a clerical amendment.

REGULATED INVESTMENT COMPANIES

Amendment No. 163:

(a) *Time for mailing certain notices to shareholders.*—Subsection (a) of the section added to the bill by this amendment amends several provisions of part I of subchapter M of chapter 1 of the code (relating to regulated investment companies) to increase from 30 days to 45 days after the close of the regulated investment company's taxable year the time within which such company must mail certain notices to its shareholders. The sections of the code which are amended are sections 852(b)(3)(C), 852(b)(3)(D)(i), 853(c), 854(b)(2), and 855(c). The amendments are to apply to taxable years of regulated investment companies ending on or after the date of the enactment of the bill.

(b) *Certain redemptions by unit investment trusts.*—Subsection (b) of the section added to the bill by Senate amendment No. 163 amends section 852 of the code (relating to taxation of regulated investment companies and their shareholders) to add at the end thereof a new subsection (d). Under section 852(b) of existing law, a regulated investment company is allowed a deduction for dividends paid (as defined in sec. 561), other than capital gains dividends, in determining its investment company taxable income, and is allowed a deduction for dividends paid (as defined in sec. 561), determined with reference to capital gains dividends only, in computing that part of the excess of its net long-term capital gain over net short-term capital loss on which it must pay a capital gains tax. Section 562(c) of the code (relating to preferential dividends) provides that the amount of any distribution shall not be considered as a dividend unless such distribution is pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that the former is entitled to such preference.

The new section 852(d) added to the code by this amendment provides that in the case of a unit investment trust—

(1) which is registered under the Investment Company Act of 1940 and issues periodic payment plan certificates (as defined in such act); and

(2) substantially all of the assets of which consist of securities issued by a management company (as defined in such act);

section 562(c) of the code (relating to preferential dividends) shall not apply to a distribution by such trust to a holder of an interest in such trust in redemption of part or all of such interest, with respect to the net capital gain of such trust attributable to such redemption. The effect of this change is that, where the requirements of the new section 852(d) are met, the distribution is considered to be a distribution by the trust which qualifies for the deduction for dividends paid with respect to capital gains dividends under section 852(b)(3)(A) of the code. This change is to apply to taxable years of regulated investment companies ending after December 31, 1963.

The House recedes on Senate amendment No. 163 with a clerical amendment.

FOREIGN TAX CREDIT WITH RESPECT TO CERTAIN FOREIGN MINERAL INCOME

Amendment No. 164: This amendment inserts a new subsection (d) in section 901 of the code (relating to credit for foreign taxes). Paragraph (1) of the new subsection (d) provides that in certain cases the amount of foreign taxes described in section 901 (relating to amount of foreign tax allowed as a credit) which are paid or accrued during the taxable year with respect to mineral income to any foreign country (if the per-country limitation applies), or to all foreign countries (if the overall limitation applies), is to be reduced for purposes of computing the foreign tax credit.

The Senate recedes.

AMOUNTS RECEIVED FROM EMPLOYER ON SALE OF RESIDENCE OF EMPLOYEE IN CONNECTION WITH TRANSFER TO NEW PLACE OF WORK

Amendment No. 165: This amendment adds a new section 1003 to part I of subchapter O of chapter 1 of the code (relating to determination of amount of and recognition of gain or loss). Subsection (a) of the new section 1003 provides that if property used by the taxpayer as his principal residence is sold by the taxpayer or his spouse pursuant to a sales contract entered into within the forced sale period for such property, and if the taxpayer's employer, not later than 1 year after the date such sales contract was entered into, pays part or all of the sale differential on such property, then for purposes of chapter 1 of the code the amount so paid is to be treated by the taxpayer or his spouse as an additional amount realized on the sale of such property to the extent that it does not exceed the lesser of (1) the sale differential, or (2) 15 percent of the gross sales price of such property.

Subsection (b) of the new section 1003 places certain limitations on the application of such section. Subsection (c) contains definitions and special rules for the application of the new section.

The new section 1003 is to apply to amounts paid with respect to sales contracts entered into after December 31, 1963, in taxable years ending after such date.

The Senate recedes.

CAPITAL GAINS AND LOSSES

Amendment No. 166: Section 219(a) of the bill as passed by the House amended the code to provide, in the case of taxpayers other than corporations, for the splitting of the long-term capital gain or loss category into two categories: (1) Class B capital gain or loss (in general, gain or loss from the sale or exchange of a capital asset held for more than 6 months but not more than 2 years); and (2) class A capital gain or loss (in general, gain or loss from the sale or exchange of a capital asset held for more than 2 years). Under the bill as passed by the House the deduction under section 1202 of the code for an excess of net long-term capital gain over net short-term capital loss was increased, in the case of adjusted class A capital gain (as defined in the bill), from 50 percent to 60 percent. It also provided that the alternative maximum capital gain tax provided by section 1201(b) of the code for taxpayers other than corporations was to be decreased, in the case of adjusted class A capital gain, from 25 percent to 21 percent.

Under existing section 1212 of the code, if a taxpayer has a net capital loss for a taxable year, the amount thereof is a short-term capital loss in each of the 5 succeeding taxable years, to the extent that such amount exceeds the total of any net capital gains of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year. Section 219(b) of the House bill in effect provided, in the case of a taxpayer other than a corporation, for an unlimited carryover of a net short-term, net class B, or net class A capital loss.

Senate amendment No. 166 strikes out this section of the bill as passed by the House.

Under the conference agreement, the House recedes with an amendment which adds a new subsection (b) to section 1212 of the code and makes technical changes in the definitions contained in paragraphs (9) and (10) of section 1222 of the code (relating to terms relating to capital gains and losses). Under paragraph (1) of the new subsection (b), in the case of a taxpayer other than a corporation, the excess of the net short-term capital loss over the net long-term capital gain for a taxable year, and the excess of the net long-term capital loss over the net short-term capital gain for such year are to be treated, respectively, as a short-term and a long-term capital loss in the succeeding taxable year. In determining a net short-term capital gain or loss of a taxable year, for purposes of computing a capital loss carryover to the succeeding taxable year, an amount equal to the excess of the capital losses allowable as a deduction for the taxable year by virtue of section 1211(b) of the code (relating to limitation on capital losses) over the capital gains for such year is treated as a short-term capital gain occurring in such year. The effect of the latter rule is to reduce first the amount of a net short-term capital loss which may be carried over to a succeeding taxable year by the amount of capital losses which were allowed against ordinary income in the loss year and then to reduce the amount of a net long-term capital loss which may be carried over to the succeeding taxable year by any balance of the capital losses allowed against ordinary income in the loss year.

Paragraph (2) of new subsection (b) contains a transitional rule. The transitional rule provides, in effect, that, in the case of a taxpayer other than a corporation, any capital loss carryover which, under subchapter P of chapter 1 of the code as in effect immediately before the enactment of the bill is treated as a short-term capital loss in the first taxable year of a taxpayer beginning after December 31, 1963, is to be treated as a short-term capital loss in such year irrespective of the fact that such carryover may be composed in whole or in part of losses which were long-term capital losses in the year in which sustained.

Under the conference agreement, the amendments of sections 1212 and 1222 of the code are to apply to taxable years beginning after December 31, 1963.

ELECTION OF STANDARD DEDUCTION BY CERTAIN INDIVIDUALS WHO ELECT TO AVERAGE INCOME

Amendment No. 171: This amendment amends section 144 of the code (relating to election of standard deduction) to allow an individual who chooses the benefits of income averaging and whose adjusted gross income for the computation year is less than $5,000 to elect the standard deduction.

The House recedes.

SMALL BUSINESS CORPORATIONS

Amendment No. 177: This amendment amends section 1371 of the code (defining "small business corporation" for purposes of subch. S of ch. 1 of the code, relating to election as to taxable status) by adding at the end thereof a new subsection (d) and amends section 1375 of the code (relating to special rules applicable to distributions of electing small business corporations) by adding at the end thereof a new subsection (e).

Under existing section 1371(a) of the code the definition of a "small business corporation" does not include any corporation which is a member of an affiliated group (as defined in sec. 1504 of the code). The new subsection (d) added to section 1371 of the code by Senate amendment No. 177 provides that, for purposes of section 1371(a), a corporation is not to be considered a member of an affiliated group at any time during the taxable year by reason of ownership of stock in another corporation if such other corporation has not begun business at any time on or after the date of its incorporation and before the close of such taxable year and if such other corporation does not have taxable income for the period included within such taxable year. The new subsection (d) is to apply to taxable years of corporations beginning after December 31, 1962.

The new subsection (e) added to section 1375 provides that under specified circumstances a distribution of money made by a corporation on or before the 15th day of the 3d month following a taxable year for which such corporation is an electing small business corporation shall be treated for purposes of chapter 1 of the code as made on the last day of such taxable year. The new subsection (e) is to apply to taxable years beginning after December 31, 1957.

The House recedes with a clerical amendment.

VALIDITY OF TAX LIENS AGAINST PURCHASERS OF MOTOR VEHICLES

Amendment No. 193: Section 6323(a) of the code provides that the lien for taxes provided by section 6321 of the code is not to be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary of the Treasury or his delegate in the appropriate office specified in section 6323(a). Senate amendment No. 193 amends section 6323(c) of the code which contains a special rule as to the validity of tax liens in the case of securities to make that special rule applicable also with respect to motor vehicles. Under the Senate amendment, even though notice of lien has been filed in the manner prescribed in section 6323(a) of the code, the lien is not to be valid with respect to a motor vehicle as against any mortgagee, pledgee, or purchaser of such motor vehicle, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

Senate amendment No. 193 also amends section 6324 of the code (relating to special liens for estate and gift taxes) to grant, in the case of the mortgage, pledge, or purchase of a motor vehicle, the same treatment which is now available in the case of the mortgage, pledge, or purchase of a security after a lien for estate or gift tax has arisen. Under the amendment, even though a special lien for estate or gift tax has arisen, such lien will not be valid with respect to any mortgagee, pledgee, or purchaser of a motor vehicle, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase, such mortgagee, pledgee, or purchaser was without notice or knowledge of the existence of such lien.

Under the amendment, these changes to sections 6323 and 6324 of the code apply to mortgages, pledges, and purchases made after the date of the enactment of the bill.

The House recedes with an amendment. Section 6323 (relating to validity of tax liens against mortgagees, pledgees, purchasers, and judgment creditors) is amended by redesignating subsection (d) as subsection (e) and by inserting a new subsection (d) which provides that even though notice of lien imposed by section 6321 has been properly filed, the lien shall not be valid with respect to a motor vehicle as against a purchaser thereof for an adequate and full consideration in money or money's worth if (1) at the time of the purchase, the purchaser is without notice or knowledge of the existence of such lien, and (2) before the purchaser obtains such notice or knowledge, he has acquired possession of such motor vehicle and has not thereafter relinquished possession of such motor vehicle to the seller or his agent.

Section 6324 (relating to special liens for estate and gift taxes) is amended by adding a new subsection (d) which provides in effect that a lien for estate or gift taxes will be invalid as against a purchaser of a motor vehicle (as defined in sec. 6323 (d)(2)) for an adequate and full consideration in money or money's worth if (1) at the time of the purchase, such purchaser is without notice or knowledge of such lien, and (2) before the purchaser obtains such notice or knowledge, he has acquired possession of such motor vehicle and has not thereafter relinquished possession of such motor vehicle to the seller or his agent.

Where a motor vehicle is purchased under the circumstances specified in the new section 6323(d) or 6324(d) of the code, the tax lien will abate with respect to the motor vehicle in question and will not be valid against any subsequent purchaser (or other successor in interest) of the vehicle.

The amendments to sections 6323 and 6324 of the code apply to purchases made after the date of the enactment of the bill.

EXCLUSION OF EARNED INCOME OF CERTAIN U.S. CITIZENS WHO ARE RESIDENTS OF FOREIGN COUNTRIES

Amendment No. 194: This amendment adds a new section to the bill amending section 911(c)(1) of the code (relating to limitations on amount of exclusion of earned income from sources without the United States). Existing section 911(c)(1) provides in effect that the amount excluded from the gross income of an individual under section 911(a) for any taxable year shall not exceed an amount which shall be computed on a daily basis at an annual rate of—

(A) except as provided in subparagraph (B), $20,000 in the case of an individual who qualifies under section 911(a); or

(B) $35,000 in the case of an individual who qualifies under section 911(a)(1) (relating to bona fide resident of foreign country), but only with respect to that portion of the taxable year occurring after such individual has been a bona fide resident of a foreign country or countries for an uninterrupted period of 3 consecutive years.

Senate amendment No. 194 amends section 911(c)(1)(A) to substitute "$4,000" for the $20,000 amount contained therein, and it amends section 911(c)(1)(B) to substitute "$6,000" for the $35,000 amount contained therein. Under the amendment these changes are applicable only with respect to taxable years beginning after December 31, 1963.

The House recedes with an amendment. Under the conference agreement, the limitation contained in subparagraph (B) of section 911(c)(1) of the code (relating to limitations on amount of exclusion of earned income from sources without the United States) is reduced from $35,000 to $25,000, effective for taxable years beginning after December 31, 1964.

DEFINITION OF HEAD OF HOUSEHOLD

Amendment No. 195: Section 1(b)(2) of the code defines a head of a household to be an individual who is not married at the close of his taxable year, is not a surviving spouse, and maintains a household which constitutes for the taxable year the principal place of abode of a dependent for whom the taxpayer is entitled to a deduction for the taxable year under section 151 of the code or (if not married at the close of the taxpayer's taxable year) a child, stepchild, or descendant. Except in the case of a father or mother, the household must be maintained as the home of the taxpayer. The effect of Senate amendment No. 195 is to remove the requirement that the household be maintained as the home of the taxpayer and to provide that a taxpayer may qualify as a head of household with respect to a child, stepchild, or descendant only if he is a dependent for whom the taxpayer is entitled to a deduction for the taxable year.

The Senate recedes.

LOSSES ARISING FROM CONFISCATION OF PROPERTY BY CUBA

Amendment No. 196: Section 165(c)(3) of the code provides that, in the case of an individual, the deduction for losses provided by section 165(a) shall, except for losses incurred in a trade or business or in a transaction entered into for profit, be limited to losses of property arising from fire, storm, shipwreck, or other casualty, or from theft. Section 172(d)(4) of the code provides for purposes of the net operating loss that, in the case of a taxpayer other than a corporation, the deductions not attributable to a taxpayer's trade or business shall be allowed only to the extent of the gross income not derived from such trade or business. This limitation does not apply to a deduction allowable under section 165(c)(3) of the code.

Senate amendment No. 196 adds a new subsection (i) to section 165 of the code which provides that, for purposes of section 165(c)(3), losses of property which arise from expropriation, intervention in, or confiscation by Cuba shall be deemed to be losses from "other casualty."

The House recedes with an amendment which limits the application of the new section 165(i) to losses of tangible property and which makes technical and conforming changes.

CREDIT OR REFUND OF SELF-EMPLOYMENT TAX

Amendment No. 197: This amendment adds a new provision to the code to permit credit or refund of self-employment tax if, by reason of an agreement made pursuant to section 218 of the Social Security Act, the self-employment income of an individual (for a year with respect to which the period of limitation for filing claim for credit or refund has expired) is different from what it would be but for the agreement.

The House recedes with an amendment. Under the conference agreement, a new paragraph (5) is added to 6511(d) of the code. The new paragraph (5) applies both to agreements and modifications of agreements under section 218 of the Social Security Act. The new paragraph (5) also provides that if the allowance of a credit or refund of an overpayment attributable to such an agreement or modification is otherwise prevented by the operation of any law or rule of law other than section 7122 of the code (relating to compromises) such credit or refund may be allowed or made if claim therefor is filed on or before whichever of the following is the later: (A) the last day of the second year after the calendar year in which such agreement or modification is agreed to by the State and the Secretary of Health, Education, and Welfare, or (B) December 31, 1965.

EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX ON VALUE OF REVERSIONARY OR REMAINDER INTEREST IN PROPERTY

Amendment No. 198: Section 6163(a) of the 1954 code provides that if the value of a reversionary or remainder interest in property is included in the value of the gross estate for purposes of the estate tax, then the payment of the part of the estate tax attributable to the interest may (at the election of the executor) be postponed until 6 months after the termination of the precedent interest or interests in the property. A similar rule applies under the 1939 code. Under section 6163(b) of the 1954 code (or sec. 925 of the 1939 code), if the Secretary of the Treasury or his delegate finds that the payment of the tax at the expiration of the period of postponement would result in undue hardship to the estate, he may extend the time for payment for a reasonable period not in excess of 2 years from such period of postponement. Under Senate amendment No. 198, he would be permitted to extend the time for payment for a reasonable period or periods not in excess of 3 years from the expiration of such period of postponement.

The House recedes with clerical amendments.

CROP INSURANCE PROCEEDS

Amendment No. 199: This amendment adds a new subsection (c) to section 451 of the code (relating to general rule for taxable year of including items in gross income). Under the new subsection, in the case of insurance proceeds received as a result of destruction or damage to crops, a taxpayer reporting on the cash basis of accounting may elect to include such proceeds in income for the year following the year of destruction or damage provided he establishes to the satisfaction of the Secretary of the Treasury or his delegate that, under his practice, income from such crops would not have been reported in the year in which raised.

The Senate recedes.

TRANSPORTATION OF DISABLED INDIVIDUAL TO AND FROM WORK

Amendment No. 200: This amendment adds a new section 219 to the code. Section 219(a) provides that in the case of a disabled individual there shall be allowed as a deduction expenses paid during the taxable year for transportation to and from work to the extent that such expenses do not exceed $600. Section 219(b) defines the term "disabled individual" and contains rules as to the submission of proof and certification of disability.

The Senate recedes.

ADDITIONAL PERSONAL EXEMPTIONS FOR DISABILITY

Amendment No. 201: This amendment adds a new subsection (f) to section 151 of the code (relating to allowance of deductions for personal exemptions). The new subsection (f) provides an additional exemption of $600 for the taxpayer if he is a disabled individual (as defined in new subsec. (f)(3)) and an additional exemption of $600 for the spouse if the spouse is a disabled individual (as so defined) and if the taxpayer is entitled to an exemption under section 151(b) of the code for such spouse.

The Senate recedes.

TIME FOR FILING CLAIM FOR REFUND OF TAXES PAID FOR GASOLINE USED ON FARMS

Amendment No. 202: The second sentence of section 6420(b) of the code provides that no claim shall be allowed under section 6420 of the code (relating to payments to ultimate purchaser of amount equivalent to tax on gasoline used on a farm for farming purposes with respect to any 1-year period (ending on June 30) unless filed on or before September 30 of the year in which such 1-year period ends. The effect of Senate amendment No. 202 is to permit the Secretary of the Treasury or his delegate to allow a claim filed after September 30 if the claimant had good cause for failing to file on or before such date.

The Senate recedes.

FACILITIES TO CONTROL WATER OR AIR POLLUTION

Amendment No. 203: Section 46(a) of the code provides, in general that the credit against income tax allowed by section 38 (relating to investment in certain depreciable property) shall be equal to 7 percent of the qualified investment (as defined in sec. 46(c)). Under section 46(c)(1), the qualified investment with respect to any taxable year is the aggregate of the applicable percentage of the basis of each new section 38 property (or of the cost of each used sec. 38 property) placed in service by the taxpayer during the taxable year. The applicable percentage (33⅓, 66⅔, or 100 percent) is determined by reference to the useful life of the property. Senate amendment No. 203 adds a new paragraph (5) to section 46(c). Under the new paragraph, in the case of section 38 property which consists of facilities or equipment to control water or air pollution, the amount of the qualified investment shall be twice the amount determined under section 46(c)(1).

The Senate recedes.

INCOME TAX COLLECTED AT SOURCE

Amendments Nos. 204, 205, 206, 207, and 208: Section 302 of the bill as passed by the House provided a 15-percent withholding rate for wages paid during calendar year 1964 and a 14-percent withholding rate for wages paid after December 31, 1964. The bill as passed by the House also provided that the withholding rate on certain payments to nonresident aliens was to be 15 percent in the case of such payments made during calendar year 1964 and 14 percent in the case of such payments made after December 31, 1964.

Under the Senate amendments the withholding rate for wages and for the payments to nonresident aliens described in the preceding paragraph is 14 percent, effective with respect to wages paid (and such payments made) after the seventh day after the date on which the bill is enacted.

The House recedes.

W. D. MILLS,
CECIL R. KING,
THOS. J. O'BRIEN,
HALE BOGGS,
JOHN W. BYRNES,
VICTOR A. KNOX,
Managers on the Part of the House.

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Public Law 88-272
88th Congress, H. R. 8363
February 26, 1964

An Act

To amend the Internal Revenue Code of 1954 to reduce individual and corporate income taxes, to make certain structural changes with respect to the income tax, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DECLARATION BY CONGRESS.

Revenue Act of 1964.

It is the sense of Congress that the tax reduction provided by this Act through stimulation of the economy, will, after a brief transitional period, raise (rather than lower) revenues and that such revenue increases should first be used to eliminate the deficits in the administrative budgets and then to reduce the public debt. To further the objective of obtaining balanced budgets in the near future, Congress by this action, recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective.

SEC. 2. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Revenue Act of 1964".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954. 68A Stat. 3.

Title I—Reduction Of Income Tax Rates And Related Amendments

PART I—INDIVIDUALS

SEC. 111. REDUCTION OF TAX ON INDIVIDUALS.

(a) INDIVIDUALS OTHER THAN HEADS OF HOUSEHOLDS.—Subsection (a) of section 1 (relating to rates of tax on individuals other than heads of households) is amended to read as follows: 26 USC 1.

"(a) RATES OF TAX ON INDIVIDUALS.—

"(1) TAXABLE YEARS BEGINNING IN 1964.—In the case of a taxable year beginning on or after January 1, 1964, and before January 1, 1965, there is hereby imposed on the taxable income of every individual (other than a head of a household to whom subsection (b) applies) a tax determined in accordance with the following table:

"If the taxable income is:	The tax is:
Not over $500	16% of the taxable income.
Over $500 but not over $1,000	$80, plus 16.5% of excess over $500.
Over $1,000 but not over $1,500	$162.50, plus 17.5% of excess over $1,000.
Over $1,500 but not over $2,000	$250, plus 18% of excess over $1,500.
Over $2,000 but not over $4,000	$340, plus 20% of excess over $2,000.
Over $4,000 but not over $6,000	$740, plus 23.5% of excess over $4,000.
Over $6,000 but not over $8,000	$1,210, plus 27% of excess over $6,000.
Over $8,000 but not over $10,000	$1,750, plus 30.5% of excess over $8,000.
Over $10,000 but not over $12,000	$2,360, plus 34% of excess over $10,000.
Over $12,000 but not over $14,000	$3,040, plus 37.5% of excess over $12,000.

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"If the taxable income is:	The tax is:
Over $14,000 but not over $16,000	$3,790, plus 41% of excess over $14,000.
Over $16,000 but not over $18,000	$4,610, plus 44.5% of excess over $16,000.
Over $18,000 but not over $20,000	$5,500, plus 47.5% of excess over $18,000.
Over $20,000 but not over $22,000	$6,450, plus 50.5% of excess over $20,000.
Over $22,000 but not over $26,000	$7,460, plus 53.5% of excess over $22,000.
Over $26,000 but not over $32,000	$9,600, plus 56% of excess over $26,000.
Over $32,000 but not over $38,000	$12,960, plus 58.5% of excess over $32,000.
Over $38,000 but not over $44,000	$16,470, plus 61% of excess over $38,000.
Over $44,000 but not over $50,000	$20,130, plus 63.5% of excess over $44,000.
Over $50,000 but not over $60,000	$23,940, plus 66% of excess over $50,000.
Over $60,000 but not over $70,000	$30,540, plus 68.5% of excess over $60,000.
Over $70,000 but not over $80,000	$37,390, plus 71% of excess over $70,000.
Over $80,000 but not over $90,000	$44,490, plus 73.5% of excess over $80,000.
Over $90,000 but not over $100,000	$51,840, plus 75% of excess over $90,000.
Over $100,000 but not over $200,000	$59,340, plus 76.5% of excess over $100,000.
Over $200,000	$135,840, plus 77% of excess over $200,000.

"(2) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1964.—In the case of a taxable year beginning after December 31, 1964, there is hereby imposed on the taxable income of every individual (other than a head of a household to whom subsection (b) applies) a tax determined in accordance with the following table:

"If the taxable income is:	The tax is:
Not over $500	14% of the taxable income.
Over $500 but not over $1,000	$70, plus 15% of excess over $500.
Over $1,000 but not over $1,500	$145, plus 16% of excess over $1,000.
Over $1,500 but not over $2,000	$225, plus 17% of excess over $1,500.
Over $2,000 but not over $4,000	$310, plus 19% of excess over $2,000.
Over $4,000 but not over $6,000	$690, plus 22% of excess over $4,000.
Over $6,000 but not over $8,000	$1,130, plus 25% of excess over $6,000.
Over $8,000 but not over $10,000	$1,630, plus 28% of excess over $8,000.
Over $10,000 but not over $12,000	$2,190, plus 32% of excess over $10,000.
Over $12,000 but not over $14,000	$2,830, plus 36% of excess over $12,000.
Over $14,000 but not over $16,000	$3,550, plus 39% of excess over $14,000.
Over $16,000 but not over $18,000	$4,330, plus 42% of excess over $16,000.
Over $18,000 but not over $20,000	$5,170, plus 45% of excess over $18,000.
Over $20,000 but not over $22,000	$6,070, plus 48% of excess over $20,000.
Over $22,000 but not over $26,000	$7,030, plus 50% of excess over $22,000.
Over $26,000 but not over $32,000	$9,030, plus 53% of excess over $26,000.
Over $32,000 but not over $38,000	$12,210, plus 55% of excess over $32,000.
Over $38,000 but not over $44,000	$15,510, plus 58% of excess over $38,000.

"If the taxable income is:	The tax is:
Over $44,000 but not over $50,000	$18,990, plus 60% of excess over $44,000.
Over $50,000 but not over $60,000	$22,590, plus 62% of excess over $50,000.
Over $60,000 but not over $70,000	$28,790, plus 64% of excess over $60,000.
Over $70,000 but not over $80,000	$35,190, plus 66% of excess over $70,000.
Over $80,000 but not over $90,000	$41,790, plus 68% of excess over $80,000.
Over $90,000 but not over $100,000	$48,590, plus 69% of excess over $90,000.
Over $100,000	$55,490, plus 70% of excess over $100,000."

(b) HEADS OF HOUSEHOLDS.—Paragraph (1) of section 1(b) (relating to rates of tax on heads of households) is amended to read as follows: 26 USC 1.

"(1) RATES OF TAX.—

"(A) TAXABLE YEARS BEGINNING IN 1964.—In the case of a taxable year beginning on or after January 1, 1964, and before January 1, 1965, there is hereby imposed on the taxable income of every individual who is the head of a household a tax determined in accordance with the following table:

"If the taxable income is:	The tax is:
Not over $1,000	16% of the taxable income.
Over $1,000 but not over $2,000	$160, plus 17.5% of excess over $1,000.
Over $2,000 but not over $4,000	$335, plus 19% of excess over $2,000.
Over $4,000 but not over $6,000	$715, plus 22% of excess over $4,000.
Over $6,000 but not over $8,000	$1,155, plus 23% of excess over $6,000.
Over $8,000 but not over $10,000	$1,615, plus 27% of excess over $8,000.
Over $10,000 but not over $12,000	$2,155, plus 29% of excess over $10,000.
Over $12,000 but not over $14,000	$2,735, plus 32% of excess over $12,000.
Over $14,000 but not over $16,000	$3,375, plus 34% of excess over $14,000.
Over $16,000 but not over $18,000	$4,055, plus 37.5% of excess over $16,000.
Over $18,000 but not over $20,000	$4,805, plus 39% of excess over $18,000.
Over $20,000 but not over $22,000	$5,585, plus 42.5% of excess over $20,000.
Over $22,000 but not over $24,000	$6,435, plus 43.5% of excess over $22,000.
Over $24,000 but not over $26,000	$7,305, plus 45.5% of excess over $24,000.
Over $26,000 but not over $28,000	$8,215, plus 47% of excess over $26,000.
Over $28,000 but not over $32,000	$9,155, plus 48.5% of excess over $28,000.
Over $32,000 but not over $36,000	$11,095, plus 51.5% of excess over $32,000.
Over $36,000 but not over $38,000	$13,155, plus 53% of excess over $36,000.
Over $38,000 but not over $40,000	$14,215, plus 54% of excess over $38,000.
Over $40,000 but not over $44,000	$15,295, plus 56% of excess over $40,000.
Over $44,000 but not over $50,000	$17,535, plus 58.5% of excess over $44,000.
Over $50,000 but not over $52,000	$21,045, plus 59.5% of excess over $50,000.
Over $52,000 but not over $60,000	$22,235, plus 61% of excess over $52,000.

"If the taxable income is:	The tax is:
Over $60,000 but not over $64,000	$27,115, plus 62% of excess over $60,000.
Over $64,000 but not over $70,000	$29,595, plus 63.5% of excess over $64,000.
Over $70,000 but not over $76,000	$33,405, plus 65% of excess over $70,000.
Over $76,000 but not over $80,000	$37,305, plus 66% of excess over $76,000.
Over $80,000 but not over $88,000	$39,945, plus 67% of excess over $80,000.
Over $88,000 but not over $90,000	$45,305, plus 69% of excess over $88,000.
Over $90,000 but not over $100,000	$46,685, plus 69.5% of excess over $90,000.
Over $100,000 but not over $120,000	$53,635, plus 71% of excess over $100,000.
Over $120,000 but not over $140,000	$67,835, plus 72.5% of excess over $120,000.
Over $140,000 but not over $160,000	$82,335, plus 74% of excess over $140,000.
Over $160,000 but not over $180,000	$97,135, plus 75% of excess over $160,000.
Over $180,000 but not over $200,000	$112,135, plus 75.5% of excess over $180,000.
Over $200,000	$127,235, plus 77% of excess over $200,000.

"(B) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1964.—In the case of a taxable year beginning after December 31, 1964, there is hereby imposed on the taxable income of every individual who is the head of a household a tax determined in accordance with the following table:

"If the taxable income is:	The tax is:
Not over $1,000	14% of the taxable income.
Over $1,000 but not over $2,000	$140, plus 16% of excess over $1,000.
Over $2,000 but not over $4,000	$300, plus 18% of excess over $2,000.
Over $4,000 but not over $6,000	$660, plus 20% of excess over $4,000.
Over $6,000 but not over $8,000	$1,060, plus 22% of excess over $6,000.
Over $8,000 but not over $10,000	$1,500, plus 25% of excess over $8,000.
Over $10,000 but not over $12,000	$2,000, plus 27% of excess over $10,000.
Over $12,000 but not over $14,000	$2,540, plus 31% of excess over $12,000.
Over $14,000 but not over $16,000	$3,160, plus 32% of excess over $14,000.
Over $16,000 but not over $18,000	$3,800, plus 35% of excess over $16,000.
Over $18,000 but not over $20,000	$4,500, plus 36% of excess over $18,000.
Over $20,000 but not over $22,000	$5,220, plus 40% of excess over $20,000.
Over $22,000 but not over $24,000	$6,020, plus 41% of excess over $22,000.
Over $24,000 but not over $26,000	$6,840, plus 43% of excess over $24,000.
Over $26,000 but not over $28,000	$7,700, plus 45% of excess over $26,000.
Over $28,000 but not over $32,000	$8,600, plus 46% of excess over $28,000.
Over $32,000 but not over $36,000	$10,440, plus 48% of excess over $32,000.
Over $36,000 but not over $38,000	$12,360, plus 50% of excess over $36,000.
Over $38,000 but not over $40,000	$13,360, plus 52% of excess over $38,000.
Over $40,000 but not over $44,000	$14,400, plus 53% of excess over $40,000.
Over $44,000 but not over $50,000	$16,520, plus 55% of excess over $44,000.

"If the taxable income is:	The tax is:
Over $50,000 but not over $52,000	$10,820, plus 56% of excess over $50,000.
Over $52,000 but not over $64,000	$20,940, plus 58% of excess over $52,000.
Over $64,000 but not over $70,000	$27,900, plus 59% of excess over $64,000.
Over $70,000 but not over $76,000	$31,440, plus 61% of excess over $70,000.
Over $76,000 but not over $80,000	$35,100, plus 62% of excess over $76,000.
Over $80,000 but not over $88,000	$37,580, plus 63% of excess over $80,000.
Over $88,000 but not over $100,000	$42,620, plus 64% of excess over $88,000.
Over $100,000 but not over $120,000	$50,300, plus 66% of excess over $100,000.
Over $120,000 but not over $140,000	$63,500, plus 67% of excess over $120,000.
Over $140,000 but not over $160,000	$76,900, plus 68% of excess over $140,000.
Over $160,000 but not over $180,000	$90,500, plus 69% of excess over $160,000.
Over $180,000	$104,300, plus 70% of excess over $180,000."

SEC. 112. MINIMUM STANDARD DEDUCTION.

(a) GENERAL RULE.—Section 141 (relating to standard deduction) is amended to read as follows: 26 USC 141.

"SEC. 141. STANDARD DEDUCTION.

"(a) STANDARD DEDUCTION.—Except as otherwise provided in this section, the standard deduction referred to in this title is the larger of the 10-percent standard deduction or the minimum standard deduction. The standard deduction shall not exceed $1,000, except that in the case of a separate return by a married individual the standard deduction shall not exceed $500.

"(b) TEN-PERCENT STANDARD DEDUCTION.—The 10-percent standard deduction is an amount equal to 10 percent of the adjusted gross income.

"(c) MINIMUM STANDARD DEDUCTION.—The minimum standard deduction is an amount equal to the sum of—

"(1) $100, multiplied by the number of exemptions allowed for the taxable year as a deduction under section 151, plus

"(2)(A) $200, in the case of a joint return of a husband and wife under section 6013,

"(B) $200, in the case of a return of an individual who is not married, or

"(C) $100, in the case of a separate return by a married individual.

"(d) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—Notwithstanding subsection (a)—

"(1) The minimum standard deduction shall not apply in the case of a separate return by a married individual if the tax of the other spouse is determined with regard to the 10-percent standard deduction.

"(2) A married individual filing a separate return may, if the minimum standard deduction is less than the 10-percent standard deduction, and if the minimum standard deduction of his spouse is greater than the 10-percent standard deduction of such spouse, elect (under regulations prescribed by the Secretary or his delegate) to have his tax determined with regard to the minimum standard deduction in lieu of being determined with regard to the 10-percent standard deduction."

26 USC 2. Post, p. 129; ante, p. 23.

(b) AMENDMENT OF SECTION 2.—The second sentence of section 2(a) (relating to tax in case of joint return or return of surviving spouse) is amended by striking out "and section 3" and inserting in lieu thereof ", section 3, and section 141".

26 USC 144.

(c) AMENDMENTS OF SECTION 144.—

(1) The first sentence of section 144(b) (relating to change of election of standard deduction) is amended to read as follows: "Under regulations prescribed by the Secretary or his delegate, a change of election with respect to the standard deduction for any taxable year may be made after the filing of the return for such year."

(2) Section 144 is amended by adding at the end thereof the following new subsection:

"(c) CHANGE OF ELECTION DEFINED.—For purposes of this title, the term 'change of election with respect to the standard deduction' means—

"(1) a change of an election to take (or not to take) the standard deduction;

"(2) a change of an election to pay (or not to pay) the tax under section 3; or

"(3) a change of an election under section 141(d)(2)."

(d) CONFORMING AMENDMENTS.—

26 USC 6212.

(1) Subparagraph (A) of section 6212(c)(2) (relating to cross references) is amended by striking out "to take" and inserting in lieu thereof "with respect to the".

26 USC 6504.

(2) Paragraph (3) of section 6504 (relating to cross references) is amended by striking out "to take" and inserting in lieu thereof "with respect to the".

SEC. 113. RELATED AMENDMENTS.

26 USC 37; post, p. 32.

(a) RETIREMENT INCOME CREDIT.—Section 37(a) (relating to credit against tax for retirement income) is amended by striking out "an amount equal to the amount received by such individual as retirement income (as defined in subsection (c) and as limited by subsection (d)), multiplied by the rate provided in section 1 for the first $2,000 of taxable income;" and inserting in lieu thereof "an amount equal to 17 percent, in the case of a taxable year beginning in 1964, or 15 percent, in the case of a taxable year beginning after December 31, 1964, of the amount received by such individual as retirement income (as defined in subsection (c) and as limited by subsection (d));".

26 USC 871.

(b) TAX ON NONRESIDENT ALIEN INDIVIDUALS.—Section 871 (relating to tax on nonresident alien individuals) is amended—

(1) By striking out "is more than $15,400, except that—" in subsection (b) and inserting in lieu thereof "is more than $19,000 in the case of a taxable year beginning in 1964 or more than $21,200 in the case of a taxable year beginning after 1964, except that—".

(2) By striking out the heading to subsection (a) and inserting in lieu thereof the following:

"(a) NO UNITED STATES BUSINESS—30 PERCENT TAX.—".

(3) By striking out the heading to subsection (b) and inserting in lieu thereof the following:

"(b) NO UNITED STATES BUSINESS—REGULAR TAX.—".

SEC. 114. CROSS REFERENCES TO TAX TABLES, ETC.

(1) For optional tax if adjusted gross income is less than $5,000, see section 301 of this Act.

(2) For income tax collected at source, see section 302 of this Act.

PART II—CORPORATIONS

SEC. 121. REDUCTION OF TAX ON CORPORATIONS.

Section 11 (relating to tax on corporations) is amended to read as follows: 26 USC 11.

"SEC. 11. TAX IMPOSED.

"(a) CORPORATIONS IN GENERAL.—A tax is hereby imposed for each taxable year on the taxable income of every corporation. The tax shall consist of a normal tax computed under subsection (b) and a surtax computed under subsection (c).

"(b) NORMAL TAX.—The normal tax is equal to the following percentage of the taxable income:

"(1) 30 percent, in the case of a taxable year beginning before January 1, 1964, and

"(2) 22 percent, in the case of a taxable year beginning after December 31, 1963.

"(c) SURTAX.—The surtax is equal to the following percentage of the amount by which the taxable income exceeds the surtax exemption for the taxable year:

"(1) 22 percent, in the case of a taxable year beginning before January 1, 1964,

"(2) 28 percent, in the case of a taxable year beginning after December 31, 1963, and before January 1, 1965, and

"(3) 26 percent, in the case of a taxable year beginning after December 31, 1964.

"(d) SURTAX EXEMPTION.—For purposes of this subtitle, the surtax exemption for any taxable year is $25,000, except that, with respect to a corporation to which section 1561 (relating to surtax exemptions in case of certain controlled corporations) applies for the taxable year, the surtax exemption for the taxable year is the amount determined under such section. Post, p. 116.

"(e) EXCEPTIONS.—Subsection (a) shall not apply to a corporation subject to a tax imposed by—

"(1) section 594 (relating to mutual savings banks conducting life insurance business), 26 USC 594.

"(2) subchapter L (sec. 801 and following, relating to insurance companies), 26 USC 801 et seq.

"(3) subchapter M (sec. 851 and following, relating to regulated investment companies and real estate investment trusts), or 26 USC 851 et seq.

"(4) section 881(a) (relating to foreign corporations not engaged in business in United States)." 26 USC 881.

SEC. 122. CURRENT TAX PAYMENTS BY CORPORATIONS.

(a) INSTALLMENT PAYMENTS OF ESTIMATED INCOME TAX BY CORPORATIONS.—Section 6154 (relating to installment payments of estimated income tax by corporations) is amended to read as follows: 26 USC 6154.

"SEC. 6154. INSTALLMENT PAYMENTS OF ESTIMATED INCOME TAX BY CORPORATIONS.

"(a) AMOUNT AND TIME FOR PAYMENT OF EACH INSTALLMENT.—The amount of estimated tax (as defined in section 6016(b)) with respect to which a declaration is required under section 6016 shall be paid as follows: 26 USC 6016.

"(1) PAYMENT IN 4 INSTALLMENTS.—If the declaration is filed on or before the 15th day of the 4th month of the taxable year, the estimated tax shall be paid in 4 installments. The amount and time for payment of each installment shall be determined in accordance with the following table:

"If the taxable year begins in—	The following percentages of the estimated tax shall be paid on the 15th day of the—			
	4th month	6th month	9th month	12th month
1964	1	1	25	25
1965	4	4	25	25
1966	9	9	25	25
1967	14	14	25	25
1968	19	19	25	25
1969	22	22	25	25
1970 or any subsequent year	25	25	25	25

"(2) PAYMENT IN 3 INSTALLMENTS.—If the declaration is filed after the 15th day of the 4th month and not after the 15th day of the 6th month of the taxable year, and is not required by section 6074(a) to be filed on or before the 15th day of such 4th month, the estimated tax shall be paid in 3 installments. The amount and time for payment of each installment shall be determined in accordance with the following table:

Post, p. 28.

"If the taxable year begins in—	The following percentages of the estimated tax shall be paid on the 15th day of the—		
	6th month	9th month	12th month
1964	1⅓	25⅓	25⅓
1965	5⅓	26⅓	26⅓
1966	12	28	28
1967	18⅔	29⅔	29⅔
1968	25⅓	31⅓	31⅓
1969	29⅓	32⅓	32⅓
1970 or any subsequent year	33⅓	33⅓	33⅓

"(3) PAYMENT IN 2 INSTALLMENTS.—If the declaration of estimated tax is filed after the 15th day of the 6th month and not after the 15th day of the 9th month of the taxable year, and is not required by section 6074(a) to be filed on or before the 15th day of such 6th month, the estimated tax shall be paid in 2 installments. The amount and time for payment of each installment shall be determined in accordance with the following table:

"If the taxable year begins in—	The following percentages of the estimated tax shall be paid on the 15th day of the—	
	9th month	12th month
1964	26	26
1965	29	29
1966	34	34
1967	39	39
1968	44	44
1969	47	47
1970 or any subsequent year	50	50

"(4) PAYMENT IN 1 INSTALLMENT.—If the declaration of estimated tax is filed after the 15th day of the 9th month of the taxable year, and is not required by section 6074(a) to be filed on or before the 15th day of such 9th month, the estimated tax shall be paid in 1 installment. The amount and time for payment of the installment shall be determined in accordance with the following table: Post, p. 28.

"If the taxable year begins in—	The following percentages of the estimated tax shall be paid on the 15th day of the 12th month
1964	52
1965	58
1966	68
1967	78
1968	88
1969	94
1970 or any subsequent year	100

"(5) LATE FILING.—If the declaration is filed after the time prescribed in section 6074(a) (determined without regard to any extension of time for filing the declaration under section 6081), paragraphs (2), (3), and (4) of this subsection shall not apply, and there shall be paid at the time of such filing all installments of estimated tax which would have been payable on or before such time if the declaration had been filed within the time prescribed in section 6074(a), and the remaining installments shall be paid at the times at which, and in the amounts in which, they would have been payable if the declaration had been so filed. 26 USC 6081.

"(b) AMENDMENT OF DECLARATION.—If any amendment of a declaration is filed, the amount of each remaining installment (if any) shall be the amount which would have been payable if the new estimate had been made when the first estimate for the taxable year was made, increased or decreased (as the case may be), by the amount computed by dividing—

"(1) the difference between (A) the amount of estimated tax required to be paid before the date on which the amendment is made, and (B) the amount of estimated tax which would have been required to be paid before such date if the new estimate had been made when the first estimate was made, by

"(2) the number of installments remaining to be paid on or after the date on which the amendment is made.

"(c) APPLICATION TO SHORT TAXABLE YEAR.—The application of this section to taxable years of less than 12 months shall be in accordance with regulations prescribed by the Secretary or his delegate.

"(d) INSTALLMENTS PAID IN ADVANCE.—At the election of the corporation, any installment of the estimated tax may be paid before the date prescribed for its payment."

(b) TIME FOR FILING DECLARATIONS OF ESTIMATED INCOME TAX BY CORPORATIONS.—Section 6074 (relating to time for filing declarations of estimated income tax by corporations) is amended to read as follows:

"SEC. 6074. TIME FOR FILING DECLARATIONS OF ESTIMATED INCOME TAX BY CORPORATIONS.

"(a) GENERAL RULE.—The declaration of estimated tax required of corporations by section 6016 shall be filed as follows:

"If the requirements of section 6016 are first met—	The declaration shall be filed on or before—
before the 1st day of the 4th month of the taxable year	the 15th day of the 4th month of the taxable year
after the last day of the 3d month and before the 1st day of the 6th month of the taxable year	the 15th day of the 6th month of the taxable year
after the last day of the 5th month and before the 1st day of the 9th month of the taxable year	the 15th day of the 9th month of the taxable year
after the last day of the 8th month and before the 1st day of the 12th month of the taxable year	the 15th day of the 12th month of the taxable year

"(b) AMENDMENT.—An amendment of a declaration may be filed in any interval between installment dates prescribed for the taxable year, but only one amendment may be filed in each such interval.

"(c) SHORT TAXABLE YEAR.—The application of this section to taxable years of less than 12 months shall be in accordance with regulations prescribed by the Secretary or his delegate."

26 USC 6655. (e) FAILURE BY CORPORATIONS TO PAY ESTIMATED INCOME TAX.—

(1) The last sentence of section 6655(c)(2) (relating to period of underpayment) is amended to read as follows: "For purposes of this paragraph, a payment of estimated tax on any installment date shall be considered a payment of any previous underpayment only to the extent such payment exceeds the amount of the installment determined under subsection (b)(1) for such installment date."

(2) Paragraph (3) of section 6655(d) (relating to exception) is amended to read as follows:

"(3)(A) An amount equal to 70 percent of the tax for the taxable year computed by placing on an annualized basis the taxable income:

"(i) for the first 3 months of the taxable year, in the case of the installment required to be paid in the 4th month,

"(ii) for the first 3 months or for the first 5 months of the taxable year, in the case of the installment required to be paid in the 6th month,

"(iii) for the first 6 months or for the first 8 months of the taxable year in the case of the installment required to be paid in the 9th month, and

"(iv) for the first 9 months or for the first 11 months of the taxable year, in the case of the installment required to be paid in the 12th month of the taxable year.

"(B) For purposes of this paragraph, the taxable income shall be placed on an annualized basis by—

"(i) multiplying by 12 the taxable income referred to in subparagraph (A), and

"(ii) dividing the resulting amount by the number of months in the taxable year (3, 5, 6, 8, 9, or 11, as the case may be) referred to in subparagraph (A)."

(d) TECHNICAL AMENDMENT.—Section 6016(f) (relating to declarations of estimated income tax by corporations) is amended to read as follows: 26 USC 6016.

"(f) CROSS REFERENCE.—

"For provisions relating to the number of amendments which may be filed, see section 6074(b)." Ante, p. 28.

SEC. 123. RELATED AMENDMENTS.

(a) TAX ON MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE, ETC.)—

(1) Subsection (a) of section 821 (relating to imposition of tax) is amended to read as follows: 26 USC 821.

"(a) IMPOSITION OF TAX.—A tax is hereby imposed for each taxable year beginning after December 31, 1963, on the mutual insurance company taxable income of every mutual insurance company (other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 831). Such tax shall consist of—

"(1) NORMAL TAX.—A normal tax of 22 percent of the mutual insurance company taxable income, or 44 percent of the amount by which such taxable income exceeds $6,000, whichever is the lesser; plus

"(2) SURTAX.—A surtax on the mutual insurance company taxable income computed as provided in section 11(c) as though the mutual insurance company taxable income were the taxable income referred to in section 11(c)." Ante, p. 25.

(2) Paragraph (1) of section 821(c) (relating to alternative tax for certain small companies) is amended to read as follows:

"(1) IMPOSITION OF TAX.—In the case of taxable years beginning after December 31, 1963, there is hereby imposed for each taxable year on the income of each mutual insurance company to which this subsection applies a tax (which shall be in lieu of the tax imposed by subsection (a)) computed as follows:

"(A) NORMAL TAX.—A normal tax of 22 percent of the taxable investment income, or 44 percent of the amount by which such taxable income exceeds $3,000, whichever is the lesser; plus

"(B) SURTAX.—A surtax on the taxable investment income computed as provided in section 11(c) as though the taxable investment income were the taxable income referred to in section 11(c)."

(b) RECEIPT OF MINIMUM DISTRIBUTIONS BY DOMESTIC CORPORATIONS.—Subsection (b) of section 963 (relating to receipt of minimum distributions by domestic corporations) is amended to read as follows: 26 USC 963.

"(b) MINIMUM DISTRIBUTION.—For purposes of this section, a minimum distribution with respect to the earnings and profits for the taxable year of any controlled foreign corporation or corporations shall, in the case of any United States shareholder, be its pro rata share of an amount determined in accordance with whichever of the following tables applies to the taxable year:

"(1) TAXABLE YEARS BEGINNING IN 1963.—

"If the effective foreign tax rate is (percentage)—	The required minimum distribution of earnings and profits is (percentage)—
Under 10	90
10 or over but less than 20	86
20 or over but less than 28	82
28 or over but less than 34	75
34 or over but less than 39	68
39 or over but less than 42	55
42 or over but less than 44	40
44 or over but less than 46	27
46 or over but less than 47	14
47 or over	0

"(2) TAXABLE YEARS BEGINNING IN 1964.—

"If the effective foreign tax rate is (percentage)—	The required minimum distribution of earnings and profits is (percentage)—
Under 10	87
10 or over but less than 19	83
19 or over but less than 27	79
27 or over but less than 33	72
33 or over but less than 37	65
37 or over but less than 40	53
40 or over but less than 42	38
42 or over but less than 44	26
44 or over but less than 45	13
45 or over	0

"(3) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1964.—

"If the effective foreign tax rate is (percentage)—	The required minimum distribution of earnings and profits is (percentage)—
Under 9	83
9 or over but less than 18	79
18 or over but less than 26	76
26 or over but less than 32	69
32 or over but less than 36	63
36 or over but less than 39	51
39 or over but less than 41	37
41 or over but less than 42	25
42 or over but less than 43	13
43 or over	0"

26 USC 242. (c) AMENDMENT OF SECTION 242.—Section 242(a) (relating to deduction for partially tax-exempt interest) is amended by adding at the end thereof the following new sentence: "No deduction shall be allowed under this section for purposes of any surtax imposed by this subtitle."

PART III—EFFECTIVE DATES

SEC. 131. GENERAL RULE.

26 USC 21. Except for purposes of section 21 of the Internal Revenue Code of 1954 (relating to effect of changes in rates during a taxable year), the amendments made by parts I and II of this title shall apply with respect to taxable years beginning after December 31, 1963.

SEC. 132. FISCAL YEAR TAXPAYERS.

Effective with respect to taxable years ending after December 31, 1963, subsection (d) of section 21 (relating to effect of changes in rates during a taxable year) is amended to read as follows:

"(d) CHANGES MADE BY REVENUE ACT OF 1964.—

"(1) INDIVIDUALS.—In applying subsection (a) to the taxable year of an individual beginning in 1963 and ending in 1964—

"(A) the rate of tax for the period on and after January 1, 1964, shall be applied to the taxable income determined as if part IV of subchapter B (relating to standard deduction for individuals), as amended by the Revenue Act of 1964, applied to taxable years ending after December 31, 1963, and

"(B) section 4 (relating to rules for optional tax), as amended by such Act, shall be applied to taxable years ending after December 31, 1963. Post, pp. 111, 140.

In applying subsection (a) to a taxable year of an individual beginning in 1963 and ending in 1964, or beginning in 1964 and ending in 1965, the change in the tax imposed under section 3 shall be treated as a change in a rate of tax.

"(2) CORPORATIONS.—In applying subsection (a) to a taxable year of a corporation beginning in 1963 and ending in 1964, if—

"(A) the surtax exemption of such corporation for such taxable year is less than $25,000 by reason of the application of section 1561 (relating to surtax exemptions in case of certain controlled corporations), or

"(B) an additional tax is imposed on the taxable income of such corporation for such taxable year by section 1562(b) (relating to additional tax in case of component members of controlled groups which elect multiple surtax exemptions), Post, p. 117.

the change in the surtax exemption, or the imposition of such additional tax, shall be treated as a change in a rate of tax taking effect on January 1, 1964."

Title II—Structural Changes

SEC. 201. DIVIDENDS RECEIVED BY INDIVIDUALS.

(a) REDUCTION OF 4 PERCENT CREDIT TO 2 PERCENT CREDIT FOR CALENDAR YEAR 1964.—

(1) GENERAL RULE.—Section 34(a) (relating to general rule for credit for dividends received) is amended by striking out "an amount equal to 4 percent of the dividends which are received after July 31, 1954, from domestic corporations and are included in gross income" and inserting in lieu thereof: 26 USC 34.

"an amount equal to the following percentage of the dividends which are received from domestic corporations and are included in gross income:

"(1) 4 percent of the amount of such dividends which are received before January 1, 1964, and

"(2) 2 percent of the amount of such dividends which are received during the calendar year 1964."

(2) LIMITATIONS.—Section 34(b)(2) (relating to limitations on amount of credit) is amended—

(A) by inserting ", or beginning after December 31, 1963" after "1955" at the end of subparagraph (A), and

(B) by inserting ", and beginning before January 1, 1964" after "1954" at the end of subparagraph (B).

(b) REPEAL OF CREDIT FOR DIVIDENDS RECEIVED BY INDIVIDUALS.—Effective with respect to dividends received after December 31, 1964, section 34 (relating to dividends received by individuals) is hereby repealed.

(c) DOUBLING OF AMOUNT OF PARTIAL EXCLUSION FROM GROSS INCOME OF DIVIDENDS RECEIVED BY INDIVIDUALS.—Section 116(a) (relating to partial exclusion from gross income of dividends received by individuals) is amended by striking out "$50" each place it appears and inserting in lieu thereof "$100".

26 USC 116.

(d) CONFORMING AMENDMENTS.—

(1) The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by striking out

"Sec. 34. Dividends received by individuals."

26 USC 35. (2) Section 35(b)(1) is amended by striking out "the sum of the credits allowable under sections 33 and 34" and inserting in lieu thereof "the credit allowable under section 33".

26 USC 37; ante, p. 24. (3) Section 37(a) is amended by striking out "section 34 (relating to credit for dividends received by individuals),".

26 USC 46. (4) Section 46(a)(3) is amended by striking out subparagraph (B), and by redesignating subparagraphs (C) and (D) as "(B)" and "(C)", respectively.

26 USC 584. (5) Section 584(c)(2) is amended by striking out "section 34 or".

26 USC 642. (6)(A) Section 642(a) is amended by striking out paragraph (3);

(B) Section 642(i) is amended to read as follows:

"(i) CROSS REFERENCES.—

26 USC 142. "(1) For disallowance of standard deduction in case of estates and trusts, see section 142(b)(4).

26 USC 652, 662. "(2) For special rule for determining the time of receipt of dividends by a beneficiary under section 652 or 662, see section 116(c)(3)."

(C) Section 116(c) is amended by adding at the end thereof the following new paragraph:

"(3) The amount of dividends properly allocable to a beneficiary under section 652 or 662 shall be deemed to have been received by the beneficiary ratably on the same date that the dividends were received by the estate or trust."

26 USC 702; supra. (7) Section 702(a)(5) is amended by striking out "a credit under section 34," and the comma after "section 116".

26 USC 854. (8) Section 854(a) is amended by striking out "section 34(a) (relating to credit for dividends received by individuals)," and the comma after "section 116 (relating to an exclusion for dividends received by individuals)".

(9) Section 854(b)(1) is amended by striking out "the credit under section 34(a)," and the comma after "section 116".

Post, p. 99. (10) Section 854(b)(2) is amended by striking out "the credit under section 34," and the comma after "section 116".

26 USC 857. (11) Section 857(c) is amended by striking out "section 34(a) (relating to credit for dividends received by individuals)," and the comma after "section 116 (relating to an exclusion for dividends received by individuals)".

26 USC 871. (12) Section 871(b) is amended by striking out "the sum of the credits under sections 34 and 35" and inserting in lieu thereof "the credit under section 35".

26 USC 1375. (13) Section 1375(b) is amended by striking out "section 34," and the comma after "section 37".

26 USC 6014. (14) Section 6014(a) is amended by striking out "34 or".

(e) EFFECTIVE DATES.—The amendments made by subsection (a) shall apply with respect to taxable years ending after December 31, 1963. The amendment made by subsection (b) shall apply with respect to taxable years ending after December 31, 1964. The amendment made by subsection (c) shall apply with respect to taxable years beginning after December 31, 1963. The amendments made by subsection (d) shall apply with respect to dividends received after December 31, 1964, in taxable years ending after such date.

SEC. 202. RETIREMENT INCOME CREDIT OF CERTAIN MARRIED INDIVIDUALS.

(a) DETERMINATION OF RETIREMENT INCOME.—Section 37 (relating to retirement income) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection: 26 USC 37.

"(i) SPECIAL RULES FOR CERTAIN MARRIED COUPLES.—

"(1) ELECTION.—A husband and wife who make a joint return for the taxable year and both of whom have attained the age of 65 before the close of the taxable year may elect (at such time and in such manner as the Secretary or his delegate by regulations prescribes) to determine the amount of the credit allowed by subsection (a) by applying the provisions of paragraph (2).

"(2) SPECIAL RULES.—If an election is made under paragraph (1) for the taxable year, for purposes of subsection (a)—

"(A) if either spouse is an individual who has received earned income within the meaning of subsection (b), the other spouse shall be considered to be an individual who has received earned income within the meaning of such subsection; and

"(B) subsection (d) shall be considered as providing that the amount of the combined retirement income of both spouses shall not exceed $2,286, less the sum of the amounts specified in paragraphs (1) and (2) of subsection (d) for each spouse."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1963.

SEC. 203. REPEAL OF REQUIREMENT THAT BASIS OF SECTION 38 PROPERTY BE REDUCED BY 7 PERCENT; OTHER PROVISIONS RELATING TO INVESTMENT CREDIT.

(a) REPEAL OF REQUIREMENT THAT BASIS BE REDUCED.—

(1) IN GENERAL.—Subsection (g) of section 48 (requiring that the basis of section 38 property be reduced by 7 percent of the qualified investment) is hereby repealed. 26 USC 48. 26 USC 38.

(2) INCREASE IN BASIS OF PROPERTY PLACED IN SERVICE BEFORE JANUARY 1, 1964.—

(A) The basis of any section 38 property (as defined in section 48(a) of the Internal Revenue Code of 1954) placed in service before January 1, 1964, shall be increased, under regulations prescribed by the Secretary of the Treasury or his delegate, by an amount equal to 7 percent of the qualified investment with respect to such property under section 46(c) of the Internal Revenue Code of 1954. If there has been any increase with respect to such property under section 48(g)(2) of such Code, the increase under the preceding sentence shall be appropriately reduced therefor. 26 USC 46.

(B) If a lessor made the election provided by section 48(d) of the Internal Revenue Code of 1954 with respect to property placed in service before January 1, 1964—

(i) subparagraph (A) shall not apply with respect to such property, but

(ii) under regulations prescribed by the Secretary of the Treasury or his delegate, the deductions otherwise allowable under section 162 of such Code to the lessee for amounts paid to the lessor under the lease (or, if such lessee has purchased such property, the basis of such property) shall be adjusted in a manner consistent with subparagraph (A).

26 USC 162.

(C) The adjustments under this paragraph shall be made as of the first day of the taxpayer's first taxable year which begins after December 31, 1963.

(3) CONFORMING AMENDMENTS.—

26 USC 48. (A) The last sentence of section 48(d) (relating to certain leased property) is hereby repealed.

26 USC 181. (B) Section 181 (relating to deduction for certain unused investment credit) is hereby repealed.

26 USC 1016. (C) Section 1016(a)(19) (relating to adjustments to basis) is amended to read as follows:

26 USC 203. "(19) to the extent provided in section 48(g) and in section 203(a)(2) of the Revenue Act of 1964, in the case of property which is or has been section 38 property (as defined in section 48(a));"

(D) The table of sections for part VI of subchapter B of chapter 1 is amended by striking out the following:

"Sec. 181. Deduction for certain unused investment credit."

(4) EFFECTIVE DATE.—Paragraphs (1) and (3) of this subsection shall apply—

(A) in the case of property placed in service after December 31, 1963, with respect to taxable years ending after such date, and

(B) in the case of property placed in service before January 1, 1964, with respect to taxable years beginning after December 31, 1963.

(b) BASIS OF CERTAIN LEASED PROPERTY TO LESSEE.—Paragraphs (1) and (2) of section 48(d) (relating to certain leased property) are amended to read as follows:

"(1) except as provided in paragraph (2), the fair market value of such property, or

"(2) if such property is leased by a corporation which is a member of an affiliated group (within the meaning of section 46(a)(5)) to another corporation which is a member of the same affiliated group, the basis of such property to the lessor."

26 USC 48, 38. (c) TREATMENT OF ELEVATORS AND ESCALATORS FOR PURPOSES OF THE INVESTMENT CREDIT.—Section 48(a)(1) (relating to section 38 property) is amended—

(1) by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", or"; and

(2) by adding after subparagraph (B) the following new subparagraph:

"(C) elevators and escalators, but only if—

"(i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer after June 30, 1963, or

"(ii) the elevator or escalator is acquired after June 30, 1963, and the original use of such elevator or escalator commences with the taxpayer and commences after such date."

(d) TREATMENT OF ELEVATORS AND ESCALATORS FOR PURPOSES OF SECTION 1245.—Section 1245(a) (relating to gain from dispositions of certain depreciable property) is amended— 26 USC 1245.

(1) by striking out so much of paragraph (2) as precedes the second sentence thereof and inserting in lieu thereof the following:

"(2) RECOMPUTED BASIS.—For purposes of this section, the term 'recomputed basis' means—

"(A) with respect to any property referred to in paragraph (3) (A) or (B), its adjusted basis recomputed by adding thereto all adjustments, attributable to periods after December 31, 1961, or

"(B) with respect to any property referred to in paragraph (3)(C), its adjusted basis recomputed by adding thereto all adjustments, attributable to periods after June 30, 1963,

reflected in such adjusted basis on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for depreciation, or for amortization under section 168."; 26 USC 168.

(2) by striking out the period at the end of paragraph (3) (B) and inserting in lieu thereof ", or"; and

(3) by adding at the end of paragraph (3) the following new subparagraph:

"(C) an elevator or an escalator."

(e) TREATMENT OF INVESTMENT CREDIT BY FEDERAL REGULATORY AGENCIES.—It was the intent of the Congress in providing an investment credit under section 38 of the Internal Revenue Code of 1954, and it is the intent of the Congress in repealing the reduction in basis required by section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer, use— 26 USC 38. Ante, p. 33.

(1) in the case of public utility property (as defined in section 46(c)(3)(B) of the Internal Revenue Code of 1954), more than a proportionate part (determined with reference to the average useful life of the property with respect to which the credit was allowed) of the credit against tax allowed for any taxable year by section 38 of such Code, or 26 USC 46.

(2) in the case of any other property, any credit against tax allowed by section 38 of such Code,

to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method.

(f) EFFECTIVE DATES.—

(1) The amendments made by subsection (b) shall apply with respect to property possession of which is transferred to a lessee on or after the date of enactment of this Act.

(2) The amendments made by subsection (c) shall apply with respect to taxable years ending after June 30, 1963.

(3) The amendments made by subsection (d) shall apply with respect to dispositions after December 31, 1963, in taxable years ending after such date.

SEC. 204. GROUP-TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES.

(a) INCLUSION IN INCOME.—

26 USC 71 et seq. (1) Part II of subchapter B of chapter 1 (relating to items specifically included in gross income) is amended by adding at the end thereof the following new section:

"SEC. 79. GROUP-TERM LIFE INSURANCE PURCHASED FOR EMPLOYEES.

"(a) GENERAL RULE.—There shall be included in the gross income of an employee for the taxable year an amount equal to the cost of group-term life insurance on his life provided for part or all of such year under a policy (or policies) carried directly or indirectly by his employer (or employers); but only to the extent that such cost exceeds the sum of—

"(1) the cost of $50,000 of such insurance, and

"(2) the amount (if any) paid by the employee toward the purchase of such insurance.

"(b) EXCEPTIONS.—Subsection (a) shall not apply to—

"(1) the cost of group-term life insurance on the life of an individual which is provided under a policy carried directly or indirectly by an employer after such individual has terminated his employment with such employer and either has reached the retirement age with respect to such employer or is disabled

26 USC 213. (within the meaning of paragraph (3) of section 213(g), determined without regard to paragraph (4) thereof),

"(2) the cost of any portion of the group-term life insurance on the life of an employee provided during part or all of the taxable year of the employee under which—

"(A) the employer is directly or indirectly the beneficiary, or

26 USC 170. "(B) a person described in section 170(c) is the sole beneficiary,

for the entire period during such taxable year for which the employee receives such insurance, and

"(3) the cost of any group-term life insurance which is pro-

26 USC 72. vided under a contract to which section 72(m)(3) applies.

"(c) DETERMINATION OF COST OF INSURANCE.—For purposes of this

26 USC 6052. section and section 6052, the cost of group-term insurance on the life of an employee provided during any period shall be determined on the basis of uniform premiums (computed on the basis of 5-year age brackets) prescribed by regulations by the Secretary or his delegate. In the case of an employee who has attained age 64, the cost prescribed shall not exceed the cost with respect to such individual if he were age 63."

(2) The table of sections for part II of subchapter B of chapter 1 is amended by adding at the end thereof the following:

"Sec. 79. Group-term life insurance purchased for employees."

26 USC 7701. (3) Section 7701(a)(20) (defining employee) is amended by striking out "For the purpose of applying the provisions of sections 104" and inserting in lieu thereof "For the purpose of applying the provisions of section 79 with respect to group-term life insurance purchased for employees, for the purpose of applying the provisions of sections 104".

Post, p. 52. (b) WITHHOLDING.—Section 3401(a) (relating to definition of wages) is amended by striking out the period at the end of paragraph (13) and inserting in lieu thereof "; or", and by adding at the end thereof the following new paragraph:

"(14) in the form of group-term life insurance on the life of an employee; or".

(c) INFORMATION REPORTING.—

(1) REQUIREMENT.—Subpart C of part III of subchapter A of chapter 61 (relating to information and returns) is amended by adding at the end thereof the following new section: 26 USC 6051.

"SEC. 6052. RETURNS REGARDING PAYMENT OF WAGES IN THE FORM OF GROUP-TERM LIFE INSURANCE.

"(a) REQUIREMENT OF REPORTING.—Every employer who during any calendar year provides group-term life insurance on the life of an employee during part or all of such calendar year under a policy (or policies) carried directly or indirectly by such employer shall make a return according to the forms or regulations prescribed by the Secretary or his delegate, setting forth the cost of such insurance and the name and address of the employee on whose life such insurance is provided, but only to the extent that the cost of such insurance is includible in the employee's gross income under section 79(a). For purposes of this section, the extent to which Ante, p. 36. the cost of group-term life insurance is includible in the employee's gross income under section 79(a) shall be determined as if the employer were the only employer paying such employee remuneration in the form of such insurance.

"(b) STATEMENTS TO BE FURNISHED TO EMPLOYEES WITH RESPECT TO WHOM INFORMATION IS FURNISHED.—Every employer making a return under subsection (a) shall furnish to each employee whose name is set forth in such return a written statement showing the cost of the group-term life insurance shown on such return. The written statement required under the preceding sentence shall be furnished to the employee on or before January 31 of the year following the calendar year for which the return under subsection (a) was made."

(2) PENALTIES FOR FAILURE TO FURNISH STATEMENTS TO PERSONS WITH RESPECT TO WHOM RETURNS ARE FILED.—Section 6678 (relat- Post, p. 75. ing to failure to furnish certain statements) is amended—

(A) by striking out "or 6049(c)" and inserting in lieu thereof "6049(c), or 6052(b)"; and

(B) by striking out "or 6049(a)(1)," and inserting in lieu thereof "6049(a)(1), or 6052(a),".

(3) CLERICAL AMENDMENT.—The table of sections for subpart C of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following:

"Sec. 6052. Returns regarding payment of wages in the form of group-term life insurance."

(4) CROSS REFERENCE.—

For penalty for failure to file information returns required by section 6052(a) of the Internal Revenue Code of 1954 (added by paragraph (1) of this subsection), see section 6652(a)(3) of such Code (as amended by section 221(b)(2) of this Act).

(d) EFFECTIVE DATES.—The amendments made by subsections (a) and (c), and paragraph (3) of section 6652(a) of the Internal Revenue Code of 1954 (as amended by section 221(b)(2) of this Act), Post, p. 74. shall apply with respect to group-term life insurance provided after December 31, 1963, in taxable years ending after such date. The amendments made by subsection (b) shall apply with respect to remuneration paid after December 31, 1963, in the form of group-term life insurance provided after such date. In applying section 79(b) of the Internal Revenue Code of 1954 (as added by subsection (a)(1) of this section) to a taxable year beginning before May 1, Ante, p. 36. 1964, if paragraph (2)(B) of such section applies with respect to an employee for the period beginning May 1, 1964, and ending with the close of his first taxable year ending after April 30, 1964, such paragraph (2)(B) shall be treated as applying with respect to such employee for the period beginning January 1, 1964, and ending April 30, 1964.

SEC. 205. AMOUNTS RECEIVED UNDER WAGE CONTINUATION PLANS.

(a) WAGE CONTINUATION PLANS.—The second sentence of section 105(d) (relating to wage continuation plans) is amended to read as follows: "The preceding sentence shall not apply to amounts attributable to the first 30 calendar days in such period, if such amounts are at a rate which exceeds 75 percent of the regular weekly rate of wages of the employee (as determined under regulations prescribed by the Secretary or his delegate). If amounts attributable to the first 30 calendar days in such period are at a rate which does not exceed 75 percent of the regular weekly rate of wages of the employee, the first sentence of this subsection (1) shall not apply to the extent that such amounts exceed a weekly rate of $75, and (2) shall not apply to amounts attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of personal injuries or sickness for at least one day during such period."

26 USC 105.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to amounts attributable to periods of absence commencing after December 31, 1963.

SEC. 206. EXCLUSION FROM GROSS INCOME OF GAIN ON SALE OR EXCHANGE OF RESIDENCE OF INDIVIDUAL WHO HAS ATTAINED AGE 65.

(a) IN GENERAL.—Part III of subchapter B of chapter 1 (relating to items specifically excluded from gross income) is amended by redesignating section 121 as section 122 and by inserting before such section the following new section:

26 USC 121, 122.

"SEC. 121. GAIN FROM SALE OR EXCHANGE OF RESIDENCE OF INDIVIDUAL WHO HAS ATTAINED AGE 65.

"(a) GENERAL RULE.—At the election of the taxpayer, gross income does not include gain from the sale or exchange of property if—

"(1) the taxpayer has attained the age of 65 before the date of such sale or exchange, and

"(2) during the 8-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as his principal residence for periods aggregating 5 years or more.

"(b) LIMITATIONS.—

"(1) WHERE ADJUSTED SALES PRICE EXCEEDS $20,000.—If the adjusted sales price of the property sold or exchanged exceeds $20,000, subsection (a) shall apply to that portion of the gain which bears the same ratio to the total amount of such gain as $20,000 bears to such adjusted sales price. For purposes of the preceding sentence, the term 'adjusted sales price' has the meaning assigned to such term by section 1034(b)(1) (determined without regard to subsection (d)(7) of this section).

"(2) APPLICATION TO ONLY ONE SALE OR EXCHANGE.—Subsection (a) shall not apply to any sale or exchange by the taxpayer if an election by the taxpayer or his spouse under subsection (a) with respect to any other sale or exchange is in effect.

"(c) ELECTION.—An election under subsection (a) may be made or revoked at any time before the expiration of the period for making a claim for credit or refund of the tax imposed by this chapter for the taxable year in which the sale or exchange occurred, and shall be made or revoked in such manner as the Secretary or his delegate shall by regulations prescribe. In the case of a taxpayer who is married, an election under subsection (a) or a revocation thereof may be made only if his spouse joins in such election or revocation.

"(d) SPECIAL RULES.—

"(1) PROPERTY HELD JOINTLY BY HUSBAND AND WIFE.—For purposes of this section, if—

"(A) property is held by a husband and wife as joint tenants, tenants by the entirety, or community property,

"(B) such husband and wife make a joint return under section 6013 for the taxable year of the sale or exchange, and 26 USC 6013.

"(C) one spouse satisfies the age, holding, and use requirements of subsection (a) with respect to such property,

then both husband and wife shall be treated as satisfying the age, holding, and use requirements of subsection (a) with respect to such property.

"(2) PROPERTY OF DECEASED SPOUSE.—For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, if—

"(A) the deceased spouse (during the 8-year period ending on the date of the sale or exchange) satisfied the holding and use requirements of subsection (a)(2) with respect to such property, and

"(B) no election by the deceased spouse under subsection (a) is in effect with respect to a prior sale or exchange,

then such individual shall be treated as satisfying the holding and use requirements of subsection (a)(2) with respect to such property.

"(3) TENANT-STOCKHOLDER IN COOPERATIVE HOUSING CORPORATION.—For purposes of this section, if the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), then— 26 USC 216.

"(A) the holding requirements of subsection (a)(2) shall be applied to the holding of such stock, and

"(B) the use requirements of subsection (a)(2) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

"(4) INVOLUNTARY CONVERSIONS.—For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

"(5) PROPERTY USED IN PART AS PRINCIPAL RESIDENCE.—In the case of property only a portion of which, during the 8-year period ending on the date of the sale or exchange, has been owned and used by the taxpayer as his principal residence for periods aggregating 5 years or more, this section shall apply with respect to so much of the gain from the sale or exchange of such property as is determined, under regulations prescribed by the Secretary or his delegate, to be attributable to the portion of the property so owned and used by the taxpayer.

"(6) DETERMINATION OF MARITAL STATUS.—In the case of any sale or exchange, for purposes of this section—

"(A) the determination of whether an individual is married shall be made as of the date of the sale or exchange; and

"(B) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

"(7) APPLICATION OF SECTIONS 1033 AND 1034.—In applying sections 1033 (relating to involuntary conversions) and 1034 (relating to sale or exchange of residence), the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section, reduced by 26 USC 1033, 1034.

the amount of gain not included in gross income pursuant to an election under this section."

(b) TECHNICAL AND CLERICAL AMENDMENTS.—

26 USC 6012. (1) Section 6012(c) (relating to persons required to make returns of income) is amended to read as follows:

"(c) CERTAIN INCOME EARNED ABROAD OR FROM SALE OF RESIDENCE.—For purposes of this section, gross income shall be computed
Ante, p. 38. without regard to the exclusion provided for in section 121 (relating to sale of residence by individual who has attained age 65) and with-
Post, p. 128. out regard to the exclusion provided for in section 911 (relating to earned income from sources without the United States)."

(2) The table of sections for part III of subchapter B of chapter 1 is amended by striking out

"Sec. 121. Cross references to other Acts."

and inserting in lieu thereof

"Sec. 121. Gain from sale or exchange of residence of individual who has attained age 65.
"Sec. 122. Cross references to other Acts."

26 USC 1033. (3) Section 1033(h) (relating to involuntary conversions) is amended by adding at the end thereof the following new paragraph:

"(3) For exclusion from gross income of certain gain from involuntary conversion of residence of taxpayer who has attained age 65, see section 121."

26 USC 1034. (4) Section 1034 (relating to sale or exchange of residence) is amended by adding at the end thereof the following new subsection:

"(k) CROSS REFERENCE.—

"For exclusion from gross income of certain gain from sale or exchange of residence of taxpayer who has attained age 65, see sec-
Ante, p. 38. tion 121."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after December 31, 1963, in taxable years ending after such date.

SEC. 207. DENIAL OF DEDUCTION FOR CERTAIN STATE, LOCAL, AND FOREIGN TAXES.

26 USC 164. (a) IN GENERAL.—Subsections (a), (b), and (c) of section 164 (relating to deduction for taxes) are amended to read as follows:

"(a) GENERAL RULE.—Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

"(1) State and local, and foreign, real property taxes.

"(2) State and local personal property taxes.

"(3) State and local, and foreign, income, war profits, and excess profits taxes.

"(4) State and local general sales taxes.

"(5) State and local taxes on the sale of gasoline, diesel fuel, and other motor fuels.

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business
26 USC 212. or an activity described in section 212 (relating to expenses for production of income).

"(b) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) PERSONAL PROPERTY TAXES.—The term 'personal property tax' means an ad valorem tax which is imposed on an annual basis in respect of personal property.

"(2) GENERAL SALES TAXES.—

"(A) IN GENERAL.—The term 'general sales tax' means a tax imposed at one rate in respect of the sale at retail of a broad range of classes of items.

"(B) SPECIAL RULES FOR FOOD, ETC.—In the case of items of food, clothing, medical supplies, and motor vehicles—

"(i) the fact that the tax does not apply in respect of some or all of such items shall not be taken into account in determining whether the tax applies in respect of a broad range of classes of items, and

"(ii) the fact that the rate of tax applicable in respect of some or all of such items is lower than the general rate of tax shall not be taken into account in determining whether the tax is imposed at one rate.

"(C) ITEMS TAXED AT DIFFERENT RATES.—Except in the case of a lower rate of tax applicable in respect of an item described in subparagraph (B), no deduction shall be allowed under this section for any general sales tax imposed in respect of an item at a rate other than the general rate of tax.

"(D) COMPENSATING USE TAXES.—A compensating use tax in respect of an item shall be treated as a general sales tax. For purposes of the preceding sentence, the term 'compensating use tax' means, in respect of any item, a tax which—

"(i) is imposed on the use, storage, or consumption of such item, and

"(ii) is complementary to a general sales tax, but only if a deduction is allowable under subsection (a)(4) in respect of items sold at retail in the taxing jurisdiction which are similar to such item.

"(3) STATE OR LOCAL TAXES.—A State or local tax includes only a tax imposed by a State, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia.

"(4) FOREIGN TAXES.—A foreign tax includes only a tax imposed by the authority of a foreign country.

"(5) SEPARATELY STATED GENERAL SALES TAXES AND GASOLINE TAXES.—If the amount of any general sales tax or of any tax on the sale of gasoline, diesel fuel, or other motor fuel is separately stated, then, to the extent that the amount so stated is paid by the consumer (otherwise than in connection with the consumer's trade or business) to his seller, such amount shall be treated as a tax imposed on, and paid by, such consumer.

"(c) DEDUCTION DENIED IN CASE OF CERTAIN TAXES.—No deduction shall be allowed for the following taxes:

"(1) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not prevent the deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

"(2) Taxes on real property, to the extent that subsection (d) requires such taxes to be treated as imposed on another taxpayer."

(b) TECHNICAL AMENDMENTS.—

(1) The first sentence of section 164(f) (relating to payments for municipal services in atomic energy communities) is amended by inserting "State" before "real property taxes". 26 USC 164.

26 USC 164.

(2) Section 164(g) (relating to cross references) is amended to read as follows:

"(g) CROSS REFERENCES.—

"(1) For provisions disallowing any deduction for the payment of the tax imposed by subchapter B of chapter 3 (relating to tax-free covenant bonds), see section 1451.

"(2) For provisions disallowing any deduction for certain taxes, see section 275."

(3)(A) Part IX of subchapter B of chapter 1 (relating to items not deductible) is amended by adding at the end thereof the following new section:

"SEC. 275. CERTAIN TAXES.

"(a) GENERAL RULE.—No deduction shall be allowed for the following taxes:

"(1) Federal income taxes, including—

"(A) the tax imposed by section 3101 (relating to the tax on employees under the Federal Insurance Contributions Act);

26 USC 3101 et seq.
26 USC 3201, 3211.

"(B) the taxes imposed by sections 3201 and 3211 (relating to the taxes on railroad employees and railroad employee representatives); and

"(C) the tax withheld at source on wages under section 3402, and corresponding provisions of prior revenue laws.

Post, p. 140.

"(2) Federal war profits and excess profits taxes.

"(3) Estate, inheritance, legacy, succession, and gift taxes.

"(4) Income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 901 (relating to the foreign tax credit).

26 USC 901.
26 USC 164.

"(5) Taxes on real property, to the extent that section 164(d) requires such taxes to be treated as imposed on another taxpayer.

"(b) CROSS REFERENCE.—

"For disallowance of certain other taxes, see section 164(c)."

(B) The table of sections for such part IX is amended by adding at the end thereof the following:

"Sec. 275. Certain taxes."

26 USC 535.

(4) Paragraph (1) of section 535(b) (relating to adjustments to accumulated taxable income) is amended by striking out "section 164(b)(6)" and inserting in lieu thereof "section 275(a)(4)".

26 USC 545.

(5) The first sentence of paragraph (1) of section 545(b) (relating to adjustments to personal holding company taxable income) is amended by striking out "section 164(b)(6)" and inserting in lieu thereof "section 275(a)(4)".

26 USC 556.

(6) The first sentence of paragraph (1) of section 556(b) (relating to adjustments to foreign personal holding company taxable income) is amended by striking out "section 164 (b)(6)" and inserting in lieu thereof "section 275(a)(4)".

26 USC 901.

(7) Paragraph (1) of section 901(d) (relating to credit for taxes imposed by foreign countries) is amended by striking out "section 164" and inserting in lieu thereof "sections 164 and 275".

26 USC 903.

(8) Section 903 (relating to credit for taxes imposed by a foreign country in lieu of income, etc., taxes) is amended by striking out "section 164(b)" and inserting in lieu thereof "sections 164(a) and 275(a)".

(c) EFFECTIVE DATE.—

(1) GENERAL RULE.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1963.

(2) SPECIAL TAXING DISTRICTS.—Section 164(c) (1) of the Internal Revenue Code of 1954 (as amended by subsection (a)) shall not prevent the deduction under section 164 of such Code (as so amended) of taxes levied by a special taxing district which is described in section 164(b) (5) of such Code (as in effect for a taxable year ending on December 31, 1963) and which was in existence on December 31, 1963, for the purpose of retiring indebtedness existing on such date. Ante, p. 40

SEC. 208. PERSONAL CASUALTY AND THEFT LOSSES.

(a) LIMITATION ON AMOUNT OF CASUALTY OR THEFT LOSS DEDUCTION.—Section 165(c) (3) (relating to losses of property not connected with trade or business) is amended to read as follows: 26 USC 165.

"(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. A loss described in this paragraph shall be allowed only to the extent that the amount of loss to such individual arising from each casualty, or from each theft, exceeds $100. For purposes of the $100 limitation of the preceding sentence, a husband and wife making a joint return under section 6013 for the taxable year in which the loss is allowed as a deduction shall be treated as one individual. No loss described in this paragraph shall be allowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to losses sustained after December 31, 1963, in taxable years ending after such date.

SEC. 209. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) CERTAIN ORGANIZATIONS ADDED TO ADDITIONAL 10-PERCENT CHARITABLE LIMITATION.—Section 170(b) (1) (A) (relating to limitation on amount of deduction for charitable contributions by individuals) is amended by striking out "or" at the end of clause (iii), and by inserting after clause (iv) the following new clauses: 26 USC 170.

"(v) a governmental unit referred to in subsection (c) (1), or

"(vi) an organization referred to in subsection (c) (2) which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from a governmental unit referred to in subsection (c) (1) or from direct or indirect contributions from the general public,". 26 USC 501.

(b) UNLIMITED CHARITABLE CONTRIBUTION DEDUCTION.—Section 170 (relating to charitable, etc., contributions and gifts) is amended by inserting after subsection (f) (added by subsection (e) of this section) the following new subsection: 26 USC 170.

"(g) APPLICATION OF UNLIMITED CHARITABLE CONTRIBUTION DEDUCTION.—

"(1) ALLOWANCE OF DEDUCTION FOR TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1963.—If the taxable year begins after December 31, 1963—

"(A) subsection (b) (1) (C) shall apply only if the taxpayer so elects (at such time and in such manner as the Secretary or his delegate by regulations prescribes) ; and

"(B) for purposes of subsection (b) (1) (C), the amount of the charitable contributions for the taxable year (and for all prior taxable years beginning after December 31, 1963) shall be determined without the application of subsection (b) (5) and solely by reference to charitable contributions described in paragraph (2).

If the taxpayer elects to have subsection (b) (1) (C) apply for the taxable year, then for such taxable year subsection (a) shall apply only with respect to charitable contributions described in paragraph (2), and no amount of charitable contributions made in the taxable year or any prior taxable year may be treated under subsection (b) (5) as having been made in the taxable year or in any succeeding taxable year.

"(2) QUALIFIED CONTRIBUTIONS.—The charitable contributions referred to in paragraph (1) are—

"(A) any charitable contribution described in subsection (b) (1) (A);

"(B) any charitable contribution, not described in subsection (b) (1) (A), to an organization described in subsection (c) (2) substantially more than half of the assets of which is devoted directly to, and substantially all of the income of which is expended directly for, the active conduct of the activities constituting the purpose or function for which it is organized and operated;

"(C) any charitable contribution, not described in subsection (b) (1) (A), to an organization described in subsection (c) (2) which meets the requirements of paragraph (3) with respect to such charitable contribution; and

"(D) any charitable contribution payment of which is made on or before the date of the enactment of the Revenue Act of 1964.

"(3) ORGANIZATIONS EXPENDING AT LEAST 50 PERCENT OF DONOR'S CONTRIBUTIONS.—An organization shall be an organization referred to in paragraph (2) (C), with respect to any charitable contribution, only if—

"(A) not later than the close of the third year after the organization's taxable year in which the contribution is received (or before such later time as the Secretary or his delegate may allow upon good cause shown by such organization), such organization expends an amount equal to at least 50 percent of such contribution for—

"(i) the active conduct of the activities constituting the purpose or function for which it is organized and operated,

"(ii) assets which are directly devoted to such active conduct,

"(iii) contributions to organizations which are described in subsection (b) (1) (A) or in paragraph (2) (B) of this subsection, or

"(iv) any combination of the foregoing; and

"(B) for the period beginning with the taxable year in which such contribution is received and ending with the taxable year in which subparagraph (A) is satisfied with respect to such contribution, such organization expends all of its net income (determined without regard to capital gains and losses) for the purposes described in clauses (i), (ii), (iii), and (iv) of subparagraph (A).

If the taxpayer so elects (at such time and in such manner as the Secretary or his delegate by regulations prescribes) with respect to contributions made by him to any organization, then, in applying subparagraph (B) with respect to contributions made by him to such organization during his taxable year for which such election is made and during all his subsequent taxable years, amounts expended by the organization after the close of any of its taxable years and on or before the 15th day of the third month following the close of such taxable year shall be treated as expended during such taxable year.

"(4) DISQUALIFYING TRANSACTIONS.—An organization shall be an organization referred to in subparagraph (B) or (C) of paragraph (2) only if at no time during the period consisting of the organization's taxable year in which the contribution is received, its 3 preceding taxable years, and its 3 succeeding taxable years, such organization—

"(A) lends any part of its income or corpus to,

"(B) pays compensation (other than reasonable compensation for personal services actually rendered) to,

"(C) makes any of its services available on a preferential basis to,

"(D) purchases more than a minimal amount of securities or other property from, or

"(E) sells more than a minimal amount of securities or other property to,

the donor of such contribution, any member of his family (as defined in section 267(c)(4)), any employee of the donor, any officer or employee of a corporation in which he owns (directly or indirectly) 50 percent or more in value of the outstanding stock, or any partner or employee of a partnership in which he owns (directly or indirectly) 50 percent or more of the capital interest or profits interest. This paragraph shall not apply to transactions occurring on or before the date of the enactment of the Revenue Act of 1964." 26 USC 267.

(c) 5-YEAR CARRYOVER OF CERTAIN CHARITABLE CONTRIBUTIONS MADE BY INDIVIDUALS.—

(1) IN GENERAL.—Section 170(b) (relating to limitations on amount of deduction for charitable contributions) is amended by adding at the end thereof the following new paragraph: 26 USC 170.

"(5) CARRYOVER OF CERTAIN EXCESS CONTRIBUTIONS BY INDIVIDUALS.—

"(A) In the case of an individual, if the amount of charitable contributions described in paragraph (1)(A) payment of which is made within a taxable year (hereinafter in this paragraph referred to as the 'contribution year') beginning after December 31, 1963, exceeds 30 percent of the taxpayer's adjusted gross income for such year (computed without regard to any net operating loss carryback to such year under section 172), such excess shall be treated as a charitable contribution described in paragraph (1)(A) paid in each of the 5 succeeding taxable years in order of time, but, with respect to any such succeeding taxable year, only to the extent of the lesser of the two following amounts: 26 USC 172.

"(i) the amount by which 30 percent of the taxpayer's adjusted gross income for such succeeding taxable year (computed without regard to any net operating loss carryback to such succeeding taxable year under section 172) exceeds the sum of the charitable contributions described in paragraph (1)(A) payment of which is made by the taxpayer within such succeeding taxable year (determined without regard to this subparagraph) and the charitable contributions described in paragraph (1)(A) payment of which was made in taxable years (beginning after December 31, 1963) before the contribution year which are treated under this subparagraph as having been paid in such succeeding taxable year; or

"(ii) in the case of the first succeeding taxable year, the amount of such excess, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess not treated under this subparagraph as a charitable contribution described in paragraph (1)(A) paid in any taxable year intervening between the contribution year and such succeeding taxable year.

"(B) In applying subparagraph (A), the excess determined under subparagraph (A) for the contribution year shall be reduced to the extent that such excess reduces taxable income (as computed for purposes of the second sentence of
26 USC 172. section 172(b)(2)) and increases the net operating loss deduction for a taxable year succeeding the contribution year."

26 USC 545. (2) TECHNICAL AMENDMENTS.—Sections 545(b)(2) (relating to deductions for charitable contributions by personal holding
26 USC 556. companies) and 556(b)(2) (relating to deductions for charitable contributions by foreign personal holding companies) are each amended by striking out "section 170(b)(2)" and inserting in lieu thereof "section 170(b)(2) and (5)".

(d) 5-YEAR CARRYOVER OF CERTAIN CHARITABLE CONTRIBUTIONS MADE BY CORPORATIONS.—

26 USC 170. (1) IN GENERAL.—Section 170(b)(2) (relating to limitation on amount of deduction for charitable contributions by corporations) is amended by striking out the sentence following subparagraph (D) and inserting in lieu thereof the following:

"Any contribution made by a corporation in a taxable year (hereinafter in this sentence referred to as the 'contribution year') in excess of the amount deductible for such year under the preceding sentence shall be deductible for each of the 5 succeeding taxable years in order of time, but only to the extent of the lesser of the two following amounts: (i) the excess of the maximum amount deductible for such succeeding taxable year under the preceding sentence over the sum of the contributions made in such year plus the aggregate of the excess contributions which were made in taxable years before the contribution year and which are deductible under this sentence for such succeeding taxable year; or (ii) in the case of the first succeeding taxable year, the amount of such excess contribution, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess contribution not deductible under this sentence for any taxable year intervening between the contribution year and such succeeding taxable year."

(2) CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.—Par-
26 USC 381. agraph (19) of section 381(c) (relating to items of distributor or transferor corporation) is amended to read as follows:

"(19) CHARITABLE CONTRIBUTIONS IN EXCESS OF PRIOR YEARS' LIMITATIONS.—Contributions made in the taxable year ending on the date of distribution or transfer and the 4 prior taxable years by the distributor or transferor corporation in excess of the amount deductible under section 170(b)(2) for such taxable years shall be deductible by the acquiring corporation for its taxable years which begin after the date of distribution or transfer, subject to the limitations imposed in section 170 (b)(2). In applying the preceding sentence, each taxable year of the distributor or transferor corporation beginning on or before the date of distribution or transfer shall be treated as a prior taxable year with reference to the acquiring corporation's taxable years beginning after such date."

(e) FUTURE INTERESTS IN TANGIBLE PERSONAL PROPERTY.—Section 170 (relating to charitable, etc., contributions and gifts) is amended by redesignating subsections (f) and (g) as subsections (h) and (i), respectively, and by inserting after subsection (e) the following new subsection: 26 USC 170.

"(f) FUTURE INTERESTS IN TANGIBLE PERSONAL PROPERTY.—For purposes of this section, payment of a charitable contribution which consists of a future interest in tangible personal property shall be treated as made only when all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired or are held by persons other than the taxpayer or those standing in a relationship to the taxpayer described in section 267(b). For purposes of the preceding sentence, a fixture which is intended to be severed from the real property shall be treated as tangible personal property." 26 USC 267.

(f) EFFECTIVE DATES.—

(1) The amendments made by subsections (a), (b), and (c), shall apply with respect to contributions which are paid in taxable years beginning after December 31, 1963.

(2) The amendments made by subsection (d) shall apply to taxable years beginning after December 31, 1963, with respect to contributions which are paid (or treated as paid under section 170(a)(2) of the Internal Revenue Code of 1954) in taxable years beginning after December 31, 1961.

(3) The amendments made by subsection (e) shall apply to transfers of future interests made after December 31, 1963, in taxable years ending after such date, except that such amendments shall not apply to any transfer of a future interest made before July 1, 1964, where—

(A) the sole intervening interest or right is a nontransferable life interest reserved by the donor, or

(B) in the case of a joint gift by husband and wife, the sole intervening interest or right is a nontransferable life interest reserved by the donors which expires not later than the death of whichever of such donors dies later.

For purposes of the exception contained in the preceding sentence, a right to make a transfer of the reserved life interest to the donee of the future interest shall not be treated as making a life interest transferable.

SEC. 210. LOSSES ARISING FROM EXPROPRIATION OF PROPERTY BY GOVERNMENTS OF FOREIGN COUNTRIES.

(a) NET OPERATING LOSS CARRYOVER.—Section 172 (relating to net operating loss deduction) is amended— 26 USC 172.

(1) by striking out "Except as provided in clause (ii)" in subsection (b)(1)(A)(i) and inserting in lieu thereof "Except as provided in clause (ii) and in subparagraph (D)";

(2) by striking out "Except as provided in subparagraph (C)" in subsection (b)(1)(B) and inserting in lieu thereof "Except as provided in subparagraphs (C) and (D)";

(3) by adding at the end of subsection (b)(1) the following new subparagraph:

"(D) In the case of a taxpayer which has a foreign expropriation loss (as defined in subsection (k)) for any taxable year ending after December 31, 1958, the portion of the net operating loss for such year attributable to such foreign ex- Post, p. 48.

propriation loss shall not be a net operating loss carryback to any taxable year preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 10 taxable years following the taxable year of such loss.";

(4) by adding at the end of subsection (b)(3) the following new subparagraphs:

"(C) Paragraph (1)(D) shall apply only if—

"(i) the foreign expropriation loss (as defined in subsection (k)) for the taxable year equals or exceeds 50 percent of the net operating loss for the taxable year,

"(ii) in the case of a foreign expropriation loss for a taxable year ending after December 31, 1963, the taxpayer elects (at such time and in such manner as the Secretary or his delegate by regulations prescribes) to have paragraph (1)(D) apply, and

"(iii) in the case of a foreign expropriation loss for a taxable year ending after December 31, 1958, and before January 1, 1964, the taxpayer elects (in such manner as the Secretary or his delegate by regulations prescribes) on or before December 31, 1965, to have paragraph (1)(D) apply.

"(D) If a taxpayer makes an election under subparagraph (C)(iii), then (notwithstanding any law or rule of law), with respect to any taxable year ending before January 1, 1964, affected by the election—

"(i) the time for making or changing any choice or election under subpart A of part III of subchapter N (relating to foreign tax credit) shall not expire before January 1, 1966, 26 USC 901-905.

"(ii) any deficiency attributable to the election under subparagraph (C)(iii) or to the application of clause (i) of this subparagraph may be assessed at any time before January 1, 1969, and

"(iii) refund or credit of any overpayment attributable to the election under subparagraph (C)(iii) or to the application of clause (i) of this subparagraph may be made or allowed if claim therefor is filed before January 1, 1969.";

(5) by redesignating subsection (k) as (l), and by inserting after subsection (j) the following new subsection:

"(k) Foreign Expropriation Loss Defined.—For purposes of subsection (b)—

"(1) The term 'foreign expropriation loss' means, for any taxable year, the sum of the losses sustained by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing. For purposes of the preceding sentence, a debt which becomes worthless shall, to the extent of any deduction allowed under section 166(a), be treated as a loss.

"(2) The portion of the net operating loss for any taxable year attributable to a foreign expropriation loss is the amount of the foreign expropriation loss for such year (but not in excess of the net operating loss for such year)."

26 USC 172. (b) Technical Amendments.—Section 172(b)(2) is amended—

(1) by striking out subparagraph (B) and inserting in lieu thereof the following:

"(B) by determining the amount of the net operating loss deduction—

"(i) without regard to the net operating loss for the loss year or for any taxable year thereafter, and

"(ii) without regard to that portion, if any, of a net operating loss for a taxable year attributable to a foreign expropriation loss, if such portion may not, under paragraph (1)(D), be carried back to such prior taxable year,"; and

(2) by adding at the end thereof the following new sentence: "For purposes of this paragraph, if a portion of the net operating loss for the loss year is attributable to a foreign expropriation loss to which paragraph (1)(D) applies, such portion shall be considered to be a separate net operating loss for such year to be applied after the other portion of such net operating loss."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply in respect of foreign expropriation losses (as defined in section 172(k) of the Internal Revenue Code of 1954, as amended by subsection (a)(5) of this section), sustained in taxable years ending after December 31, 1958. Ante, p. 48.

SEC. 211. ONE-PERCENT LIMITATION ON MEDICINE AND DRUGS.

(a) GENERAL RULE.—Subsection (b) of section 213 (relating to medical, dental, etc., expenses) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to amounts paid for the care of— 26 USC 213.

"(1) the taxpayer and his spouse, if either of them has attained the age of 65 before the close of the taxable year, or

"(2) any dependent described in subsection (a)(1)(A)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1963.

SEC. 212. CARE OF DEPENDENTS.

(a) CHILD CARE ALLOWANCE.—Section 214 (relating to expenses for care of certain dependents) is amended to read as follows: 26 USC 214.

"SEC. 214. EXPENSES FOR CARE OF CERTAIN DEPENDENTS.

"(a) GENERAL RULE.—There shall be allowed as a deduction expenses paid during the taxable year by a taxpayer who is a woman or widower, or is a husband whose wife is incapacitated or is institutionalized, for the care of one or more dependents (as defined in subsection (d)(1)), but only if such care is for the purpose of enabling the taxpayer to be gainfully employed.

"(b) LIMITATIONS.—

"(1) DOLLAR LIMIT.—

"(A) Except as provided in subparagraph (B), the deduction under subsection (a) shall not exceed $600 for any taxable year.

"(B) The $600 limit of subparagraph (A) shall be increased (to an amount not above $900) by the amount of expenses incurred by the taxpayer for any period during which the taxpayer had 2 or more dependents.

"(2) WORKING WIVES AND HUSBANDS WITH INCAPACITATED WIVES.—In the case of a woman who is married and in the case of a husband whose wife is incapacitated, the deduction under subsection (a)—

"(A) shall not be allowed unless the taxpayer and his spouse file a joint return for the taxable year, and

"(B) shall be reduced by the amount (if any) by which the adjusted gross income of the taxpayer and his spouse exceeds $6,000.

This paragraph shall not apply, in the case of a woman who is married, to expenses incurred while her husband is incapable of self-support because mentally or physically defective, or, in the case of a husband whose wife is incapacitated, to expenses incurred while his wife is institutionalized if such institutionalization is for a period of at least 90 consecutive days (whether or not within one taxable year) or a shorter period if terminated by her death.

"(3) CERTAIN PAYMENTS NOT TAKEN INTO ACCOUNT.—Subsection (a) shall not apply to any amount paid to an individual with respect to whom the taxpayer is allowed for his taxable year
26 USC 151. a deduction under section 151 (relating to deductions for personal exemptions).

"(c) SPECIAL RULE WHERE WIFE IS INCAPACITATED OR INSTITUTIONALIZED.—In the case of a husband whose wife is incapacitated or is institutionalized, the deduction under subsection (a) shall be allowed only for expenses incurred while the wife was incapacitated or institutionalized (as the case may be) for a period of at least 90 consecutive days (whether or not within one taxable year) or a shorter period if terminated by her death.

"(d) DEFINITIONS.—For purposes of this section—

"(1) DEPENDENT.—The term 'dependent' means a person with respect to whom the taxpayer is entitled to an exemption under section 151(e)(1)—

"(A) who has not attained the age of 13 years and who
26 USC 152. (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer; or

"(B) who is physically or mentally incapable of caring for himself.

"(2) WIDOWER.—The term 'widower' includes an unmarried individual who is legally separated from his spouse under a decree of divorce or of separate maintenance.

"(3) INCAPACITATED WIFE.—A wife shall be considered incapacitated only (A) while she is incapable of caring for herself because mentally or physically defective, or (B) while she is institutionalized.

"(4) INSTITUTIONALIZED WIFE.—A wife shall be considered institutionalized only while she is, for the purpose of receiving medical care or treatment, an inpatient, resident, or inmate of a public or private hospital, sanitarium, or other similar institution.

"(5) DETERMINATION OF STATUS.—A woman shall not be considered as married if—

"(A) she is legally separated from her spouse under a decree of divorce or of separate maintenance at the close of the taxable year, or

"(B) she has been deserted by her spouse, does not know his whereabouts (and has not known his whereabouts at any time during the taxable year), and has applied to a court of competent jurisdiction for appropriate process to compel him to pay support or otherwise to comply with the law or a judicial order, as determined under regulations prescribed by the Secretary or his delegate."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1963.

SEC. 213. MOVING EXPENSES.

(a) DEDUCTION ALLOWED FOR MOVING EXPENSES.—

(1) Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by redesignating section 217 as section 218 and by inserting after section 216 the following new section:

"SEC. 217. MOVING EXPENSES.

"(a) DEDUCTION ALLOWED.—There shall be allowed as a deduction moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee at a new principal place of work.

"(b) DEFINITION OF MOVING EXPENSES.—

"(1) IN GENERAL.—For purposes of this section, the term 'moving expenses' means only the reasonable expenses—

"(A) of moving household goods and personal effects from the former residence to the new residence, and

"(B) of traveling (including meals and lodging) from the former residence to the new place of residence.

"(2) INDIVIDUALS OTHER THAN TAXPAYER.—In the case of any individual other than the taxpayer, expenses referred to in paragraph (1) shall be taken into account only if such individual has both the former residence and the new residence as his principal place of abode and is a member of the taxpayer's household.

"(c) CONDITIONS FOR ALLOWANCE.—No deduction shall be allowed under this section unless—

"(1) the taxpayer's new principal place of work—

"(A) is at least 20 miles farther from his former residence than was his former principal place of work, or

"(B) if he had no former principal place of work, is at least 20 miles from his former residence, and

"(2) during the 12-month period immediately following his arrival in the general location of his new principal place of work, the taxpayer is a full-time employee, in such general location, during at least 39 weeks.

"(d) RULES FOR APPLICATION OF SUBSECTION (c)(2).—

"(1) Subsection (c)(2) shall not apply to any item to the extent that the taxpayer receives reimbursement or other expense allowance from his employer for such item.

"(2) If a taxpayer has not satisfied the condition of subsection (c)(2) before the time prescribed by law (including extensions thereof) for filing the return for the taxable year during which he paid or incurred moving expenses which would otherwise be deductible under this section, but may still satisfy such condition, then such expenses may (at the election of the taxpayer) be deducted for such taxable year notwithstanding subsection (c)(2).

"(3) If—

"(A) for any taxable year moving expenses have been deducted in accordance with the rule provided in paragraph (2), and

"(B) the condition of subsection (c)(2) is not satisfied by the close of the subsequent taxable year,

then an amount equal to the expenses which were so deducted shall be included in gross income for such subsequent taxable year.

"(e) DISALLOWANCE OF DEDUCTION WITH RESPECT TO REIMBURSEMENTS NOT INCLUDED IN GROSS INCOME.—No deduction shall be allowed under this section for any item to the extent that the taxpayer receives reimbursement or other expense allowance for such item which is not included in his gross income.

"(f) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section."

(2) The table of sections for part VII of subchapter B of chapter 1 is amended by striking out—

"Sec. 217. Cross references."

and inserting in lieu thereof the following:

"Sec. 217. Moving expenses.
"Sec. 218. Cross references."

26 USC 62. (b) ADJUSTED GROSS INCOME.—Section 62 (defining adjusted gross income) is amended by inserting after paragraph (7) the following new paragraph:

"(8) MOVING EXPENSE DEDUCTION.—The deduction allowed by section 217."

Ante, p. 51.

(c) WITHHOLDING.—Section 3401(a) (relating to definition of "wages") is amended by adding after paragraph (14) (added by section 204(b) of this Act) the following new paragraph:

Ante, p. 36.

"(15) to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217."

(d) EFFECTIVE DATES.—The amendments made by subsections (a) and (b) shall apply to expenses incurred after December 31, 1963, in taxable years ending after such date. The amendment made by subsection (c) shall apply with respect to remuneration paid after the seventh day following the date of the enactment of this Act.

SEC. 214. 100 PERCENT DIVIDENDS RECEIVED DEDUCTION FOR MEMBERS OF ELECTING AFFILIATED GROUPS.

26 USC 243. (a) 100 PERCENT DIVIDENDS RECEIVED DEDUCTION.—Section 243 (relating to dividends received by corporations) is amended to read as follows:

"SEC. 243. DIVIDENDS RECEIVED BY CORPORATIONS.

"(a) GENERAL RULE.—In the case of a corporation, there shall be allowed as a deduction an amount equal to the following percentages of the amount received as dividends from a domestic corporation which is subject to taxation under this chapter:

"(1) 85 percent, in the case of dividends other than dividends described in paragraph (2) or (3);

"(2) 100 percent, in the case of dividends received by a small business investment company operating under the Small Business Investment Act of 1958; and

72 Stat. 689.
15 USC 661 note.

"(3) 100 percent, in the case of qualifying dividends (as defined in subsection (b)(1)).

"(b) QUALIFYING DIVIDENDS.—

"(1) DEFINITION.—For purposes of subsection (a)(3), the term 'qualifying dividends' means dividends received by a corporation which, at the close of the day the dividends are received, is a member of the same affiliated group of corporations (as defined in paragraph (5)) as the corporation distributing the dividends, if—

"(A) such affiliated group has made an election under paragraph (2) which is effective for the taxable years of its members which include such day, and

"(B) such dividends are distributed out of earnings and profits of a taxable year of the distributing corporation ending after December 31, 1963—

"(i) on each day of which the distributing corporation and the corporation receiving the dividends were members of such affiliated group, and

Post, p. 117.

"(ii) for which an election under section 1562 (relating to election of multiple surtax exemptions) is not effective.

"(2) Election.—An election under this paragraph shall be made for an affiliated group by the common parent corporation, and shall be made for any taxable year of the common parent corporation at such time and in such manner as the Secretary or his delegate by regulations prescribes. Such election may not be made for an affiliated group for any taxable year of the common parent corporation for which an election under section 1562 is effective. Each corporation which is a member of such group at any time during its taxable year which includes the last day of such taxable year of the common parent corporation must consent to such election at such time and in such manner as the Secretary or his delegate by regulations prescribes. An election under this paragraph shall be effective— Post, p. 117.

"(A) for the taxable year of each member of such affiliated group which includes the last day of the taxable year of the common parent corporation with respect to which the election is made (except that in the case of a taxable year of a member beginning in 1963 and ending in 1964, if the election is effective for the taxable year of the common parent corporation which includes the last day of such taxable year of such member, such election shall be effective for such taxable year of such member, if such member consents to such election with respect to such taxable year), and

"(B) for the taxable year of each member of such affiliated group which ends after the last day of such taxable year of the common parent corporation but which does not include such date, unless the election is terminated under paragraph (4).

"(3) Effect of election.—If an election by an affiliated group is effective with respect to a taxable year of the common parent corporation, then under regulations prescribed by the Secretary or his delegate—

"(A) no member of such affiliated group may consent to an election under section 1562 for such taxable year,

"(B) the members of such affiliated group shall be treated as one taxpayer for purposes of making the elections under section 901(a) (relating to allowance of foreign tax credit) and section 904(b)(1) (relating to election of overall limitation), and 26 USC 901. 26 USC 904.

"(C) the members of such affiliated group shall be limited to one—

"(i) $100,000 minimum accumulated earnings credit under section 535(c)(2) or (3), 26 USC 535.

"(ii) $100,000 limitation for exploration expenditures under section 615(a) and (b), 26 USC 615.

"(iii) $400,000 limitation for exploration expenditures under section 615(c)(1),

"(iv) $25,000 limitation on small business deduction of life insurance companies under sections 804(a)(4) and 809(d)(10), and 26 USC 804. 26 USC 809.

"(v) $100,000 exemption for purposes of estimated tax filing requirements under section 6016 and the addition to tax under section 6655 for failure to pay estimated tax. 26 USC 6016. 26 USC 6655.

"(4) Termination.—An election by an affiliated group under paragraph (2) shall terminate with respect to the taxable year of the common parent corporation and with respect to the taxable years of the members of such affiliated group which include the last day of such taxable year of the common parent corporation if—

"(A) CONSENT OF MEMBERS.—Such affiliated group files a termination of such election (at such time and in such manner as the Secretary or his delegate by regulations prescribes) with respect to such taxable year of the common parent corporation, and each corporation which is a member of such affiliated group at any time during its taxable year which includes the last day of such taxable year of the common parent corporation consents to such termination, or

"(B) REFUSAL BY NEW MEMBER TO CONSENT.—During such taxable year of the common parent corporation such affiliated group includes a member which—

"(i) was not a member of such group during such common parent corporation's immediately preceding taxable year, and

"(ii) such member files a statement that it does not consent to the election at such time and in such manner as the Secretary or his delegate by regulations prescribes.

"(5) DEFINITION OF AFFILIATED GROUP.—For purposes of this subsection, the term 'affiliated group' has the meaning assigned to it by section 1504(a), except that for such purposes sections
26 USC 1504. 1504(b)(2) and 1504(c) shall not apply.

"(6) SPECIAL RULES FOR INSURANCE COMPANIES.—If an election under this subsection is effective for the taxable year of an in-
26 USC 802. surance company subject to taxation under section 802 or 821—
Ante, p. 29. "(A) part II of subchapter B of chapter 6 (relating to certain controlled corporations) shall be applied without
Post, p. 120. regard to section 1563(a)(4) (relating to certain insurance companies) and section 1563(b)(2)(D) (relating to certain excluded members) with respect to such company and the other corporations which are members of the controlled group of corporations (as determined under section 1563 without regard to subsections (a)(4) and (b)(2)(D)) of which such company is a member, and

"(B) for purposes of paragraph (1), a distribution by such company out of earnings and profits of a taxable year for which an election under this subsection was not effective, and for which such company was not a component member of a controlled group of corporations within the meaning of section 1563 solely by reason of section 1563(b)(2)(D), shall not be a qualifying dividend.

"(c) SPECIAL RULES FOR CERTAIN DISTRIBUTIONS.—For purposes of subsection (a)—
26 USC 591. "(1) Any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, etc.) shall not be treated as a dividend.

"(2) A dividend received from a regulated investment com-
Ante, p. 32; pany shall be subject to the limitations prescribed in section 854.
post, p. 99. "(3) Any dividend received from a real estate investment trust which, for the taxable year of the trust in which the dividend is paid, qualifies under part II of subchapter M (section 856 and
26 USC 856-858. following) shall not be treated as a dividend.

"(4) Any dividend received which is described in section 244
26 USC 244. (relating to dividends received on preferred stock of a public utility) shall not be treated as a dividend.

"(d) CERTAIN DIVIDENDS FROM FOREIGN CORPORATIONS.—For
26 USC 245. purposes of subsection (a) and for purposes of section 245, any dividend from a foreign corporation from earnings and profits accumulated by a domestic corporation during a period with respect to which such domestic corporation was subject to taxation under this chapter

(or corresponding provisions of prior law) shall be treated as a dividend from a domestic corporation which is subject to taxation under this chapter."

(b) TECHNICAL AMENDMENTS.—

(1) Section 244 (relating to dividends received on certain preferred stock) is amended by inserting "(a) GENERAL RULE.—" before "In case of a corporation," and by adding at the end thereof the following new subsection: 26 USC 244.

"(b) EXCEPTION.—If the dividends described in subsection (a)(1) are qualifying dividends (as defined in section 243(b)(1), but determined without regard to section 243(c)(4))—

"(1) subsection (a) shall be applied separately to such qualifying dividends, and Ante, p. 52.

"(2) for purposes of subsection (a)(3), the percentage applicable to such qualifying dividends shall be 100 percent in lieu of 85 percent."

(2) Section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) is amended by striking out "243(a), 244," each place it appears therein and inserting in lieu thereof "243(a)(1), 244(a),". 26 USC 246.

(3) Section 804(a)(5) (relating to the application of section 246(b) to taxable investment income of life insurance companies) is amended by striking out "243(a), 244," and inserting in lieu thereof "243(a)(1), 244(a),". 26 USC 804.

(4) Section 809(d)(8)(B) (relating to the application of section 246(b) to the life insurance company's share of certain dividends) is amended by striking out "243(a), 244," each place it appears therein and inserting in lieu thereof "243(a)(1), 244(a),". 26 USC 809.

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply with respect to dividends received in taxable years ending after December 31, 1963.

SEC. 215. INTEREST ON LOANS INCURRED TO PURCHASE CERTAIN INSURANCE AND ANNUITY CONTRACTS.

(a) DISALLOWANCE OF INTEREST DEDUCTION.—Section 264(a) (relating to certain amounts paid in connection with insurance contracts) is amended— 26 USC 264.

(1) by inserting after paragraph (2) the following new paragraph:

"(3) Except as provided in subsection (c), any amount paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract (other than a single premium contract or a contract treated as a single premium contract) pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of such contract (either from the insurer or otherwise)."

(2) by adding at the end thereof the following new sentence: "Paragraph (3) shall apply only in respect of contracts purchased after August 6, 1963."

(b) EXCEPTIONS.—Section 264 is amended by adding at the end thereof the following new subsection:

"(c) EXCEPTIONS.—Subsection (a)(3) shall not apply to any amount paid or accrued by a person during a taxable year on indebtedness incurred or continued as part of a plan referred to in subsection (a)(3)—

"(1) if no part of 4 of the annual premiums due during the 7-year period (beginning with the date the first premium on the contract to which such plan relates was paid) is paid under such plan by means of indebtedness,

"(2) if the total of the amounts paid or accrued by such person during such taxable year for which (without regard to this paragraph) no deduction would be allowable by reason of subsection (a)(3) does not exceed $100,

"(3) if such amount was paid or accrued on indebtedness incurred because of an unforeseen substantial loss of income or unforeseen substantial increase in his financial obligations, or

"(4) if such indebtedness was incurred in connection with his trade or business.

For purposes of applying paragraph (1), if there is a substantial increase in the premiums on a contract, a new 7-year period described in such paragraph with respect to such contract shall commence on the date the first such increased premium is paid."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to amounts paid or accrued in taxable years beginning after December 31, 1963.

SEC. 216. INTEREST ON INDEBTEDNESS INCURRED OR CONTINUED TO PURCHASE OR CARRY TAX-EXEMPT BONDS.

(a) APPLICATION WITH RESPECT TO CERTAIN FINANCIAL INSTITUTIONS.—Section 265 (relating to expenses and interest relating to tax-exempt income) is amended by adding at the end of paragraph (2) the following new sentence: "In applying the preceding sentence to a financial institution (other than a bank) which is a face-amount certificate company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 and following) and which is subject to the banking laws of the State in which such institution is incorporated, interest on face-amount certificates (as defined in section 2(a)(15) of such Act) issued by such institution, and interest on amounts received for the purchase of such certificates to be issued by such institution, shall not be considered as interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from the taxes imposed by this subtitle, to the extent that the average amount of such obligations held by such institution during the taxable year (as determined under regulations prescribed by the Secretary or his delegate) does not exceed 15 percent of the average of the total assets held by such institution during the taxable year (as so determined)."

26 USC 265.

54 Stat. 789.

15 USC 80a-2.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to taxable years ending after the date of the enactment of this Act.

SEC. 217. LIMITATION OF TRAVEL ALLOCATION REQUIREMENT TO FOREIGN TRAVEL.

26 USC 274.

(a) LIMITATION OF APPLICATION OF SECTION 274(c).—Section 274 (c) (relating to traveling) is amended to read as follows:

"(c) CERTAIN FOREIGN TRAVEL.—

"(1) IN GENERAL.—In the case of any individual who travels outside the United States away from home in pursuit of a trade or business or in pursuit of an activity described in section 212, no deduction shall be allowed under section 162 or section 212 for that portion of the expenses of such travel otherwise allowable under such section which, under regulations prescribed by the Secretary or his delegate, is not allocable to such trade or business or to such activity.

26 USC 212.
26 USC 162.

"(2) EXCEPTION.—Paragraph (1) shall not apply to the expenses of any travel outside the United States away from home if—

"(A) such travel does not exceed one week, or

"(B) the portion of the time of travel outside the United States away from home which is not attributable to the pursuit of the taxpayer's trade or business or an activity described in section 212 is less than 25 percent of the total time on such travel. 26 USC 212.

"(3) DOMESTIC TRAVEL EXCLUDED.—For purposes of this subsection, travel outside the United States does not include any travel from one point in the United States to another point in the United States."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to taxable years ending after December 31, 1962, but only in respect of periods after such date.

SEC. 218. ACQUISITION OF STOCK IN EXCHANGE FOR STOCK OF CORPORATION WHICH IS IN CONTROL OF ACQUIRING CORPORATION.

(a) DEFINITION OF REORGANIZATION.—Section 368(a)(1) (relating to definition of reorganization) is amended by inserting after "voting stock" in subparagraph (B) "(or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation)". 26 USC 368.

(b) TECHNICAL AMENDMENTS.—

(1) Section 368(a)(2)(C) (relating to special rules) is amended to read as follows:

"(C) TRANSFERS OF ASSETS OR STOCK TO SUBSIDIARIES IN CERTAIN PARAGRAPH (1)(A), (1)(B), AND (1)(C) CASES.—A transaction otherwise qualifying under paragraph (1)(A), (1)(B), or (1)(C) shall not be disqualified by reason of the fact that part or all of the assets or stock which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets or stock."

(2) Section 368(b) (relating to definition of party to a reorganization) is amended by striking out the last two sentences and inserting in lieu thereof the following: "In the case of a reorganization qualifying under paragraph (1)(B) or (1)(C) of subsection (a), if the stock exchanged for the stock or properties is stock of a corporation which is in control of the acquiring corporation, the term 'a party to a reorganization' includes the corporation so controlling the acquiring corporation. In the case of a reorganization qualifying under paragraph (1)(A), (1)(B), or (1)(C) of subsection (a) by reason of paragraph (2)(C) of subsection (a), the term 'a party to a reorganization' includes the corporation controlling the corporation to which the acquired assets or stock are transferred."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to transactions after December 31, 1963, in taxable years ending after such date.

SEC. 219. RETROACTIVE QUALIFICATION OF CERTAIN UNION-NEGOTIATED MULTIEMPLOYER PENSION PLANS.

(a) BEGINNING OF PERIOD AS QUALIFIED TRUST.—Section 401 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by redesignating subsection (i) as subsection (j), and by inserting after subsection (h) the following new subsection: 26 USC 401.

"(i) CERTAIN UNION-NEGOTIATED MULTIEMPLOYER PENSION PLANS.—In the case of a trust forming part of a pension plan which

has been determined by the Secretary or his delegate to constitute a qualified trust under subsection (a) and to be exempt from taxation
26 USC 501. under section 501(a) for a period beginning after contributions were first made to or for such trust, if it is shown to the satisfaction of the Secretary or his delegate that—

"(1) such trust was created pursuant to a collective bargaining agreement between employee representatives and two or more employers who are not related (determined under regulations prescribed by the Secretary or his delegate),

"(2) any disbursements of contributions, made to or for such trust before the time as of which the Secretary or his delegate determined that the trust constituted a qualified trust, substantially complied with the terms of the trust, and the plan of which the trust is a part, as subsequently qualified, and

"(3) before the time as of which the Secretary or his delegate determined that the trust constitutes a qualified trust, the contributions to or for such trust were not used in a manner which would jeopardize the interests of its beneficiaries,

then such trust shall be considered as having constituted a qualified trust under subsection (a) and as having been exempt from taxation under section 501(a) for the period beginning on the date on which contributions were first made to or for such trust and ending on the date such trust first constituted (without regard to this subsection) a qualified trust under subsection (a)."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954, but only with respect to contributions made after December 31, 1954.

SEC. 220. QUALIFIED PENSION, ETC., PLAN COVERAGE FOR EMPLOYEES OF CERTAIN SUBSIDIARY EMPLOYERS.

(a) EMPLOYEES OF FOREIGN SUBSIDIARIES COVERED BY SOCIAL SECURITY AGREEMENTS.—Part I of subchapter D of chapter 1 (relating to
26 USC 401-405. pension, profit-sharing, stock bonus plans, etc.) is amended by adding at the end thereof the following new section:

"SEC. 406. CERTAIN EMPLOYEES OF FOREIGN SUBSIDIARIES.

"(a) TREATMENT AS EMPLOYEES OF DOMESTIC CORPORATION.—For purposes of applying this part with respect to a pension, profit-
26 USC 401. sharing, or stock bonus plan described in section 401(a), an annu-
26 USC 403. ity plan described in section 403(a), or a bond purchase plan
26 USC 405. described in section 405(a), of a domestic corporation, an individual who is a citizen of the United States and who is an employee of
26 USC 3121. a foreign subsidiary (as defined in section 3121(l)(8)) of such domestic corporation shall be treated as an employee of such domestic corporation, if—

"(1) such domestic corporation has entered into an agreement under section 3121(l) which applies to the foreign subsidiary of which such individual is an employee;

"(2) the plan of such domestic corporation expressly provides for contributions or benefits for individuals who are citizens of the United States and who are employees of its foreign subsidiaries to which an agreement entered into by such domestic corporation under section 3121(l) applies; and

"(3) contributions under a funded plan of deferred compensation (whether or not a plan described in section 401(a), 403(a), or 405(a)) are not provided by any other person with respect to the remuneration paid to such individual by the foreign subsidiary.

"(b) SPECIAL RULES FOR APPLICATION OF SECTION 401(a).—

"(1) NONDISCRIMINATION REQUIREMENTS.—For purposes of applying paragraphs (3)(B) and (4) of section 401(a) with respect to an individual who is treated as an employee of a domestic corporation under subsection (a)— 26 USC 401.

"(A) if such individual is an officer, shareholder, or person whose principal duties consist in supervising the work of other employees of a foreign subsidiary of such domestic corporation, he shall be treated as having such capacity with respect to such domestic corporation; and

"(B) the determination of whether such individual is a highly compensated employee shall be made by treating such individual's total compensation (determined with the application of paragraph (2) of this subsection) as compensation paid by such domestic corporation and by determining such individual's status with regard to such domestic corporation.

"(2) DETERMINATION OF COMPENSATION.—For purposes of applying paragraph (5) of section 401(a) with respect to an individual who is treated as an employee of a domestic corporation under subsection (a)—

"(A) the total compensation of such individual shall be the remuneration paid to such individual by the foreign subsidiary which would constitute his total compensation if his services had been performed for such domestic corporation, and the basic or regular rate of compensation of such individual shall be determined under regulations prescribed by the Secretary or his delegate; and

"(B) such individual shall be treated as having paid the amount paid by such domestic corporation which is equivalent to the tax imposed by section 3101. 26 USC 3101.

"(c) TERMINATION OF STATUS AS DEEMED EMPLOYEE NOT TO BE TREATED AS SEPARATION FROM SERVICE FOR PURPOSES OF CAPITAL GAIN PROVISIONS.—For purposes of applying section 402(a)(2) and section 403(a)(2) with respect to an individual who is treated as an employee of a domestic corporation under subsection (a), such individual shall not be considered as separated from the service of such domestic corporation solely by reason of the fact that— 26 USC 402. 26 USC 403.

"(1) the agreement entered into by such domestic corporation under section 3121(l) which covers the employment of such individual is terminated under the provisions of such section, 26 USC 3121.

"(2) such individual becomes an employee of a foreign subsidiary with respect to which such agreement does not apply,

"(3) such individual ceases to be an employee of the foreign subsidiary by reason of which he is treated as an employee of such domestic corporation, if he becomes an employee of another corporation controlled by such domestic corporation, or

"(4) the provision of the plan described in subsection (a)(2) is terminated.

"(d) DEDUCTIBILITY OF CONTRIBUTIONS.—For purposes of applying sections 404 and 405(c) with respect to contributions made to or under a pension, profit-sharing, stock bonus, annuity, or bond purchase plan by a domestic corporation, or by another corporation which is entitled to deduct its contributions under section 404(a)(3)(B), on behalf of an individual who is treated as an employee of such domestic corporation under subsection (a)— 26 USC 404, 405.

"(1) except as provided in paragraph (2), no deduction shall be allowed to such domestic corporation or to any other corporation which is entitled to deduct its contributions under such sections, "(2) there shall be allowed as a deduction to the foreign subsidiary of which such individual is an employee an amount equal to the amount which (but for paragraph (1)) would be deductible under section 404 (or section 405(c)) by the domestic corporation if he were an employee of the domestic corporation, and

26 USC 404, 405.

"(3) any reference to compensation shall be considered to be a reference to the total compensation of such individual (determined with the application of subsection (b)(2)).

Any amount deductible by a foreign subsidiary under this subsection shall be deductible for its taxable year with or within which the taxable year of such domestic corporation ends.

"(e) TREATMENT AS EMPLOYEE UNDER RELATED PROVISIONS.—An individual who is treated as an employee of a domestic corporation under subsection (a) shall also be treated as an employee of such domestic corporation, with respect to the plan described in subsection (a)(2), for purposes of applying the following provisions of this title:

26 USC 72.

"(1) Section 72(d) (relating to employees' annuities).

"(2) Section 72(f) (relating to special rules for computing employees' contributions).

26 USC 101.

"(3) Section 101(b) (relating to employees' death benefits).

26 USC 2039.

"(4) Section 2039 (relating to annuities).

26 USC 2517.

"(5) Section 2517 (relating to certain annuities under qualified plans)."

(b) EMPLOYEES OF DOMESTIC SUBSIDIARIES ENGAGED IN BUSINESS OUTSIDE THE UNITED STATES.—Part I of subchapter D of chapter 1 (relating to pension, profit-sharing, stock bonus plans, etc.) is amended by adding after section 406 (as added by subsection (a)) the following new section:

26 USC 401-405.
Ante, p. 58.

"SEC. 407. CERTAIN EMPLOYEES OF DOMESTIC SUBSIDIARIES ENGAGED IN BUSINESS OUTSIDE THE UNITED STATES.

"(a) TREATMENT AS EMPLOYEES OF DOMESTIC PARENT CORPORATION.—

"(1) IN GENERAL.—For purposes of applying this part with respect to a pension, profit-sharing, or stock bonus plan described in section 401(a), an annuity plan described in section 403(a), or a bond purchase plan described in section 405(a), of a domestic parent corporation, an individual who is a citizen of the United States and who is an employee of a domestic subsidiary (within the meaning of paragraph (2)) of such domestic parent corporation shall be treated as an employee of such domestic parent corporation, if—

"(A) the plan of such domestic parent corporation expressly provides for contributions or benefits for individuals who are citizens of the United States and who are employees of its domestic subsidiaries; and

"(B) contributions under a funded plan of deferred compensation (whether or not a plan described in section 401(a), 403(a), or 405(a)) are not provided by any other person with respect to the remuneration paid to such individual by the domestic subsidiary.

"(2) DEFINITIONS.—For purposes of this section—

"(A) DOMESTIC SUBSIDIARY.—A corporation shall be treated as a domestic subsidiary for any taxable year only if—

"(i) such corporation is a domestic corporation 80 percent or more of the outstanding voting stock of which is owned by another domestic corporation;

"(ii) 95 percent or more of its gross income for the three-year period immediately preceding the close of its taxable year which ends on or before the close of the taxable year of such other domestic corporation (or for such part of such period during which the corporation was in existence) was derived from sources without the United States; and

"(iii) 90 percent or more of its gross income for such period (or such part) was derived from the active conduct of a trade or business.

If for the period (or part thereof) referred to in clauses (ii) and (iii) such corporation has no gross income, the provisions of clauses (ii) and (iii) shall be treated as satisfied if it is reasonable to anticipate that, with respect to the first taxable year thereafter for which such corporation has gross income, the provisions of such clauses will be satisfied.

"(B) DOMESTIC PARENT CORPORATION.—The domestic parent corporation of any domestic subsidiary is the domestic corporation which owns 80 percent or more of the outstanding voting stock of such domestic subsidiary.

"(b) SPECIAL RULES FOR APPLICATION OF SECTION 401(a).— 26 USC 401.

"(1) NONDISCRIMINATION REQUIREMENTS.—For purposes of applying paragraphs (3)(B) and (4) of section 401(a) with respect to an individual who is treated as an employee of a domestic parent corporation under subsection (a)—

"(A) if such individual is an officer, shareholder, or person whose principal duties consist in supervising the work of other employees of a domestic subsidiary, he shall be treated as having such capacity with respect to such domestic parent corporation; and

"(B) the determination of whether such individual is a highly compensated employee shall be made by treating such individual's total compensation (determined with the application of paragraph (2) of this subsection) as compensation paid by such domestic parent corporation and by determining such individual's status with regard to such domestic parent corporation.

"(2) DETERMINATION OF COMPENSATION.—For purposes of applying paragraph (5) of section 401(a) with respect to an individual who is treated as an employee of a domestic parent corporation under subsection (a), the total compensation of such individual shall be the remuneration paid to such individual by the domestic subsidiary which would constitute his total compensation if his services had been performed for such domestic parent corporation, and the basic or regular rate of compensation of such individual shall be determined under regulations prescribed by the Secretary or his delegate.

"(c) TERMINATION OF STATUS AS DEEMED EMPLOYEE NOT TO BE TREATED AS SEPARATION FROM SERVICE FOR PURPOSES OF CAPITAL GAIN PROVISIONS.—For purposes of applying section 402(a)(2) and section 403(a)(2) with respect to an individual who is treated as an employee of a domestic parent corporation under subsection (a), such individual shall not be considered as separated from the service of such domestic parent corporation solely by reason of the fact that— 26 USC 402, 403.

"(1) the corporation of which such individual is an employee ceases, for any taxable year, to be a domestic subsidiary within the meaning of subsection (a)(2)(A), "(2) such individual ceases to be an employee of a domestic subsidiary of such domestic parent corporation, if he becomes an employee of another corporation controlled by such domestic parent corporation, or

"(3) the provision of the plan described in subsection (a)(1)(A) is terminated.

"(d) DEDUCTIBILITY OF CONTRIBUTIONS.—For purposes of applying sections 404 and 405(c) with respect to contributions made to or under a pension, profit-sharing, stock bonus, annuity, or bond purchase plan by a domestic parent corporation, or by another corporation which is entitled to deduct its contributions under section 404(a)(3)(B), on behalf of an individual who is treated as an employee of such domestic corporation under subsection (a)—

26 USC 404, 405.

"(1) except as provided in paragraph (2), no deduction shall be allowed to such domestic parent corporation or to any other corporation which is entitled to deduct its contributions under such sections,

"(2) there shall be allowed as a deduction to the domestic subsidiary of which such individual is an employee an amount equal to the amount which (but for paragraph (1)) would be deductible under section 404 (or section 405(c)) by the domestic parent corporation if he were an employee of the domestic parent corporation, and

"(3) any reference to compensation shall be considered to be a reference to the total compensation of such individual (determined with the application of subsection (b)(2)).

Any amount deductible by a domestic subsidiary under this subsection shall be deductible for its taxable year with or within which the taxable year of such domestic parent corporation ends.

"(e) TREATMENT AS EMPLOYEE UNDER RELATED PROVISIONS.—An individual who is treated as an employee of a domestic parent corporation under subsection (a) shall also be treated as an employee of such domestic parent corporation, with respect to the plan described in subsection (a)(1)(A), for purposes of applying the following provisions of this title:

26 USC 72. "(1) Section 72(d) (relating to employees' annuities).

"(2) Section 72(f) (relating to special rules for computing employees' contributions).

26 USC 101. "(3) Section 101(b) (relating to employees' death benefits).

26 USC 2039. "(4) Section 2039 (relating to annuities).

26 USC 2517. "(5) Section 2517 (relating to certain annuities under qualified plans)."

(c) TECHNICAL AMENDMENTS.—

(1) The table of sections for part I of subchapter D of chapter 1 is amended by adding at the end thereof the following:

"Sec. 406. Certain employees of foreign subsidiaries.
"Sec. 407. Certain employees of domestic subsidiaries engaged in business outside the United States."

26 USC 3121. (2) Section 3121(a)(5) (relating to definition of wages) is amended by striking out "or" at the end of subparagraph (A) and by striking out subparagraph (B) and inserting in lieu thereof the following new subparagraphs:

"(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a), or

26 USC 403.

"(C) under or to a bond purchase plan which, at the time of such payment, is a qualified bond purchase plan described in section 405(a);".

(3) Section 209(e) of the Social Security Act (relating to the definition of wages) is amended to read as follows: 64 Stat. 492 42 USC 409.

"(e) Any payment made to, or on behalf of, an employee or his beneficiary (1) from or to a trust exempt from tax under section 165(a) of the Internal Revenue Code of 1939 at the time of such payment or, in the case of a payment after 1954, under sections 401 and 501(a) of the Internal Revenue Code of 1954, unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust, or (2) under or to an annuity plan which, at the time of such payment, meets the requirements of section 165(a) (3), (4), (5), and (6) of the Internal Revenue Code of 1939 or, in the case of a payment after 1954 and prior to 1963, the requirements of section 401(a) (3), (4), (5), and (6) of the Internal Revenue Code of 1954, or (3) under or to an annuity plan which, at the time of any such payment after 1962, is a plan described in section 403(a) of the Internal Revenue Code of 1954, or (4) under or to a bond purchase plan which, at the time of any such payment after 1962, is a qualified bond purchase plan described in section 405(a) of the Internal Revenue Code of 1954;". 53 Stat. 67. 26 USC 401, 501. 26 USC 403. 26 USC 405.

(d) Effective Date.—The amendments made by subsections (a), (b), and (c)(1) shall apply to taxable years ending after December 31, 1963. The amendments made by subsections (c) (2) and (3) shall apply to remuneration paid after December 31, 1962.

SEC. 221. EMPLOYEE STOCK OPTIONS AND PURCHASE PLANS.

(a) In General.—Part II of subchapter D of chapter 1 is amended to read as follows:

"PART II—CERTAIN STOCK OPTIONS

"SEC. 421. GENERAL RULES.

"(a) Effect of Qualifying Transfer.—If a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a), 423(a), or 424(a) are met— Post, pp. 64, 67, 69.

"(1) except as provided in section 422(c) (1), no income shall result at the time of the transfer of such share to the individual upon his exercise of the option with respect to such share;

"(2) no deduction under section 162 (relating to trade or business expenses) shall be allowable at any time to the employer corporation, a parent or subsidiary corporation of such corporation, or a corporation issuing or assuming a stock option in a transaction to which section 425(a) applies, with respect to the share so transferred; and 26 USC 162. Post, p. 71.

"(3) no amount other than the price paid under the option shall be considered as received by any of such corporations for the share so transferred.

"(b) Effect of Disqualifying Disposition.—If the transfer of a share of stock to an individual pursuant to his exercise of an option would otherwise meet the requirements of section 422(a), 423(a), or 424(a) except that there is a failure to meet any of the holding period requirements of section 422(a) (1), 423(a) (1), or 424(a) (1), then any increase in the income of such individual or deduction from the income of his employer corporation for the taxable year in which such exercise occurred attributable to such disposition, shall be treated as an increase in income or a deduction from income in the taxable year of such individual or of such employer corporation in which such disposition occurred.

"(c) EXERCISE BY ESTATE.—

"(1) IN GENERAL.—If an option to which this part applies is exercised after the death of the employee by the estate of the decedent, or by a person who acquired the right to exercise such option by bequest or inheritance or by reason of the death of the decedent, the provisions of subsection (a) shall apply to the same extent as if the option had been exercised by the decedent, except that—

"(A) the holding period and employment requirements of sections 422(a), 423(a), and 424(a) shall not apply, and

"(B) any transfer by the estate of stock acquired shall be considered a disposition of such stock for purposes of sections 423(c) and 424(c)(1).

ost, pp. 67, 9.

"(2) DEDUCTION FOR ESTATE TAX.—If an amount is required to be included under section 422(c)(1), 423(c), or 424(c)(1) in gross income of the estate of the deceased employee or of a person described in paragraph (1), there shall be allowed to the estate or such person a deduction with respect to the estate tax attributable to the inclusion in the taxable estate of the deceased employee of the net value for estate tax purposes of the option. For this purpose, the deduction shall be determined under section 691(c) as if the option acquired from the deceased employee were an item of gross income in respect of the decedent under section 691 and as if the amount includible in gross income under section 422(c)(1), 423(c), or 424(c)(1) were an amount included in gross income under section 691 in respect of such item of gross income.

26 USC 691.

"(3) BASIS OF SHARES ACQUIRED.—In the case of a share of stock acquired by the exercise of an option to which paragraph (1) applies—

"(A) the basis of such share shall include so much of the basis of the option as is attributable to such share; except that the basis of such share shall be reduced by the excess (if any) of (i) the amount which would have been includible in gross income under section 422(c)(1), 423(c), or 424(c)(1) if the employee had exercised the option on the date of his death and had held the share acquired pursuant to such exercise at the time of his death, over (ii) the amount which is includible in gross income under such section; and

"(B) the last sentence of sections 422(c)(1), 423(c), and 424(c)(1) shall apply only to the extent that the amount includible in gross income under such sections exceeds so much of the basis of the option as is attributable to such share.

"SEC. 422. QUALIFIED STOCK OPTIONS.

"(a) IN GENERAL.—Subject to the provisions of subsection (c)(1), section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of a qualified stock option if—

Ante, p. 63.

"(1) no disposition of such share is made by such individual within the 3-year period beginning on the day after the day of the transfer of such share, and

"(2) at all times during the period beginning with the date of the granting of the option and ending on the day 3 months before the date of such exercise, such individual was an employee of either the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies. Post, p. 71.

"(b) QUALIFIED STOCK OPTION.—For purposes of this part, the term 'qualified stock option' means an option granted to an individual after December 31, 1963 (other than a restricted stock option granted pursuant to a contract described in section 424(c)(3)(A)), for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if— Post, p. 69.

"(1) the option is granted pursuant to a plan which includes the aggregate number of shares which may be issued under options, and the employees (or class of employees) eligible to receive options, and which is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

"(2) such option is granted within 10 years from the date such plan is adopted, or the date such plan is approved by the stockholders, whichever is earlier;

"(3) such option by its terms is not exercisable after the expiration of 5 years from the date such option is granted;

"(4) except as provided in subsection (c)(1), the option price is not less than the fair market value of the stock at the time such option is granted;

"(5) such option by its terms is not exercisable while there is outstanding (within the meaning of subsection (c)(2)) any qualified stock option (or restricted stock option) which was granted, before the granting of such option, to such individual to purchase stock in his employer corporation or in a corporation which (at the time of the granting of such option) is a parent or subsidiary corporation of the employer corporation, or in a predecessor corporation of any of such corporations;

"(6) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him; and

"(7) such individual, immediately after such option is granted, does not own stock possessing more than 5 percent of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation; except that if the equity capital of such corporation or corporations (determined at the time the option is granted) is less than $2,000,000, then, for purposes of applying the limitation of this paragraph, there shall be added to such 5 percent the percentage (not higher than 5 percent) which bears the same ratio to 5 percent as the difference between such equity capital and $2,000,000 bears to $1,000,000.

"(c) SPECIAL RULES.—

"(1) EXERCISE OF OPTION WHEN PRICE IS LESS THAN VALUE OF STOCK.—If a share of stock is transferred pursuant to the exercise by an individual of an option which fails to qualify as a qualified stock option under subsection (b) because there was a failure in an attempt, made in good faith, to meet the requirement of subsection (b)(4), the requirement of subsection (b)(4) shall be considered to have been met, but there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income for the taxable year in which such option is exercised, an amount equal to the lesser of—

"(A) 150 percent of the difference between the option price and the fair market value of the share at the time the option was granted, or

"(B) the difference between the option price and the fair market value of the share at the time of such exercise.

The basis of the share acquired shall be increased by an amount equal to the amount included in his gross income under this paragraph in the taxable year in which the exercise occurred.

"(2) CERTAIN OPTIONS TREATED AS OUTSTANDING.—For purposes of subsection (b)(5)—

"(A) any restricted stock option which is not terminated before January 1, 1965, and

"(B) any qualified stock option granted after December 31, 1963,

shall be treated as outstanding until such option is exercised in full or expires by reason of the lapse of time. For purposes of the preceding sentence, a restricted stock option granted before January 1, 1964, shall not be treated as outstanding for any period before the first day on which (under the terms of such option) it may be exercised.

"(3) OPTIONS GRANTED TO CERTAIN SHAREHOLDERS.—For purposes of subsection (b)(7)—

"(A) the term 'equity capital' means—

"(i) in the case of one corporation, the sum of its money and other property (in an amount equal to the adjusted basis of such property for determining gain), less the amount of its indebtedness (other than indebtedness to shareholders), and

"(ii) in the case of a group of corporations consisting of a parent and its subsidiary corporations, the sum of the equity capital of each of such corporations adjusted, under regulations prescribed by the Secretary or his delegate, to eliminate the effect of intercorporate ownership and transactions among such corporations:

Post, p. 71.

"(B) the rules of section 425(d) shall apply in determining the stock ownership of the individual; and

"(C) stock which the individual may purchase under outstanding options shall be treated as stock owned by such individual.

If an individual is granted an option which permits him to purchase stock in excess of the limitation of subsection (b)(7) (determined by applying the rules of this paragraph), such option shall be treated as meeting the requirement of subsection (b)(7) to the extent that such individual could, if the option were fully exercised at the time of grant, purchase stock under such option without exceeding such limitation. The portion of such option which is treated as meeting the requirement of subsection (b)(7) shall be deemed to be that portion of the option which is first exercised.

"(4) CERTAIN DISQUALIFYING DISPOSITIONS WHERE AMOUNT REALIZED IS LESS THAN VALUE AT EXERCISE.—If—

"(A) an individual who has acquired a share of stock by the exercise of a qualified stock option makes a disposition of such share within the 3-year period described in subsection (a)(1), and

"(B) such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to such individual,

then the amount which is includible in the gross income of such individual, and the amount which is deductible from the income of his employer corporation, as compensation attributable to the exercise of such option shall not exceed the excess (if any) of the amount realized on such sale or exchange over the adjusted basis of such share.

"(5) CERTAIN TRANSFERS BY INSOLVENT INDIVIDUALS.—If an insolvent individual holds a share of stock acquired pursuant to his exercise of a qualified stock option, and if such share is transferred to a trustee, receiver, or other similar fiduciary, in any proceeding under the Bankruptcy Act or any other similar insolvency proceeding, neither such transfer, nor any other transfer of such share for the benefit of his creditors in such proceeding, shall constitute a 'disposition of such share' for purposes of subsection (a)(1).

30 Stat. 544; 52 Stat. 840. 11 USC 1 note

"(6) APPLICATION OF SUBSECTION (b)(5) WHERE OPTIONS ARE FOR STOCK OF SAME CLASS IN SAME CORPORATION.—The requirement of subsection (b)(5) shall be considered to have been met in the case of any option (referred to in this paragraph as 'new option') granted to an individual if—

"(A) the new option and all outstanding options referred to in subsection (b)(5) are to purchase stock of the same class in the same corporation, and

"(B) the new option by its terms is not exercisable while there is outstanding (within the meaning of paragraph (2)) any qualified stock option (or restricted stock option) which was granted, before the granting of the new option, to such individual to purchase stock in such corporation at a price (determined as of the date of grant of the new option) higher than the option price of the new option.

"SEC. 423. EMPLOYEE STOCK PURCHASE PLANS.

"(a) GENERAL RULE.—Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of an option granted after December 31, 1963 (other than a restricted stock option granted pursuant to a plan described in section 424(c)(3)(B)), under an employee stock purchase plan (as defined in subsection (b)) if—

Ante, p. 63.
Post, p. 69.

"(1) no disposition of such share is made by him within 2 years after the date of the granting of the option nor within 6 months after the transfer of such share to him; and

"(2) at all times during the period beginning with the date of the granting of the option and ending on the day 3 months before the date of such exercise, he is an employee of the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies.

"(b) EMPLOYEE STOCK PURCHASE PLAN.—For purposes of this part, the term 'employee stock purchase plan' means a plan which meets the following requirements:

"(1) the plan provides that options are to be granted only to employees of the employer corporation or of its parent or subsidiary corporation to purchase stock in any such corporation;

"(2) such plan is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

"(3) under the terms of the plan, no employee can be granted an option if such employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation. For purposes of this paragraph, the rules of section 425(d) shall apply in determining the stock ownership of an individual, and stock which the employee may purchase under outstanding options shall be treated as stock owned by the employee;

"(4) under the terms of the plan, options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by such corporation, except that there may be excluded—

"(A) employees who have been employed less than 2 years,

"(B) employees whose customary employment is 20 hours or less per week,

"(C) employees whose customary employment is for not more than 5 months in any calendar year, and

"(D) officers, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees;

"(5) under the terms of the plan, all employees granted such options shall have the same rights and privileges, except that the amount of stock which may be purchased by any employee under such option may bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of employees, and the plan may provide that no employee may purchase more than a maximum amount of stock fixed under the plan;

"(6) under the terms of the plan, the option price is not less than the lesser of—

"(A) an amount equal to 85 percent of the fair market value of the stock at the time such option is granted, or

"(B) an amount which under the terms of the option may not be less than 85 percent of the fair market value of the stock at the time such option is exercised;

"(7) under the terms of the plan, such option cannot be exercised after the expiration of—

"(A) 5 years from the date such option is granted if, under the terms of such plan, the option price is to be not less than 85 percent of the fair market value of such stock at the time of the exercise of the option, or

"(B) 27 months from the date such option is granted, if the option price is not determinable in the manner described in subparagraph (A);

"(8) under the terms of the plan, no employee may be granted an option which permits his rights to purchase stock under all such plans of his employer corporation and its parent and subsidiary corporations to accrue at a rate which exceeds $25,000 of fair market value of such stock (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time. For purposes of this paragraph—

"(A) the right to purchase stock under an option accrues when the option (or any portion thereof) first becomes exercisable during the calendar year;

"(B) the right to purchase stock under an option accrues at the rate provided in the option, but in no case may such rate exceed $25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and

"(C) a right to purchase stock which has accrued under one option granted pursuant to the plan may not be carried over to any other option; and

"(9) under the terms of the plan, such option is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him.

For purposes of paragraphs (3) to (9), inclusive, where additional terms are contained in an offering made under a plan, such additional terms shall, with respect to options exercised under such offering, be treated as a part of the terms of such plan.

"(c) SPECIAL RULE WHERE OPTION PRICE IS BETWEEN 85 PERCENT AND 100 PERCENT OF VALUE OF STOCK.—If the option price of a share of stock acquired by an individual pursuant to a transfer to which subsection (a) applies was less than 100 percent of the fair market value of such share at the time such option was granted, then, in the event of any disposition of such share by him which meets the holding period requirements of subsection (a), or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income, for the taxable year in which falls the date of such disposition or for the taxable year closing with his death, whichever applies, an amount equal to the lesser of—

"(1) the excess of the fair market value of the share at the time of such disposition or death over the amount paid for the share under the option, or

"(2) the excess of the fair market value of the share at the time the option was granted over the option price.

If the option price is not fixed or determinable at the time the option is granted, then for purposes of this subsection, the option price shall be determined as if the option were exercised at such time. In the case of the disposition of such share by the individual, the basis of the share in his hands at the time of such disposition shall be increased by an amount equal to the amount so includible in his gross income.

"SEC. 424. RESTRICTED STOCK OPTIONS.

"(a) IN GENERAL.—Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise after 1949 of a restricted stock option, if— Ante, p. 63.

"(1) no disposition of such share is made by him within 2 years from the date of the granting of the option nor within 6 months after the transfer of such share to him, and

"(2) at the time he exercises such option—

"(A) he is an employee of either the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies, or

"(B) he ceased to be an employee of such corporations within the 3-month period preceding the time of exercise.

"(b) RESTRICTED STOCK OPTION.—For purposes of this part, the term 'restricted stock option' means an option granted after February 26, 1945, and before January 1, 1964 (or, if it meets the requirements of subsection (c)(3), an option granted after December 31, 1963), to an individual, for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if—

"(1) at the time such option is granted—

"(A) the option price is at least 85 percent of the fair market value at such time of the stock subject to the option, or

"(B) in the case of a variable price option, the option price (computed as if the option had been exercised when granted) is at least 85 percent of the fair market value of the stock at the time such option is granted;

"(2) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him;

"(3) such individual, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the employer corporation or of its parent or subsidiary corporation. This paragraph shall not apply if at the time such option is granted the option price is at least 110 percent of the fair market value of the stock subject to the option, and such option either by its terms is not exercisable after the expiration of 5 years from the date such option is granted or is exercised within one year after August 16, 1954. For purposes of this paragraph, the provisions of section 425(d) shall apply in determining the stock ownership of an individual; and

Post, p. 71.

"(4) such option by its terms is not exercisable after the expiration of 10 years from the date such option is granted, if such option has been granted on or after June 22, 1954.

"(c) SPECIAL RULES.—

"(1) OPTIONS UNDER WHICH OPTION PRICE IS BETWEEN 85 PERCENT AND 95 PERCENT OF VALUE OF STOCK.—If no disposition of a share of stock acquired by an individual on his exercise after 1949 of a restricted stock option is made by him within 2 years from the date of the granting of the option nor within 6 months after the transfer of such share to him, but, at the time the restricted stock option was granted, the option price (computed under subsection (b)(1)) was less than 95 percent of the fair market value at such time of such share, then, in the event of any disposition of such share by him, or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income, for the taxable year in which falls the date of such disposition or for the taxable year closing with his death, whichever applies—

"(A) in the case of a share of stock acquired under an option qualifying under subsection (b)(1)(A), an amount equal to the amount (if any) by which the option price is exceeded by the lesser of—

"(i) the fair market value of the share at the time of such disposition or death, or

"(ii) the fair market value of the share at the time the option was granted; or

"(B) in the case of stock acquired under an option qualifying under subsection (b)(1)(B), an amount equal to the lesser of—

"(i) the excess of the fair market value of the share at the time of such disposition or death over the price paid under the option, or

"(ii) the excess of the fair market value of the share at the time the option was granted over the option price (computed as if the option had been exercised at such time).

In the case of a disposition of such share by the individual, the basis of the share in his hands at the time of such disposition shall be increased by an amount equal to the amount so includible in his gross income.

"(2) VARIABLE PRICE OPTION.—For purposes of subsection (b)(1), the term 'variable price option' means an option under which the purchase price of the stock is fixed or determinable under a formula in which the only variable is the fair market value of the stock at any time during a period of 6 months which includes the time the option is exercised; except that in the case of options granted after September 30, 1958, such term does not include any such option in which such formula provides for determining such price by reference to the fair market value of the stock at any time before the option is exercised if such value may be greater than the average fair market value of the stock during the calendar month in which the option is exercised.

"(3) CERTAIN OPTIONS GRANTED AFTER DECEMBER 31, 1963.—For purposes of subsection (b), an option granted after December 31, 1963, meets the requirements of this paragraph if granted pursuant to—

"(A) a binding written contract entered into before January 1, 1964, or

"(B) a written plan adopted and approved before January 1, 1964, which (as of January 1, 1964, and as of the date of the granting of the option)—

"(i) met the requirements of paragraphs (4) and (5) of section 423(b), or Ante, p. 67.

"(ii) was being administered in a way which did not discriminate in favor of officers, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees.

"SEC. 425. DEFINITIONS AND SPECIAL RULES.

"(a) CORPORATE REORGANIZATIONS, LIQUIDATIONS, ETC.—For purposes of this part, the term 'issuing or assuming a stock option in a transaction to which section 425(a) applies' means a substitution of a new option for the old option, or an assumption of the old option, by an employer corporation, or a parent or subsidiary of such corporation, by reason of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation, if—

"(1) the excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares is not more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and

"(2) the new option or the assumption of the old option does not give the employee additional benefits which he did not have under the old option.

For purposes of this subsection, the parent-subsidiary relationship shall be determined at the time of any such transaction under this subsection.

"(b) ACQUISITION OF NEW STOCK.—For purposes of this part, if stock is received by an individual in a distribution to which section 305, 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies, and such distribution was made with respect to stock transferred to him upon his exercise of the option, such stock shall be considered as having been transferred to him on his exercise of such option. A similar rule shall be applied in the case of a series of such distributions.

26 USC 305, 354, 355, 356, 1036, 1031.

"(c) DISPOSITION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), for purposes of this part, the term 'disposition' includes a sale, exchange, gift, or a transfer of legal title, but does not include—

"(A) a transfer from a decedent to an estate or a transfer by bequest or inheritance;

"(B) an exchange to which section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applies; or

"(C) a mere pledge or hypothecation.

"(2) JOINT TENANCY.—The acquisition of a share of stock in the name of the employee and another jointly with the right of survivorship or a subsequent transfer of a share of stock into such joint ownership shall not be deemed a disposition, but a termination of such joint tenancy (except to the extent such employee acquires ownership of such stock) shall be treated as a disposition by him occurring at the time such joint tenancy is terminated.

"(d) ATTRIBUTION OF STOCK OWNERSHIP.—For purposes of this part, in applying the percentage limitations of sections 422(b)(7), 423(b)(3), and 424(b)(3)—

Ante, pp. 64, 67, 69.

"(1) the individual with respect to whom such limitation is being determined shall be considered as owning the stock owned, directly or indirectly, by or for his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

"(2) stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries.

"(e) PARENT CORPORATION.—For purposes of this part, the term 'parent corporation' means any corporation (other than the employer corporation) in an unbroken chain of corporations ending with the employer corporation if, at the time of the granting of the option, each of the corporations other than the employer corporation owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

"(f) SUBSIDIARY CORPORATION.—For purposes of this part, the term 'subsidiary corporation' means any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

"(g) SPECIAL RULE FOR APPLYING SUBSECTIONS (e) AND (f).—In applying subsections (e) and (f) for purposes of section 422(a)(2), 423(a)(2), and 424(a)(2), there shall be substituted for the term 'employer corporation' wherever it appears in subsections (e) and (f) the term 'grantor corporation', or the term 'corporation issuing or assuming a stock option in a transaction to which section 425(a) applies', as the case may be.

Ante, p. 71.

"(h) MODIFICATION, EXTENSION, OR RENEWAL OF OPTION.—

"(1) IN GENERAL.—For purposes of this part, if the terms of any option to purchase stock are modified, extended, or renewed, such modification, extension, or renewal shall be considered as the granting of a new option.

"(2) SPECIAL RULES FOR SECTIONS 423 AND 424 OPTIONS.—

"(A) In the case of the transfer of stock pursuant to the exercise of an option to which section 423 or 424 applies and which has been so modified, extended, or renewed, then, except as provided in subparagraph (B), the fair market value of such stock at the time of the granting of such option shall be considered as whichever of the following is the highest:

"(i) the fair market value of such stock on the date of the original granting of the option,

"(ii) the fair market value of such stock on the date of the making of such modification, extension, or renewal, or "(iii) the fair market value of such stock at the time of the making of any intervening modification, extension, or renewal.

"(B) Subparagraph (A) shall not apply with respect to a modification, extension, or renewal of a restricted stock option before January 1, 1964 (or after December 31, 1963, if made pursuant to a binding written contract entered into before January 1, 1964), if the aggregate of the monthly average fair market values of the stock subject to the option for the 12 consecutive calendar months before the date of the modification, extension, or renewal, divided by 12, is an amount less than 80 percent of the fair market value of such stock on the date of the original granting of the option or the date of the making of any intervening modification, extension, or renewal, whichever is the highest.

"(3) DEFINITION OF MODIFICATION.—The term 'modification' means any change in the terms of the option which gives the employee additional benefits under the option, but such term shall not include a change in the terms of the option—

"(A) attributable to the issuance or assumption of an option under subsection (a);

"(B) to permit the option to qualify under sections 422(b)(6), 423(b)(9), and 424(b)(2); or Ante, pp. 64, 67, 69.

"(C) in the case of an option not immediately exercisable in full, to accelerate the time at which the option may be exercised.

If a restricted stock option is exercisable after the expiration of 10 years from the date such option is granted, subparagraph (B) shall not apply unless the terms of the option are also changed to make it not exercisable after the expiration of such period.

"(i) STOCKHOLDER APPROVAL.—For purposes of this part, if the grant of an option is subject to approval by stockholders, the date of grant of the option shall be determined as if the option had not been subject to such approval.

"(j) CROSS REFERENCES.—

"For provisions requiring the reporting of certain acts with respect to a qualified stock option, options granted under employer stock purchase plans, or a restricted stock option, see section 6039."

(b) ADMINISTRATIVE PROVISIONS.—

(1) REPORTING REQUIREMENT FOR CERTAIN OPTIONS.—Subpart A of part III of subchapter A of chapter 61 (relating to information returns) is amended by renumbering section 6039 as 6040, and by inserting after section 6038 the following new section: 26 USC 6031-6039. 26 USC 6038, 6039.

"SEC. 6039. INFORMATION REQUIRED IN CONNECTION WITH CERTAIN OPTIONS.

"(a) REQUIREMENT OF REPORTING.—Every corporation—

"(1) which in any calendar year transfers a share of stock to any person pursuant to such person's exercise of a qualified stock option or a restricted stock option, or

"(2) which in any calendar year records (or has by its agent recorded) a transfer of the legal title of a share of stock—

"(A) acquired by the transferor pursuant to his exercise of an option described in section 423(c) (relating to special rule where option price is between 85 percent and 100 percent of value of stock), or

Ante, p. 69. "(B) acquired by the transferor pursuant to his exercise of a restricted stock option described in section 424(c)(1) (relating to options under which option price is between 85 percent and 95 percent of value of stock),

shall, for such calendar year, make a return at such time and in such manner, and setting forth such information, as the Secretary or his delegate may by regulations prescribe. For purposes of the preceding sentence, any option which a corporation treats as a qualified stock option, a restricted stock option, or an option granted under an employee stock purchase plan, shall be deemed to be such an option. A return is required by reason of a transfer described in paragraph (2) of a share only with respect to the first transfer of such share by the person who exercised the option.

"(b) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS FURNISHED.—Every corporation making a return under subsection (a) shall furnish to each person whose name is set forth in such return a written statement setting forth such information as the Secretary or his delegate may by regulations prescribe. The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was made.

"(c) IDENTIFICATION OF STOCK.—Any corporation which transfers any share of stock pursuant to the exercise of an option described in subsection (a)(2) shall identify such stock in a manner adequate to carry out the purposes of this section.

"(d) CROSS REFERENCES.—

"For definition of—

"(1) The term 'qualified stock option', see section 422(b).

"(2) The term 'employee stock purchase plan', see section 423(b).

"(3) The term 'restricted stock option', see section 424(b)."

(2) PENALTIES FOR FAILURE TO FILE INFORMATION RETURNS.—

26 USC 6652. Section 6652(a) (relating to failure to file certain information returns) is amended to read as follows:

"(a) RETURNS RELATING TO PAYMENTS OF DIVIDENDS, ETC., AND CERTAIN TRANSFERS OF STOCK.—In the case of each failure—

26 USC 6042. "(1) to file a statement of the aggregate amount of payments to another person required by section 6042(a)(1) (relating to payments of dividends aggregating $10 or more), section 6044(a)(1) (relating to payments of patronage dividends aggregating

26 USC 6049. $10 or more), or section 6049(a)(1) (relating to payments of interest aggregating $10 or more),

"(2) to make a return required by section 6039(a) (relating to reporting information in connection with certain options) with respect to a transfer of stock or a transfer of legal title to stock, or

Ante, p. 37. "(3) to make a return required by section 6052(a) (relating to reporting payment of wages in the form of group-term life insurance) with respect to group-term life insurance on the life of an employee,

on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid (upon notice and demand by the Secretary or his delegate and in the same manner as tax), by the person failing to file a statement referred to in paragraph (1) or failing to make a return referred to in paragraph (2) or (3), $10 for each such failure, but the total amount imposed on the delinquent person for all such failures during any calendar year shall not exceed $25,000."

(3) PENALTIES FOR FAILURE TO FURNISH STATEMENTS TO PERSONS WITH RESPECT TO WHOM RETURNS ARE FILED.—Section 6678 (relating to failure to furnish certain statements) is amended— 26 USC 6678.

(A) by striking out "section 6042(c)," and inserting in lieu thereof "section 6039(b), 6042(c),"; and 26 USC 6042. Ante, p. 73.

(B) by striking out "section 6042(a) (1)," and inserting in lieu thereof "section 6039(a), 6042(a) (1),".

(c) TECHNICAL AMENDMENTS.—

(1) Section 402(a)(3)(B) (relating to taxability of beneficiary of employees' trust) is amended by striking out "section 421(d) (2) and (3)" and inserting in lieu thereof "subsections (e) and (f) of section 425". 26 USC 402. Ante, p. 71.

(2) The last sentence of subparagraph (B) of section 691(c) (2) (relating to allowance of deduction for estate tax in case of items constituting income in respect of a decedent) is amended to read as follows: "Such net value shall be determined with respect to the provisions of section 421(c)(2), relating to the deduction for estate tax with respect to stock options to which part II of subchapter D applies." Ante, p. 63.

(d) CLERICAL AMENDMENTS.—

(1) The table of parts for subchapter D of chapter 1 is amended by striking out

"Part II. Miscellaneous provisions."

and inserting in lieu thereof the following:

"Part II. Certain stock options."

(2) The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by striking out

"Sec. 6039. Cross references."

and inserting in lieu thereof:

"Sec. 6039. Information required in connection with certain options.
"Sec. 6040. Cross references."

(e) EFFECTIVE DATES AND TRANSITION RULES.—

(1) Except as provided in paragraphs (2) and (3), the amendments made by this section shall apply to taxable years ending after December 31, 1963.

(2) The amendments made by paragraphs (1) and (3) of subsection (b), and paragraph (2) of section 6652(a) of the Internal Revenue Code of 1954 (as amended by paragraph (2) of subsection (b)), shall apply to stock transferred pursuant to options exercised on or after January 1, 1964. 26 USC 6652.

(3) In the case of an option granted after December 31, 1963, and before January 1, 1965—

(A) paragraphs (1) and (2) of section 422(b) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall not apply, and Ante, p. 64.

(B) paragraph (1) of section 425(h) of such Code (as added by subsection (a)) shall not apply to any change in the terms of such option made before January 1, 1965, to permit such option to qualify under paragraphs (3), (4), and (5) of such section 422(b).

SEC. 222. SALES AT RETAIL UNDER REVOLVING CREDIT PLANS.

(a) TREATMENT UNDER INSTALLMENT METHOD.—Section 453 (relating to installment method of accounting) is amended by adding at the end thereof the following new subsection: Post, p. 105.

"(e) REVOLVING CREDIT TYPE PLANS.—For purposes of subsection (a), the term 'installment plan' includes a revolving credit type plan which provides that the purchaser of personal property at retail may pay for such property in a series of periodic payments of an agreed portion of the amounts due the seller under the plan, except that such term does not include any such plan with respect to a purchaser who uses his account primarily as an ordinary charge account."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply in respect of sales made during taxable years beginning after December 31, 1963.

SEC. 223. TIMING OF DEDUCTIONS IN CERTAIN CASES WHERE ASSERTED LIABILITIES ARE CONTESTED.

(a) TAXABLE YEAR OF DEDUCTION.—

26 USC 461. (1) Section 461 (relating to general rule for taxable year of deduction) is amended by adding at the end thereof the following new subsection:

"(f) CONTESTED LIABILITIES.—If—

"(1) the taxpayer contests an asserted liability,

"(2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability,

"(3) the contest with respect to the asserted liability exists after the time of the transfer, and

"(4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year),

then the deduction shall be allowed for the taxable year of the transfer. This subsection shall not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States."

53 Stat. 24. (2) Section 43 of the Internal Revenue Code of 1939 (relating to period for which deductions and credits taken) is amended by adding at the end thereof the following new sentences: "If—

"(1) the taxpayer contests an asserted liability,

"(2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability,

"(3) the contest with respect to the asserted liability exists after the time of the transfer, and

"(4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year),

then the deduction shall be allowed for the taxable year of the transfer. The preceding sentence shall not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States."

(b) EFFECTIVE DATES.—Except as provided in subsections (c) and (d)—

(1) the amendment made by subsection (a)(1) shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954, and

(2) the amendment made by subsection (a)(2) shall apply to taxable years to which the Internal Revenue Code of 1939 applies.

(c) ELECTION AS TO TRANSFERS IN TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1964.—

(1) The amendments made by subsection (a) shall not apply to any transfer of money or other property described in subsection (a) made in a taxable year beginning before January 1, 1964, if the taxpayer elects, in the manner provided by regulations prescribed by the Secretary of the Treasury or his delegate, to have this paragraph apply. Such an election—

(A) must be made within one year after the date of the enactment of this Act,

(B) may not be revoked after the expiration of such one-year period, and

(C) shall apply to all transfers described in the first sentence of this paragraph (other than transfers described in paragraph (2)).

In the case of any transfer to which this paragraph applies, the deduction shall be allowed only for the taxable year in which the contest with respect to such transfer is settled.

(2) Paragraph (1) shall not apply to any transfer if the assessment of any deficiency which would result from the application of the election in respect of such transfer is, on the date of the election under paragraph (1), prevented by the operation of any law or rule of law.

(3) If the taxpayer makes an election under paragraph (1), and if, on the date of such election, the assessment of any deficiency which results from the application of the election in respect of any transfer is not prevented by the operation of any law or rule of law, the period within which assessment of such deficiency may be made shall not expire earlier than 2 years after the date of the enactment of this Act.

(d) CERTAIN OTHER TRANSFERS IN TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1964.—The amendments made by subsection (a) shall not apply to any transfer of money or other property described in subsection (a) made in a taxable year beginning before January 1, 1964, if—

(1) no deduction has been allowed in respect of such transfer for any taxable year before the taxable year in which the contest with respect to such transfer is settled, and

(2) refund or credit of any overpayment which would result from the application of such amendments to such transfer is prevented by the operation of any law or rule of law.

In the case of any transfer to which this subsection applies, the deduction shall be allowed for the taxable year in which the contest with respect to such transfer is settled.

SEC. 224. INTEREST ON CERTAIN DEFERRED PAYMENTS.

(a) IN GENERAL.—Part III of subchapter E of chapter 1 (relating to accounting periods and methods of accounting) is amended by adding at the end thereof the following new section: 26 USC 481, 482.

"SEC. 483. INTEREST ON CERTAIN DEFERRED PAYMENTS.

"(a) AMOUNT CONSTITUTING INTEREST.—For purposes of this title, in the case of any contract for the sale or exchange of property there shall be treated as interest that part of a payment to which this section applies which bears the same ratio to the amount of such payment as the total unstated interest under such contract bears to the total of the payments to which this section applies which are due under such contract.

"(b) TOTAL UNSTATED INTEREST.—For purposes of this section, the term 'total unstated interest' means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of—

"(1) the sum of the payments to which this section applies which are due under the contract, over

"(2) the sum of the present values of such payments and the present values of any interest payments due under the contract.

For purposes of paragraph (2), the present value of a payment shall be determined, as of the date of the sale or exchange, by discounting such payment at the rate, and in the manner, provided in regulations prescribed by the Secretary or his delegate. Such regulations shall provide for discounting on the basis of 6-month brackets and shall provide that the present value of any interest payment due not more than 6 months after the date of the sale or exchange is an amount equal to 100 percent of such payment.

"(c) PAYMENTS TO WHICH SECTION APPLIES.—

"(1) IN GENERAL.—Except as provided in subsection (f), this section shall apply to any payment on account of the sale or exchange of property which constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract—

"(A) under which some or all of the payments are due more than one year after the date of such sale or exchange, and

"(B) under which, using a rate provided by regulations prescribed by the Secretary or his delegate for purposes of this subparagraph, there is total unstated interest.

Any rate prescribed for determining whether there is total unstated interest for purposes of subparagraph (B) shall be at least one percentage point lower than the rate prescribed for purposes of subsection (b)(2).

"(2) TREATMENT OF EVIDENCE OF INDEBTEDNESS.—For purposes of this section, an evidence of indebtedness of the purchaser given in consideration for the sale or exchange of property shall not be considered a payment, and any payment due under such evidence of indebtedness shall be treated as due under the contract for the sale or exchange.

"(d) PAYMENTS THAT ARE INDEFINITE AS TO TIME, LIABILITY, OR AMOUNT.—In the case of a contract for the sale or exchange of property under which the liability for, or the amount or due date of, any portion of a payment cannot be determined at the time of the sale or exchange, this section shall be separately applied to such portion as if it (and any amount of interest attributable to such portion) were the only payments due under the contract; and such determinations of liability, amount, and due date shall be made at the time payment of such portion is made.

"(e) CHANGE IN TERMS OF CONTRACT.—If the liability for, or the amount or due date of, any payment (including interest) under a contract for the sale or exchange of property is changed, the 'total unstated interest' under the contract shall be recomputed and allocated (with adjustment for prior interest (including unstated interest) payments) under regulations prescribed by the Secretary or his delegate.

"(f) EXCEPTIONS AND LIMITATIONS.—

"(1) SALES PRICE OF $3,000 OR LESS.—This section shall not apply to any payment on account of the sale or exchange of property if it can be determined at the time of such sale or exchange that the sales price cannot exceed $3,000.

"(2) CARRYING CHARGES.—In the case of the purchaser, the tax treatment of amounts paid on account of the sale or exchange of property shall be made without regard to this section if any such amounts are treated under section 163(b) as if they included interest.

26 USC 163.

"(3) TREATMENT OF SELLER.—In the case of the seller, the tax treatment of any amounts received on account of the sale or exchange of property shall be made without regard to this section if no part of any gain on such sale or exchange would be considered as gain from the sale or exchange of a capital asset or property described in section 1231.

26 USC 1231.

"(4) SALES OR EXCHANGES OF PATENTS.—This section shall not apply to any payments made pursuant to a transfer described in section 1235(a) (relating to sale or exchange of patents).

26 USC 1235.

"(5) ANNUITIES.—This section shall not apply to any amount the liability for which depends in whole or in part on the life expectancy of one or more individuals and which constitutes an amount received as an annuity to which section 72 applies." 26 USC 72.

(b) CLERICAL AMENDMENT.—The table of sections for such part is amended by adding at the end thereof the following new item:

"Sec. 483. Interest on certain deferred payments."

(c) CERTAIN CARRYING CHARGES.—Section 163(b)(1) (relating to installment purchases where interest charge is not separately stated) is amended— 26 USC 163.

(1) by striking out "personal property is purchased" and inserting in lieu thereof "personal property or educational services are purchased"; and

(2) by adding at the end thereof the following new sentence: "For purposes of this paragraph, the term 'educational services' means any service (including lodging) which is purchased from an educational institution (as defined in section 151(e)(4)) and which is provided for a student of such institution." 26 USC 151.

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to payments made after December 31, 1963, on account of sales or exchanges of property occurring after June 30, 1963, other than any sale or exchange made pursuant to a binding written contract (including an irrevocable written option) entered into before July 1, 1963. The amendments made by subsection (c) shall apply to payments made during taxable years beginning after December 31, 1963.

SEC. 225. PERSONAL HOLDING COMPANIES.

(a) PERSONAL HOLDING COMPANY TAX RATE.—Section 541 (relating to imposition of personal holding company tax) is amended by striking out "tax equal to" and all that follows and inserting in lieu thereof: "tax equal to 70 percent of the undistributed personal holding company income." 26 USC 541.

(b) DEFINITION OF PERSONAL HOLDING COMPANY.—Paragraph (1) of section 542(a) (relating to the gross income requirement for personal holding company purposes) is amended to read as follows: 26 USC 542.

"(1) ADJUSTED ORDINARY GROSS INCOME REQUIREMENT.—At least 60 percent of its adjusted ordinary gross income (as defined in section 543(b)(2)) for the taxable year is personal holding company income (as defined in section 543(a)), and". 26 USC 543.

(c) EXCLUDED CORPORATIONS.—

(1) DOMESTIC BUILDING AND LOAN ASSOCIATIONS.—Paragraph (2) of section 542(c) (relating to corporations excepted from the definition of personal holding company) is amended to read as follows:

"(2) a bank as defined in section 581, or a domestic building and loan association within the meaning of section 7701(a)(19) without regard to subparagraphs (D) and (E) thereof;". 26 USC 7701.

(2) LENDING AND FINANCE COMPANIES.—Section 542(c) is amended by striking out paragraphs (6), (7), (8), and (9), by renumbering paragraphs (10) and (11) as paragraphs (7) and (8), and by inserting after paragraph (5) the following new paragraph:

"(6) a lending or finance company if—

"(A) 60 percent or more of its ordinary gross income (as defined in section 543(b)(1)) is derived directly from the active and regular conduct of a lending or finance business;

"(B) the personal holding company income for the taxable year (computed without regard to income described in subsection (d)(3) and income derived directly from the active and regular conduct of a lending or finance business, and computed by including as personal holding company income the entire amount of the gross income from rents, royalties, produced film rents, and compensation for use of corporate property by shareholders) is not more than 20 percent of the ordinary gross income;

"(C) the sum of the deductions which are directly allocable to the active and regular conduct of its lending or finance business equals or exceeds the sum of—

"(i) 15 percent of so much of the ordinary gross income derived therefrom as does not exceed $500,000, plus

"(ii) 5 percent of so much of the ordinary gross income derived therefrom as exceeds $500,000 but not $1,000,000; and

"(D) the loans to a person who is a shareholder in such company during the taxable year by or for whom 10 percent or more in value of its outstanding stock is owned directly or indirectly (including, in the case of an individual, stock owned by members of his family as defined in section 544 (a)(2)), outstanding at any time during such year do not exceed $5,000 in principal amount;".

Post, p. 93.

26 USC 542.

(3) SPECIAL RULES FOR SECTION 542(c)(6).—Section 542 is amended by adding at the end thereof the following new subsection:

"(d) SPECIAL RULES FOR APPLYING SUBSECTION (c)(6).—

"(1) LENDING OR FINANCE BUSINESS DEFINED.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), for purposes of subsection (c)(6), the term 'lending or finance business' means a business of—

"(i) making loans,

"(ii) purchasing or discounting accounts receivable, notes, or installment obligations,

"(iii) rendering services or making facilities available in connection with activities described in clauses (i) and (ii) carried on by the corporation rendering services or making facilities available, or

"(iv) rendering services or making facilities available to another corporation which is engaged in the lending or finance business (within the meaning of this paragraph), if such services or facilities are related to the lending or finance business (within such meaning) of such other corporation and such other corporation and the corporation rendering services or making facilities available are members of the same affiliated group (as defined in section 1504).

26 USC 1504.

"(B) EXCEPTIONS.—For purposes of subparagraph (A), the term 'lending or finance business' does not include the business of—

"(i) making loans, or purchasing or discounting accounts receivable, notes, or installment obligations, if (at the time of the loan, purchase, or discount) the remaining maturity exceeds 60 months, unless the loans, notes, or installment obligations are evidenced or secured by contracts of conditional sale, chattel mortgages, or chattel lease agreements arising out of the sale of goods or services in the course of the borrower's or transferor's trade or business, or "(ii) making loans evidenced by, or purchasing, certificates of indebtedness issued in a series, under a trust indenture, and in registered form or with interest coupons attached.

For purposes of clause (i), the remaining maturity shall be treated as including any period for which there may be a renewal or extension under the terms of an option exercisable by the borrower.

"(2) BUSINESS DEDUCTIONS.—For purposes of subsection (c)(6)(C), the deductions which may be taken into account shall include only—

"(A) deductions which are allowable only by reason of section 162 or section 404, except there shall not be included any such deduction in respect of compensation for personal services rendered by shareholders (including members of the shareholder's family as described in section 544(a)(2)), and Post, p. 9[illegible]

"(B) deductions allowable under section 167, and deductions allowable under section 164 for real property taxes, but in either case only to the extent that the property with respect to which such deductions are allowable is used directly in the active and regular conduct of the lending or finance business. 26 USC 167. Ante, p. 4[illegible]

"(3) INCOME RECEIVED FROM CERTAIN AFFILIATED CORPORATIONS.—For purposes of subsection (c)(6)(B), in the case of a lending or finance company which meets the requirements of subsection (c)(6)(A), there shall not be treated as personal holding company income the lawful income received from a corporation which meets the requirements of subsection (c)(6) and which is a member of the same affiliated group (as defined in section 1504) of which such company is a member." 26 USC 1504.

(d) PERSONAL HOLDING COMPANY INCOME.—Subsections (a) and (b) of section 543 (relating to personal holding company income) are amended to read as follows: 26 USC 543.

"(a) GENERAL RULE.—For purposes of this subtitle, the term 'personal holding company income' means the portion of the adjusted ordinary gross income which consists of:

"(1) DIVIDENDS, ETC.—Dividends, interest, royalties (other than mineral, oil, or gas royalties or copyright royalties), and annuities. This paragraph shall not apply to—

"(A) interest constituting rent (as defined in subsection (b)(3)),

"(B) interest on amounts set aside in a reserve fund under section 511 or 607 of the Merchant Marine Act, 1936, and 54 Stat. 110[illegible] 46 USC 1161.

"(C) a dividend distribution of divested stock (as defined in subsection (e) of section 1111), but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years before the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered. 49 Stat. 200[illegible] 46 USC 1177. 26 USC 1111.

"(2) RENTS.—The adjusted income from rents; except that such adjusted income shall not be included if—

"(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income, and

"(B) the sum of—

"(i) the dividends paid during the taxable year (determined under section 562), 26 USC 562.

"(ii) the dividends considered as paid on the last day of the taxable year under section 563(c) (as limited by the second sentence of section 563(b)), and 26 USC 563.

"(iii) the consent dividends for the taxable year (de-
26 USC 565. termined under section 565),
equals or exceeds the amount, if any, by which the personal holding company income for the taxable year (computed without regard to this paragraph and paragraph (6), and computed by including as personal holding company income copyright royalties and the adjusted income from mineral, oil, and gas royalties) exceeds 10 percent of the ordinary gross income.

"(3) MINERAL, OIL, AND GAS ROYALTIES.—The adjusted income from mineral, oil, and gas royalties; except that such adjusted income shall not be included if—

"(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income,

"(B) the personal holding company income for the taxable year (computed without regard to this paragraph, and computed by including as personal holding company income copyright royalties and the adjusted income from rents) is not more than 10 percent of the ordinary gross income, and

"(C) the sum of the deductions which are allowable under section 162 (relating to trade or business expenses) other than—

"(i) deductions for compensation for personal services rendered by the shareholders, and

"(ii) deductions which are specifically allowable under
26 USC 162. sections other than section 162,
equals or exceeds 15 percent of the adjusted ordinary gross income.

"(4) COPYRIGHT ROYALTIES.—Copyright royalties; except that copyright royalties shall not be included if—

"(A) such royalties (exclusive of royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole, or in part, by any shareholder) constitute 50 percent or more of the ordinary gross income,

"(B) the personal holding company income for the taxable year computed—

"(i) without regard to copyright royalties, other than royalties received for the use of, or right to use, copyrights or interests in copyrights in works created in whole, or in part, by any shareholder owning more than 10 percent of the total outstanding capital stock of the corporation,

"(ii) without regard to dividends from any corporation in which the taxpayer owns at least 50 percent of all classes of stock entitled to vote and at least 50 percent of the total value of all classes of stock and which corporation meets the requirements of this subparagraph and subparagraphs (A) and (C), and

"(iii) by including as personal holding company income the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties,
is not more than 10 percent of the ordinary gross income, and

"(C) the sum of the deductions which are properly allocable to such royalties and which are allowable under section 162, other than—

"(i) deductions for compensation for personal services rendered by the shareholders,

"(ii) deductions for royalties paid or accrued, and

"(iii) deductions which are specifically allowable under sections other than section 162, equals or exceeds 25 percent of the amount by which the ordinary gross income exceeds the sum of the royalties paid or accrued and the amounts allowable as deductions under section 167 (relating to depreciation) with respect to copyright royalties. 26 USC 167.

For purposes of this subsection, the term 'copyright royalties' means compensation, however designated, for the use of, or the right to use, copyrights in works protected by copyright issued under title 17 of the United States Code (other than by reason of section 2 or 6 thereof) and to which copyright protection is also extended by the laws of any country other than the United States of America by virtue of any international treaty, convention, or agreement, or interests in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work and payments (other than produced film rents as defined in paragraph (5)(B)) received for the use of, or right to use, films. For purposes of this paragraph, the term 'shareholder' shall include any person who owns stock within the meaning of section 544. Post, p. 93.

"(5) PRODUCED FILM RENTS.—

"(A) Produced film rents; except that such rents shall not be included if such rents constitute 50 percent or more of the ordinary gross income.

"(B) For purposes of this section, the term 'produced film rents' means payments received with respect to an interest in a film for the use of, or right to use, such film, but only to the extent that such interest was acquired before substantial completion of production of such film.

"(6) USE OF CORPORATION PROPERTY BY SHAREHOLDER.—Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the corporation in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. This paragraph shall apply only to a corporation which has personal holding company income for the taxable year (computed without regard to this paragraph and paragraph (2), and computed by including as personal holding company income copyright royalties and the adjusted income from mineral, oil, and gas royalties) in excess of 10 percent of its ordinary gross income.

"(7) PERSONAL SERVICE CONTRACTS.—

"(A) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

"(B) amounts received from the sale or other disposition of such a contract.

This paragraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

"(8) Estates and trusts.—Amounts includible in computing the taxable income of the corporation under part I of subchapter J (sec. 641 and following, relating to estates, trusts, and beneficiaries).

26 USC 641 et seq.

"(b) Definitions.—For purposes of this part—

"(1) Ordinary gross income.—The term 'ordinary gross income' means the gross income determined by excluding—

"(A) all gains from the sale or other disposition of capital assets, and

"(B) all gains (other than those referred to in subparagraph (A)) from the sale or other disposition of property described in section 1231(b).

26 USC 1231.

"(2) Adjusted ordinary gross income.—The term 'adjusted ordinary gross income' means the ordinary gross income adjusted as follows:

"(A) Rents.—From the gross income from rents (as defined in the second sentence of paragraph (3) of this subsection) subtract the amount allowable as deductions for—

"(i) exhaustion, wear and tear, obsolescence, and amortization of property other than tangible personal property which is not customarily retained by any one lessee for more than three years,

"(ii) property taxes,

"(iii) interest, and

"(iv) rent,

to the extent allocable, under regulations prescribed by the Secretary or his delegate, to such gross income from rents. The amount subtracted under this subparagraph shall not exceed such gross income from rents.

"(B) Mineral royalties, etc.—From the gross income from mineral, oil, and gas royalties described in paragraph (4), and from the gross income from working interests in an oil or gas well, subtract the amount allowable as deductions for—

"(i) exhaustion, wear and tear, obsolescence, amortization, and depletion,

"(ii) property and severance taxes,

"(iii) interest, and

"(iv) rent,

to the extent allocable, under regulations prescribed by the Secretary or his delegate, to such gross income from royalties or such gross income from working interests in oil or gas wells. The amount subtracted under this subparagraph with respect to royalties shall not exceed the gross income from such royalties, and the amount subtracted under this subparagraph with respect to working interests shall not exceed the gross income from such working interests.

"(C) Interest.—There shall be excluded—

"(i) interest received on a direct obligation of the United States held for sale to customers in the ordinary course of trade or business by a regular dealer who is making a primary market in such obligations, and

"(ii) interest on a condemnation award, a judgment, and a tax refund.

"(3) Adjusted income from rents.—The term 'adjusted income from rents' means the gross income from rents, reduced by the amount subtracted under paragraph (2)(A) of this subsection.

For purposes of the preceding sentence, the term 'rents' means compensation, however designated, for the use of, or right to use, property, and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation; but does not include amounts constituting personal holding company income under subsection (a)(6), nor copyright royalties (as defined in subsection (a)(4)), nor produced film rents (as defined in subsection (a)(5)(B)).

"(4) ADJUSTED INCOME FROM MINERAL, OIL, AND GAS ROYALTIES.—The term 'adjusted income from mineral, oil, and gas royalties' means the gross income from mineral, oil, and gas royalties (including production payments and overriding royalties), reduced by the amount subtracted under paragraph (2)(B) of this subsection in respect of such royalties."

(e) FOREIGN PERSONAL HOLDING COMPANY INCOME AND STOCK OWNERSHIP.—Section 553 (relating to foreign personal holding company income) and section 554 (relating to stock ownership) are amended to read as follows: Post, p. 86.

"SEC. 553. FOREIGN PERSONAL HOLDING COMPANY INCOME.

"(a) FOREIGN PERSONAL HOLDING COMPANY INCOME.—For purposes of this subtitle, the term 'foreign personal holding company income' means that portion of the gross income, determined for purposes of section 552, which consists of: 26 USC 552.

"(1) DIVIDENDS, ETC.—Dividends, interest, royalties, and annuities. This paragraph shall not apply to a dividend distribution of divested stock (as defined in subsection (e) of section 1111) but only if the stock with respect to which the distribution is made was owned by the distributee on September 6, 1961, or was owned by the distributee for at least 2 years before the date on which the antitrust order (as defined in subsection (d) of section 1111) was entered. 26 USC 1111.

"(2) STOCK AND SECURITIES TRANSACTIONS.—Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

"(3) COMMODITIES TRANSACTIONS.—Gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange. This paragraph shall not apply to gains by a producer, processor, merchant, or handler of the commodity which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others.

"(4) ESTATES AND TRUSTS.—Amounts includible in computing the taxable income of the corporation under part I of subchapter J (sec. 641 and following, relating to estates, trusts, and beneficiaries); and gains from the sale or other disposition of any interest in an estate or trust.

"(5) PERSONAL SERVICE CONTRACTS.—

"(A) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract: and

"(B) amounts received from the sale or other disposition of such a contract.

This paragraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

"(6) USE OF CORPORATION PROPERTY BY SHAREHOLDER.—Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the corporation in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. This paragraph shall apply only to a corporation which has foreign personal holding company income for the taxable year, computed without regard to this paragraph and paragraph (7), in excess of 10 percent of its gross income.

"(7) RENTS.—Rents, unless constituting 50 percent or more of the gross income. For purposes of this paragraph, the term 'rents' means compensation, however designated, for the use of, or right to use, property; but does not include amounts constituting foreign personal holding company income under paragraph (6).

"(b) LIMITATION ON GROSS INCOME IN CERTAIN TRANSACTIONS.—For purposes of this part—

"(1) gross income and foreign personal holding company income determined with respect to transactions described in subsection (a)(2) (relating to gains from stock and security transactions) shall include only the excess of gains over losses from such transactions, and

"(2) gross income and foreign personal holding company income determined with respect to transactions described in subsection (a)(3) (relating to gains from commodity transactions) shall include only the excess of gains over losses from such transactions.

"SEC. 554. STOCK OWNERSHIP.

"(a) CONSTRUCTIVE OWNERSHIP.—For purposes of determining whether a corporation is a foreign personal holding company, insofar as such determination is based on stock ownership under section 552(a)(2), section 553(a)(5), or section 553(a)(6)—

26 USC 552.
Ante, p. 85.

"(1) STOCK NOT OWNED BY INDIVIDUAL.—Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

"(2) FAMILY AND PARTNERSHIP OWNERSHIP.—An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For purposes of this paragraph, the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

"(3) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

"(4) APPLICATION OF FAMILY-PARTNERSHIP AND OPTION RULES.—Paragraphs (2) and (3) shall be applied—

"(A) for purposes of the stock ownership requirement provided in section 552(a)(2), if, but only if, the effect is to make the corporation a foreign personal holding company; 26 USC 552.

"(B) for purposes of section 553(a)(5) (relating to personal service contracts) or of section 553(a)(6) (relating to the use of property by shareholders), if, but only if, the effect is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income. Ante, p. 85.

"(5) CONSTRUCTIVE OWNERSHIP AS ACTUAL OWNERSHIP.—Stock constructively owned by a person by reason of the application of paragraph (1) or (3) shall, for purposes of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as owned by him for purposes of again applying such paragraph in order to make another the constructive owner of such stock.

"(6) OPTION RULE IN LIEU OF FAMILY AND PARTNERSHIP RULE.—If stock may be considered as owned by an individual under either paragraph (2) or (3) it shall be considered as owned by him under paragraph (3).

"(b) CONVERTIBLE SECURITIES.—Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock—

"(1) for purposes of the stock ownership requirement provided in section 552(a)(2), but only if the effect of the inclusion of all such securities is to make the corporation a foreign personal holding company;

"(2) for purposes of section 553(a)(5) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income; and

"(3) for purposes of section 553(a)(6) (relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income.

The requirement in paragraphs (1), (2), and (3) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others are not included, but no convertible securities shall be included unless all outstanding securities having a prior conversion date are also included."

(f) DIVIDENDS-PAID DEDUCTION.—

(1) Paragraph (2) of section 316(b) (relating to special rules for dividend defined) is amended to read as follows: 26 USC 316.

"(2) DISTRIBUTIONS BY PERSONAL HOLDING COMPANIES.—

"(A) In the case of a corporation which—

"(i) under the law applicable to the taxable year in which the distribution is made, is a personal holding company (as defined in section 542), or 26 USC 542.

"(ii) for the taxable year in respect of which the distribution is made under section 563(b) (relating to dividends paid after the close of the taxable year), or section 547 (relating to deficiency dividends), or the cor- 26 USC 563.

responding provisions of prior law, is a personal holding company under the law applicable to such taxable year, the term 'dividend' also means any distribution of property (whether or not a dividend as defined in subsection (a)) made by the corporation to its shareholders, to the extent of its undistributed personal holding company income (deter-
26 USC 545. mined under section 545 without regard to distributions under this paragraph) for such year.

"(B) For purposes of subparagraph (A), the term 'distribution of property' includes a distribution in complete liquidation occurring within 24 months after the adoption of a plan of liquidation, but—

"(i) only to the extent of the amounts distributed to distributees other than corporate shareholders, and

"(ii) only to the extent that the corporation designates such amounts as a dividend distribution and duly notifies such distributees of such designation, under regulations prescribed by the Secretary or his delegate, but

"(iii) not in excess of the sum of such distributees' allocable share of the undistributed personal holding company income for such year, computed without regard
26 USC 562. to this subparagraph or section 562(b)."

26 USC 331. (2) Section 331(b) (relating to nonapplication of section 301) is amended by inserting after "any distribution of property" the phrase "(other than a distribution referred to in paragraph (2)(B) of section 316(b))".

(3) Section 562(b) (relating to distributions in liquidation) is amended to read as follows:

"(b) DISTRIBUTIONS IN LIQUIDATION.—

"(1) Except in the case of a personal holding company
26 USC 542. described in section 542 or a foreign personal holding company
26 USC 552. described in section 552—

"(A) in the case of amounts distributed in liquidation, the part of such distribution which is properly chargeable to earnings and profits accumulated after February 28, 1913, shall be treated as a dividend for purposes of computing the dividends paid deduction, and

"(B) in the case of a complete liquidation occurring within 24 months after the adoption of a plan of liquidation, any distribution within such period pursuant to such plan shall, to the extent of the earnings and profits (computed without regard to capital losses) of the corporation for the taxable year in which such distribution is made, be treated as a dividend for purposes of computing the dividends paid deduction.

"(2) In the case of a complete liquidation of a personal holding company, occurring within 24 months after the adoption of a plan of liquidation, the amount of any distribution within such period pursuant to such plan shall be treated as a dividend for purposes of computing the dividends paid deduction, to the extent that such amount is distributed to corporate distributees and represents such corporate distributees' allocable share of the undistributed personal holding company income for the taxable year of such distribution computed without regard to this paragraph
26 USC 316. and without regard to subparagraph (B) of section 316(b)(2)."

26 USC 551. (4) Section 551(b) (relating to amount included in gross income) is amended by striking out "received as a dividend" and inserting in lieu thereof "received as a dividend (determined as if

any distribution in liquidation actually made in such taxable year had not been made)".

(g) ONE-MONTH LIQUIDATIONS.—Section 333 (relating to election as to recognition of gain in certain liquidations) is amended by adding at the end thereof the following new subsection: 26 USC 333.

"(g) SPECIAL RULE.—

"(1) LIQUIDATIONS BEFORE JANUARY 1, 1967.—In the case of a liquidation occurring before January 1, 1967, of a corporation referred to in paragraph (3)—

"(A) the date 'December 31, 1953' referred to in subsections (e)(2) and (f)(1) shall be treated as if such date were 'December 31, 1962', and

"(B) in the case of stock in such corporation held for more than 6 months, the term 'a dividend' as used in subsection (e)(1) shall be treated as if such term were 'long-term capital gain'.

Subparagraph (B) shall not apply to any earnings and profits to which the corporation succeeds after December 31, 1963, pursuant to any corporate reorganization or pursuant to any liquidation to which section 332 applies, except earnings and profits which on December 31, 1963, constituted earnings and profits of a corporation referred to in paragraph (3), and except earnings and profits which were earned after such date by a corporation referred to in paragraph (3). 26 USC 332.

"(2) LIQUIDATIONS AFTER DECEMBER 31, 1966.—

"(A) IN GENERAL.—In the case of a liquidation occurring after December 31, 1966, of a corporation to which this subparagraph applies—

"(i) the date 'December 31, 1953' referred to in subsections (e)(2) and (f)(1) shall be treated as if such date were 'December 31, 1962', and

"(ii) so much of the gain recognized under subsection (e)(1) as is attributable to the earnings and profits accumulated after February 28, 1913, and before January 1, 1967, shall, in the case of stock in such corporation held for more than 6 months, be treated as long-term capital gain, and only the remainder of such gain shall be treated as a dividend.

Clause (ii) shall not apply to any earnings and profits to which the corporation succeeds after December 31, 1963, pursuant to any corporate reorganization or pursuant to any liquidation to which section 332 applies, except earnings and profits which on December 31, 1963, constituted earnings and profits of a corporation referred to in paragraph (3), and except earnings and profits which were earned after such date by a corporation referred to in paragraph (3).

"(B) CORPORATIONS TO WHICH APPLICABLE.—Subparagraph (A) shall apply only with respect to a corporation which is referred to in paragraph (3) and which—

"(i) on January 1, 1964, owes qualified indebtedness (as defined in section 545(c)), 26 USC 545.

"(ii) before January 1, 1968, notifies the Secretary or his delegate that it may wish to have subparagraph (A) apply to it and submits such information as may be required by regulations prescribed by the Secretary or his delegate, and

"(iii) liquidates before the close of the taxable year in which such corporation ceases to owe such qualified indebtedness or (if earlier) the taxable year referred to in subparagraph (C).

"(C) ADJUSTED POST-1963 EARNINGS AND PROFITS EXCEED QUALIFIED INDEBTEDNESS.—In the case of any corporation, the taxable year referred to in this subparagraph is the first taxable year at the close of which its adjusted post-1963 earnings and profits equal or exceed the amount of such corporation's qualified indebtedness on January 1, 1964. For purposes of the preceding sentence, the term 'adjusted post-1963 earnings and profits' means the sum of—

"(i) the earnings and profits of such corporation for taxable years beginning after December 31, 1963, without diminution by reason of any distributions made out of such earnings and profits, and

"(ii) the deductions allowed for taxable years beginning after December 31, 1963, for exhaustion, wear and tear, obsolescence, amortization, or depletion.

"(3) CORPORATIONS REFERRED TO.—For purposes of paragraphs (1) and (2), a corporation referred to in this paragraph is a corporation which for at least one of the two most recent taxable years ending before the date of the enactment of this subsection was not a personal holding company under section 542, but would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such taxable year.

26 USC 542.

"(4) MISTAKE AS TO APPLICABILITY OF SUBSECTION.—An election made under this section by a qualified electing shareholder of a corporation in which such shareholder states that such election is made on the assumption that such corporation is a corporation referred to in paragraph (3) shall have no force or effect if it is determined that the corporation is not a corporation referred to in paragraph (3)."

(h) EXCEPTION FOR CERTAIN CORPORATIONS.—

(1) GENERAL RULE.—Except as provided in paragraph (2), in the case of a corporation referred to in section 333(g)(3) of the Internal Revenue Code of 1954 (as added by subsection (g) of this section), the amendments made by this section (other than subsections (f) and (g)) shall not apply if there is a complete liquidation of such corporation and if the distribution of all the property under such liquidation occurs before January 1, 1966.

26 USC 333.

(2) EXCEPTION.—Paragraph (1) shall not apply to any liquidation to which section 332 of the Internal Revenue Code of 1954 applies unless—

26 USC 332.

(A) the corporate distributee (referred to in subsection (b)(1) of such section 332) in such liquidation is liquidated in a complete liquidation to which such section 332 does not apply, and

(B) the distribution of all the property under such liquidation occurs before the 91st day after the last distribution referred to in paragraph (1) and before January 1, 1966.

(i) DEDUCTION FOR AMORTIZATION OF INDEBTEDNESS.—

26 USC 545.

(1) Section 545(a) (relating to definition of undistributed personal holding company income) is amended by striking out "subsection (b)" and inserting in lieu thereof "subsections (b) and (c)".

(2) Section 545 is amended by adding at the end thereof the following new subsection:

"(c) SPECIAL ADJUSTMENT TO TAXABLE INCOME.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, for purposes of subsection (a) there shall be allowed as a deduction amounts used, or amounts irrevocably set aside (to the extent reasonable with reference to the size and terms of the indebtedness), to pay or retire qualified indebtedness.

"(2) CORPORATIONS TO WHICH APPLICABLE.—This subsection shall apply only with respect to a corporation—

"(A) which for at least one of the two most recent taxable years ending before the date of the enactment of this subsection was not a personal holding company under section 542, but would have been a personal holding company under section 542 for such taxable year if the law applicable for the first taxable year beginning after December 31, 1963, had been applicable to such taxable year, or 26 USC 542.

"(B) to the extent that it succeeds to the deduction referred to in paragraph (1) by reason of section 381(c)(15). 26 USC 381.

"(3) QUALIFIED INDEBTEDNESS.—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, for purposes of this subsection the term 'qualified indebtedness' means—

"(i) the outstanding indebtedness incurred by the taxpayer after December 31, 1933, and before January 1, 1964, and

"(ii) the outstanding indebtedness incurred after December 31, 1963, for the purpose of making a payment or set-aside referred to in paragraph (1) in the same taxable year, but, in the case of such a payment or set-aside which is made on or after the first day of the first taxable year beginning after December 31, 1963, only to the extent the deduction otherwise allowed in paragraph (1) with respect to such payment or set-aside is treated as nondeductible by reason of the election provided in paragraph (4).

"(B) EXCEPTION.—For purposes of subparagraph (A), qualified indebtedness does not include any amounts which were, at any time after December 31, 1963, and before the payment or set-aside, owed to a person who at such time owned (or was considered as owning within the meaning of section 318(a)) more than 10 percent in value of the taxpayer's outstanding stock.

"(C) REDUCTION FOR AMOUNTS IRREVOCABLY SET ASIDE.—For purposes of subparagraph (A), the qualified indebtedness with respect to a contract shall be reduced by amounts irrevocably set aside before the taxable year to pay or retire such indebtedness; and no deduction shall be allowed under paragraph (1) for payments out of amounts so set aside.

"(4) ELECTION NOT TO DEDUCT.—A taxpayer may elect, under regulations prescribed by the Secretary or his delegate, to treat as nondeductible an amount otherwise deductible under paragraph (1); but only if the taxpayer files such election on or before the 15th day of the third month following the close of the taxable year with respect to which such election applies, designating therein the amounts which are to be treated as nondeductible and specifying the indebtedness (referred to in paragraph (3)(A)(ii)) incurred for the purpose of making the payment or set-aside.

"(5) LIMITATIONS.—The deduction otherwise allowed by this subsection for the taxable year shall be reduced by the sum of—

"(A) the amount, if any, by which—

"(i) the deductions allowed for the taxable year and all preceding taxable years beginning after December 31, 1963, for exhaustion, wear and tear, obsolescence, amortization, or depletion (other than such deductions which are disallowed in computing undistributed personal holding company income under subsection (b)(8)), exceed

"(ii) any reduction, by reason of this subparagraph, of the deductions otherwise allowed by this subsection for such preceding taxable years, and

"(B) the amount, if any, by which—

"(i) the deductions allowed under subsection (b)(5) in computing undistributed personal holding company income for the taxable year and all preceding taxable years beginning after December 31, 1963, exceed

"(ii) any reduction, by reason of this subparagraph, of the deductions otherwise allowed by this subsection for such preceding taxable years.

"(6) PRO-RATA REDUCTION IN CERTAIN CASES.—For purposes of paragraph (3)(A), if property (of a character which is subject to an allowance for exhaustion, wear and tear, obsolescence, amortization, or depletion) is disposed of after December 31, 1963, the total amounts of qualified indebtedness of the taxpayer shall be reduced pro-rata in the taxable year of such disposition by the amount, if any, by which—

"(A) the adjusted basis of such property at the time of such disposition, exceeds

"(B) the amount of qualified indebtedness which ceased to be qualified indebtedness with respect to the taxpayer by reason of the assumption of the indebtedness by the transferee."

26 USC 381. (3) Paragraph (15) of section 381(c) (relating to carryovers in certain corporate acquisitions) is amended to read as follows:

"(15) INDEBTEDNESS OF CERTAIN PERSONAL HOLDING COMPANIES.—The acquiring corporation shall be considered to be the distributor or transferor corporation for the purpose of determining the applicability of subsections (b)(7) and (c) of section 545, relating to deduction with respect to payment of certain indebtedness." 26 USC 545.

(j) INCREASE IN BASIS WITH RESPECT TO CERTAIN FOREIGN PERSONAL HOLDING COMPANY STOCK OR SECURITIES.—

(1) IN GENERAL.—Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by redesignating section 1022 as section 1023 and by inserting after section 1021 the following new section: 26 USC 1021-1023.

"SEC. 1022. INCREASE IN BASIS WITH RESPECT TO CERTAIN FOREIGN PERSONAL HOLDING COMPANY STOCK OR SECURITIES.

"(a) GENERAL RULE.—The basis (determined under section 1014(b)(5), relating to basis of stock or securities in a foreign personal holding company) of a share of stock or a security, acquired from a decedent dying after December 31, 1963, of a corporation which was a foreign personal holding company for its most recent taxable year ending before the date of the decedent's death shall be increased by its proportionate share of any Federal estate tax attributable to the net appreciation in value of all of such shares and securities determined as provided in this section. 26 USC 1014.

"(b) PROPORTIONATE SHARE.—For purposes of subsection (a), the proportionate share of a share of stock or of a security is that amount which bears the same ratio to the aggregate increase determined under subsection (c) (2) as the appreciation in value of such share or security bears to the aggregate appreciation in value of all such shares and securities having appreciation in value.

"(c) SPECIAL RULES AND DEFINITIONS.—For purposes of this section—

"(1) FEDERAL ESTATE TAX.—The term 'Federal estate tax' means only the tax imposed by section 2001 or 2101, reduced by any credit allowable with respect to a tax on prior transfers by section 2013 or 2102. 26 USC 2001, 2101. 26 USC 2013, 2102.

"(2) FEDERAL ESTATE TAX ATTRIBUTABLE TO NET APPRECIATION IN VALUE.—The Federal estate tax attributable to the net appreciation in value of all shares of stock and securities to which subsection (a) applies is that amount which bears the same ratio to the Federal estate tax as the net appreciation in value of all of such shares and securities bears to the value of the gross estate as determined under chapter 11 (including section 2032, relating to alternate valuation). 26 USC 2032.

"(3) NET APPRECIATION.—The net appreciation in value of all shares and securities to which subsection (a) applies is the amount by which the fair market value of all such shares and securities exceeds the adjusted basis of such property in the hands of the decedent.

"(4) FAIR MARKET VALUE.—For purposes of this section, the term 'fair market value' means fair market value determined under chapter 11 (including section 2032, relating to alternate valuation). 26 USC 2001-2209.

"(d) LIMITATIONS.—This section shall not apply to any foreign personal holding company referred to in section 342(a)(2)." 26 USC 342.

(2) AMENDMENT OF SECTION 1016(a).—Section 1016(a) (relating to adjustments to basis) is amended by striking out the period at the end thereof and by inserting in lieu thereof a semicolon and by adding at the end thereof the following new paragraph: Ante, p. 34.

"(21) to the extent provided in section 1022, relating to increase in basis for certain foreign personal holding company stock or securities." Ante, p. 92.

(3) CLERICAL AMENDMENT.—The table of sections for part II of subchapter O of chapter 1 is amended by striking out

"Sec. 1022. Cross references."

and inserting in lieu thereof the following:

"Sec. 1022. Increase in basis with respect to certain foreign personal holding company stock or securities.
"Sec. 1023. Cross references."

(k) TECHNICAL AMENDMENTS.—

(1) Section 542(b) (relating to corporations filing consolidated returns) is amended by striking out "gross income" each place it appears and inserting in lieu thereof "adjusted ordinary gross income". 26 USC 542.

(2) Section 543 (relating to personal holding company income) is amended by striking out subsection (d) (relating to special adjustment on disposition of antitrust stock received as a dividend). 26 USC 543.

(3) Section 544 (relating to rules for determining stock ownership) is amended— Post, p. 93.

(A) by striking out "section 543(a)(5)" each place it appears and inserting in lieu thereof "section 543(a)(7)", and

26 USC 543. (B) by striking out "section 543(a)(9)" each place it appears and inserting in lieu thereof "section 543(a)(4)".

(4) REAL ESTATE INVESTMENT TRUSTS.—Paragraph (6) of section 856(a) (relating to definition of real estate investment trust) is amended by striking out "gross income" and inserting in lieu thereof "adjusted ordinary gross income (as defined in section 543(b)(2))". 26 USC 856.

(5) UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS.—Section 1361(i) (relating to personal holding company income) is amended to read as follows: 26 USC 1361.

"(i) PERSONAL HOLDING COMPANY INCOME.—

"(1) EXCLUDED FROM INCOME OF ENTERPRISE.—There shall be excluded from the gross income of the enterprise as to which an election has been made under subsection (a) any item of gross income (computed without regard to the adjustments provided in section 543(b) (3) or (4)) if, but for this paragraph, such item (adjusted, where applicable, as provided in section 543(b) (3) or (4)) would constitute personal holding company income (as defined in section 543(a)) of such enterprise.

"(2) INCOME AND DEDUCTIONS OF OWNERS.—Items excluded from the gross income of the enterprise under paragraph (1), and the expenses attributable thereto, shall be treated as the income and deductions of the proprietor or partners (in accordance with their distributive shares of partnership income) of such enterprise.

"(3) DISTRIBUTIONS.—If—

"(A) the amount excluded from gross income under paragraph (2) exceeds the expenses attributable thereto, and

"(B) any portion of such excess is distributed to the proprietor or partner during the year earned,

such portion shall not be taxed as a corporate distribution. The portion of such excess not distributed during such year shall be considered as paid-in surplus or as a contribution to capital as of the close of such year."

(6) ASSESSMENT AND COLLECTION OF PERSONAL HOLDING COMPANY TAX.—Section 6501(f) (relating to personal holding company tax) is amended by striking out "gross income, described in section 543(a)," and inserting in lieu thereof "gross income and adjusted ordinary gross income, described in section 543,". 26 USC 6501.

(l) EFFECTIVE DATES.—

(1) The amendments made by this section (other than by subsections (c)(1), (f), (g), and (j)) shall apply to taxable years beginning after December 31, 1963.

(2) The amendment made by subsection (c)(1) shall apply to taxable years beginning after October 16, 1962.

(3) The amendments made by subsections (f) and (g) shall apply to distributions made in any taxable year of the distributing corporation beginning after December 31, 1963.

(4) The amendments made by subsection (j) shall apply in respect of decedents dying after December 31, 1963.

(5) Subsection (h) shall apply to taxable years beginning after December 31, 1963.

SEC. 226. TREATMENT OF PROPERTY IN CASE OF OIL AND GAS WELLS.

26 USC 614. (a) IN GENERAL.—Section 614(b) (relating to special rule as to operating mineral interests) is amended to read as follows:

"(b) SPECIAL RULES AS TO OPERATING MINERAL INTERESTS IN OIL AND GAS WELLS.—In the case of oil and gas wells—

"(1) IN GENERAL.—Except as otherwise provided in this subsection—

"(A) all of the taxpayer's operating mineral interests in a separate tract or parcel of land shall be combined and treated as one property, and

"(B) the taxpayer may not combine an operating mineral interest in one tract or parcel of land with an operating mineral interest in another tract or parcel of land.

"(2) ELECTION TO TREAT OPERATING MINERAL INTERESTS AS SEPARATE PROPERTIES.—If the taxpayer has more than one operating mineral interest in a single tract or parcel of land, he may elect to treat one or more of such operating mineral interests as separate properties. The taxpayer may not have more than one combination of operating mineral interests in a single tract or parcel of land. If the taxpayer makes the election provided in this paragraph with respect to any interest in a tract or parcel of land, each operating mineral interest which is discovered or acquired by the taxpayer in such tract or parcel of land after the taxable year for which the election is made shall be treated—

"(A) if there is no combination of interests in such tract or parcel, as a separate property unless the taxpayer elects to combine it with another interest, or

"(B) if there is a combination of interests in such tract or parcel, as part of such combination unless the taxpayer elects to treat it as a separate property.

"(3) CERTAIN UNITIZATION OR POOLING ARRANGEMENTS.—

"(A) IN GENERAL.—Under regulations prescribed by the Secretary or his delegate, if one or more of the taxpayer's operating mineral interests participate, under a voluntary or compulsory unitization or pooling agreement, in a single cooperative or unit plan of operation, then for the period of such participation—

"(i) they shall be treated for all purposes of this subtitle as one property, and

"(ii) the application of paragraphs (1), (2), and (4) in respect of such interests shall be suspended.

"(B) LIMITATION.—Subparagraph (A) shall apply to a voluntary agreement only if all the operating mineral interests covered by such agreement—

"(i) are in the same deposit, or are in 2 or more deposits the joint development or production of which is logical from the standpoint of geology, convenience, economy, or conservation, and

"(ii) are in tracts or parcels of land which are contiguous or in close proximity.

"(C) SPECIAL RULE IN THE CASE OF ARRANGEMENTS ENTERED INTO IN TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1964.—If—

"(i) two or more of the taxpayer's operating mineral interests participate under a voluntary or compulsory unitization or pooling agreement entered into in any taxable year beginning before January 1, 1964, in a single cooperative or unit plan of operation,

"(ii) the taxpayer, for the last taxable year beginning before January 1, 1964, treated such interests as two or more separate properties, and

"(iii) it is determined that such treatment was proper under the law applicable to such taxable year,

such taxpayer may continue to treat such interests in a consistent manner for the period of such participation.

"(4) MANNER, TIME, AND SCOPE OF ELECTION.—

"(A) MANNER AND TIME.—Any election provided in paragraph (2) shall be made for each operating mineral interest, in the manner prescribed by the Secretary or his delegate by regulations, not later than the time prescribed by law for filing the return (including extensions thereof) for whichever of the following taxable years is the later: The first taxable year beginning after December 31, 1963, or the first taxable year in which any expenditure for development or operation in respect of such operating mineral interest is made by the taxpayer after the acquisition of such interest.

"(B) SCOPE.—Any election under paragraph (2) shall be for all purposes of this subtitle and shall be binding on the taxpayer for all subsequent taxable years.

"(5) TREATMENT OF CERTAIN PROPERTIES.—If, on the day preceding the first day of the first taxable year beginning after December 31, 1963, the taxpayer has any operating mineral interests which he treats under subsection (d) of this section (as in effect before the amendments made by the Revenue Act of 1964), such treatment shall be continued and shall be deemed to have been adopted pursuant to paragraphs (1) and (2) of this subsection (as amended by such Act)."

(b) TECHNICAL AMENDMENTS.—

26 USC 614. (1) The heading of section 614(c) is amended to read as follows:

"(c) SPECIAL RULES AS TO OPERATING MINERAL INTERESTS IN MINES.—"

Repeal. (2) Paragraph (5) of section 614(c) is hereby repealed.

(3) Section 614(d) is amended to read as follows:

"(d) OPERATING MINERAL INTERESTS DEFINED.—For purposes of this section, the term 'operating mineral interest' includes only an interest in respect of which the costs of production of the mineral are required to be taken into account by the taxpayer for purposes of
26 USC 613. computing the 50 percent limitation provided for in section 613, or would be so required if the mine, well, or other natural deposit were in the production stage."

(4) Section 614(e)(2) is amended by striking out "within the meaning of subsection (b)(3)".

(c) ALLOCATION OF BASIS IN CERTAIN CASES.—For purposes of the Internal Revenue Code of 1954—

(1) FAIR MARKET VALUE RULE.—Except as provided in paragraph (2), if a taxpayer has a section 614(b) aggregation, then the adjusted basis (as of the first day of the first taxable year beginning after December 31, 1963) of each property included in such aggregation shall be determined by multiplying the adjusted basis of the aggregation by a fraction—

(A) the numerator of which is the fair market value of such property, and

(B) the denominator of which is the fair market value of such aggregation.

For purposes of this paragraph, the adjusted basis and the fair market value of the aggregation, and the fair market value of each property included therein, shall be determined as of the day preceding the first day of the first taxable year which begins after December 31, 1963.

(2) ALLOCATION OF ADJUSTMENTS, ETC.—If the taxpayer makes an election under this paragraph with respect to any section 614(b) aggregation, then the adjusted basis (as of the first day of the

first taxable year beginning after December 31, 1963) of each property included in such aggregation shall be the adjusted basis of such property at the time it was first included in the aggregation by the taxpayer, adjusted for that portion of those adjustments to the basis of the aggregation which are reasonably attributable to such property. If, under the preceding sentence, the total of the adjusted bases of the interests included in the aggregation exceeds the adjusted basis of the aggregation (as of the day preceding the first day of the first taxable year which begins after December 31, 1963), the adjusted bases of the properties which include such interests shall be adjusted, under regulations prescribed by the Secretary of the Treasury or his delegate, so that the total of the adjusted bases of such interests equals the adjusted basis of the aggregation. An election under this paragraph shall be made at such time and in such manner as the Secretary of the Treasury or his delegate shall by regulations prescribe.

(3) DEFINITIONS.—For purposes of this subsection—

(A) SECTION 614(b) AGGREGATION.—The term "section 614(b) aggregation" means any aggregation to which section 614(b)(1)(A) of the Internal Revenue Code of 1954 (as in effect before the amendments made by subsection (a) of this section) applied for the day preceding the first day of the first taxable year beginning after December 31, 1963. 26 USC 614.

(B) PROPERTY.—The term "property" has the same meaning as is applicable, under section 614 of the Internal Revenue Code of 1954, to the taxpayer for the first taxable year beginning after December 31, 1963.

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after December 31, 1963.

SEC. 227. TREATMENT OF CERTAIN IRON ORE ROYALTIES.

(a) IN GENERAL.—

(1) AMENDMENT OF SECTION 631(c).—Section 631(c) (relating to disposal of coal with a retained economic interest) is amended— 26 USC 631.

(A) by striking out the heading and inserting in lieu thereof the following:

"(c) DISPOSAL OF COAL OR DOMESTIC IRON ORE WITH A RETAINED ECONOMIC INTEREST.—";

(B) by inserting "or iron ore mined in the United States," after "coal (including lignite),";

(C) by inserting "or iron ore" after "coal" each other place it appears in section 631(c); and

(D) by adding at the end thereof the following new sentence:

"This subsection shall not apply to any disposal of iron ore—

"(1) to a person whose relationship to the person disposing of such iron ore would result in the disallowance of losses under section 267 or 707(b), or 26 USC 267, 707.

"(2) to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of such iron ore."

(2) AMENDMENT OF SECTION 1231(b).—Section 1231(b)(2) (defining property used in the trade or business) is amended to read as follows: 26 USC 1231.

"(2) TIMBER, COAL, OR DOMESTIC IRON ORE.—Such term includes timber, coal, and iron ore with respect to which section 631 applies."

68A Stat. 82. 26 USC 272. (3) AMENDMENT OF SECTION 272.—The text of section 272 (relating to disposal of coal) is amended by inserting "or iron ore" after "coal" each place it appears.

(b) CLERICAL AMENDMENTS.—

Ante, p. 97. (1) the heading of section 631 is amended to read as follows:

"SEC. 631. GAIN OR LOSS IN THE CASE OF TIMBER, COAL, OR DOMESTIC IRON ORE."

(2) The table of sections for part III of subchapter I of chapter 1 is amended by striking out

"Sec. 631. Gain or loss in the case of timber or coal."

and inserting in lieu thereof the following:

"Sec. 631. Gain or loss in the case of timber, coal, or domestic iron ore."

(3) The heading of section 272 is amended to read as follows:

"SEC. 272. DISPOSAL OF COAL OR DOMESTIC IRON ORE."

(4) The table of sections for part IX of subchapter B of chapter 1 is amended by striking out

"Sec. 272. Disposal of coal."

and inserting in lieu thereof the following:

"Sec. 272. Disposal of coal or domestic iron ore."

26 USC 1016. (5) Section 1016(a)(15) is amended by inserting "or domestic iron ore" after "coal".

26 USC 1402. (6) Section 1402(a)(3)(B) is amended to read as follows:

"(B) from the cutting of timber, or the disposal of timber, coal, or iron ore, if section 631 applies to such gain or loss, or"

68 Stat. 1055. 42 USC 411. (7) Section 211(a)(3) of the Social Security Act is amended by striking out clause (B) and inserting in lieu thereof "(B) from the cutting of timber, or the disposal of timber, coal, or iron ore, if section 631 of the Internal Revenue Code of 1954 applies to such gain or loss,".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to amounts received or accrued in taxable years beginning after December 31, 1963, attributable to iron ore mined in such taxable years.

SEC. 228. INSURANCE COMPANIES.

(a) CERTAIN MUTUALIZATION DISTRIBUTIONS MADE IN 1962.—

26 USC 809. (1) DEDUCTION FOR CERTAIN MUTUALIZATION DISTRIBUTIONS.—Section 809(d)(11) (relating to deductions in computing gain from operations in the case of certain mutualization distributions) is amended by striking out "and 1961" and inserting in lieu thereof "1961, and 1962".

(2) APPLICATION OF SECTION 815.—Section 809(g)(3) (relating to application of section 815 to certain mutualization distributions) is amended by striking out "or 1961" and inserting in lieu thereof "1961, or 1962".

(b) ACCRUAL OF BOND DISCOUNT.—

26 USC 818. (1) LIFE INSURANCE COMPANIES.—Section 818(b) (relating to amortization of premium and accrual of discount) is amended by adding at the end thereof the following new paragraph:

26 USC 171. "(3) EXCEPTION.—For taxable years beginning after December 31, 1962, no accrual of discount shall be required under paragraph (1) on any bond (as defined in section 171(d)), except in the case of discount which is—

"(A) interest to which section 103 applies, or

26 USC 1232. "(B) original issue discount (as defined in section 1232(b))."

For purposes of section 805(b)(3)(A), the current earnings rate for any taxable year beginning before January 1, 1963, shall be determined as if the preceding sentence applied to such taxable year."

(2) MUTUAL INSURANCE COMPANIES.—Section 822(d)(2) (relating to amortization of premium and accrual of discount) is amended by adding at the end thereof the following new sentence: "For taxable years beginning after December 31, 1962, no accrual of discount shall be required under this paragraph on any bond (as defined in section 171(d))." 26 USC 822.

(c) CONTRIBUTIONS TO QUALIFIED, ETC., PLANS.—Section 832(c)(10) (relating to deductions allowed in computing taxable income of certain insurance companies) is amended by inserting before the semicolon at the end thereof "and in part I of subchapter D (sec. 401 and following, relating to pension, profit-sharing, stock bonus plans, etc.)". 26 USC 832.

(d) EFFECTIVE DATES.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1961. The amendment made by subsection (c) shall apply to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

SEC. 229. REGULATED INVESTMENT COMPANIES.

(a) TIME FOR MAILING CERTAIN NOTICES TO SHAREHOLDERS.—The following provisions (relating to notices to shareholders by regulated investment companies) are amended by striking out "30 days", wherever appearing therein, and inserting in lieu thereof "45 days":

(1) Section 852(b)(3)(C), 26 USC 852-855.
(2) Section 852(b)(8)(D)(i),
(3) Section 853(c), Ante, p. 32.
(4) Section 854(b)(2), and
(5) Section 855(c).

(b) CERTAIN REDEMPTIONS BY UNIT INVESTMENT TRUSTS.—Section 852 (relating to taxation of regulated investment companies and their shareholders) is amended by adding at the end thereof the following new subsection:

"(d) DISTRIBUTIONS IN REDEMPTION OF INTERESTS IN UNIT INVESTMENT TRUSTS.—In the case of a unit investment trust—

"(1) which is registered under the Investment Company Act of 1940 and issues periodic payment plan certificates (as defined in such Act), and 54 Stat. 789. 15 USC 80a-

"(2) substantially all of the assets of which consist of securities issued by a management company (as defined in such Act),

section 562(c) (relating to preferential dividends) shall not apply to a distribution by such trust to a holder of an interest in such trust in redemption of part or all of such interest, with respect to the net capital gain of such trust attributable to such redemption."

(c) EFFECTIVE DATES.—The amendments made by subsection (a) shall apply to taxable years of regulated investment companies ending on or after the date of the enactment of this Act. The amendment made by subsection (b) shall apply to taxable years of regulated investment companies ending after December 31, 1963.

SEC. 230. CAPITAL LOSS CARRYOVERS FOR TAXPAYERS OTHER THAN CORPORATIONS.

(a) IN GENERAL.—Section 1212 (relating to capital loss carryover) is amended— 26 USC 1212.

(1) by striking out "If for any taxable year the taxpayer" and inserting in lieu thereof:

"(a) CORPORATIONS.—If for any taxable year a corporation"; and

(2) by adding at the end thereof the following new subsection:

"(b) OTHER TAXPAYERS.—

"(1) IN GENERAL.—If a taxpayer other than a corporation has a net capital loss for any taxable year beginning after December 31, 1963—

"(A) the excess of the net short-term capital loss over the net long-term capital gain for such year shall be a short-term capital loss in the succeeding taxable year, and

"(B) the excess of the net long-term capital loss over the net short-term capital gain for such year shall be a long-term capital loss in the succeeding taxable year.

For purposes of this paragraph, in determining such excesses an amount equal to the excess of the sum allowed for the taxable year under section 1211(b) over the gains from sales or exchanges of capital assets (determined without regard to this sentence) shall be treated as a short-term capital gain in such year.

"(2) TRANSITIONAL RULE.—In the case of a taxpayer other than a corporation, there shall be treated as a short-term capital loss in the first taxable year beginning after December 31, 1963, any amount which is treated as a short-term capital loss in such year under this subchapter as in effect immediately before the enactment of the Revenue Act of 1964."

(b) TECHNICAL AMENDMENTS.—

26 USC 1222. (1) Section 1222(9) (relating to net capital gain) is amended to read as follows:

"(9) NET CAPITAL GAIN.—In the case of a corporation, the term 'net capital gain' means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges."

(2) The second sentence of section 1222(10) (relating to net capital loss) is amended by striking out "For the purpose" and inserting in lieu thereof "In the case of a corporation, for the purpose".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1963.

SEC. 231. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.

(a) GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.—

26 USC 1231-1249. Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is amended by adding at the end thereof the following new section:

"SEC. 1250. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.

"(a) GENERAL RULE.—

"(1) ORDINARY INCOME.—Except as otherwise provided in this section, if section 1250 property is disposed of after December 31, 1963, the applicable percentage of the lower of—

"(A) the additional depreciation (as defined in subsection (b)(1)) in respect of the property, or

"(B) the excess of—

"(i) the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of such property (in the case of any other disposition), over

"(ii) the adjusted basis of such property,

shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle.

"(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term 'applicable percentage' means 100 percent minus one percentage point for each full month the property was held after the date on which the property was held 20 full months.

"(b) ADDITIONAL DEPRECIATION DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The term 'additional depreciation' means, in the case of any property, the depreciation adjustments in respect of such property; except that, in the case of property held more than one year, it means such adjustments only to the extent that they exceed the amount of the depreciation adjustments which would have resulted if such adjustments had been determined for each taxable year under the straight line method of adjustment. For purposes of the preceding sentence, if a useful life (or salvage value) was used in determining the amount allowed as a deduction for any taxable year, such life (or value) shall be used in determining the depreciation adjustments which would have resulted for such year under the straight line method.

"(2) PROPERTY HELD BY LESSEE.—In the case of a lessee, in determining the depreciation adjustments which would have resulted in respect of any building erected (or other improvement made) on the leased property, or in respect of any cost of acquiring the lease, the lease period shall be treated as including all renewal periods. For purposes of the preceding sentence—

"(A) the term 'renewal period' means any period for which the lease may be renewed, extended, or continued pursuant to an option exercisable by the lessee, but

"(B) the inclusion of renewal periods shall not extend the period taken into account by more than ⅔ of the period on the basis of which the depreciation adjustments were allowed.

"(3) DEPRECIATION ADJUSTMENTS.—The term 'depreciation adjustments' means, in respect of any property, all adjustments attributable to periods after December 31, 1963, reflected in the adjusted basis of such property on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for exhaustion, wear and tear, obsolescence, or amortization (other than amortization under section 168). For purposes of the preceding sentence, if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed as a deduction for any period was less than the amount allowable, the amount taken into account for such period shall be the amount allowed. 26 USC 168.

"(c) SECTION 1250 PROPERTY.—For purposes of this section, the term 'section 1250 property' means any real property (other than section 1245 property, as defined in section 1245(a)(3)) which is or has been property of a character subject to the allowance for depreciation provided in section 167. 26 USC 167.

"(d) EXCEPTIONS AND LIMITATIONS.—

"(1) GIFTS.—Subsection (a) shall not apply to a disposition by gift.

"(2) TRANSFERS AT DEATH.—Except as provided in section 691 (relating to income in respect of a decedent), subsection (a) shall not apply to a transfer at death.

"(3) CERTAIN TAX-FREE TRANSACTIONS.—If the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371(a), 374(a), 721, or 731, then the amount of gain taken into account by the transferor under subsection (a)(1) shall not exceed the amount of gain recognized to the transferor on the transfer of such property (determined without regard to this section). This paragraph shall not apply to a disposition

26 USC 332, 361, 371, 37[illegible] 721, 731.

to an organization (other than a cooperative described in section
26 USC 521. 521) which is exempt from the tax imposed by this chapter.

"(4) LIKE KIND EXCHANGES; INVOLUNTARY CONVERSIONS, ETC.—

"(A) RECOGNITION LIMIT.—If property is disposed of and gain (determined without regard to this section) is not recognized in whole or in part under section 1031 or 1033, then the amount of gain taken into account by the transferor under subsection (a)(1) shall not exceed the greater of the following:

26 USC 1031, 1033.

"(i) the amount of gain recognized on the disposition (determined without regard to this section), increased as provided in subparagraph (B), or

"(ii) the amount determined under subparagraph (C).

"(B) INCREASE FOR CERTAIN STOCK.—With respect to any transaction, the increase provided by this subparagraph is the amount equal to the fair market value of any stock purchased in a corporation which (but for this paragraph) would result in nonrecognition of gain under section 1033 (a)(3)(A).

"(C) ADJUSTMENT WHERE INSUFFICIENT SECTION 1250 PROPERTY IS ACQUIRED.—With respect to any transaction, the amount determined under this subparagraph shall be the excess of—

"(i) the amount of gain which would (but for this paragraph) be taken into account under subsection (a)(1), over

"(ii) the fair market value (or cost in the case of a transaction described in section 1033(a)(3)) of the section 1250 property acquired in the transaction.

"(D) BASIS OF PROPERTY ACQUIRED.—In the case of property purchased by the taxpayer in a transaction described in section 1033(a)(3), in applying the last sentence of section 1033(c), such sentence shall be applied—

"(i) first solely to section 1250 properties and to the amount of gain not taken into account under subsection (a)(1) by reason of this paragraph, and

"(ii) then to all purchased properties to which such sentence applies and to the remaining gain not recognized on the transaction as if the cost of the section 1250 properties were the basis of such properties computed under clause (i).

In the case of property acquired in any other transaction to which this paragraph applies, rules consistent with the preceding sentence shall be applied under regulations prescribed by the Secretary or his delegate.

"(E) ADDITIONAL DEPRECIATION WITH RESPECT TO PROPERTY DISPOSED OF.—In the case of any transaction described in section 1031 or 1033, the additional depreciation in respect of the section 1250 property acquired which is attributable to the section 1250 property disposed of shall be an amount equal to the amount of the gain which was not taken into account under subsection (a)(1) by reason of the application of this paragraph.

Ante, p. 101.

"(5) SECTION 1071 AND 1081 TRANSACTIONS.—Under regulations prescribed by the Secretary or his delegate, rules consistent with paragraphs (3) and (4) of this subsection and with subsections (e) and (f) shall apply in the case of transactions described in section 1071 (relating to gain from sale or exchange to effectuate

26 USC 1071, 1081.

policies of FCC) or section 1081 (relating to exchanges in obedience to SEC orders). 26 USC 1081.

"(6) PROPERTY DISTRIBUTED BY A PARTNERSHIP TO A PARTNER.—

"(A) IN GENERAL.—For purposes of this section, the basis of section 1250 property distributed by a partnership to a partner shall be deemed to be determined by reference to the adjusted basis of such property to the partnership.

"(B) ADDITIONAL DEPRECIATION.—In respect of any property described in subparagraph (A), the additional depreciation attributable to periods before the distribution by the partnership shall be—

"(i) the amount of the gain to which subsection (a) would have applied if such property had been sold by the partnership immediately before the distribution at its fair market value at such time and the applicable percentage for the property had been 100 percent, reduced by

"(ii) if section 751(b) applied to any part of such gain, the amount of such gain to which section 751(b) would have applied if the applicable percentage for the property had been 100 percent. 26 USC 751.

"(7) DISPOSITION OF PRINCIPAL RESIDENCE.—Subsection (a) shall not apply to a disposition of—

"(A) property to the extent used by the taxpayer as his principal residence (within the meaning of section 1034, relating to sale or exchange of residence), and 26 USC 1034.

"(B) property in respect of which the taxpayer meets the age and ownership requirements of section 121 (relating to gains from sale or exchange of residence of individual who has attained the age of 65) but only to the extent that he meets the use requirements of such section in respect of such property. Ante, p. 38.

"(e) HOLDING PERIOD.—For purposes of determining the applicable percentage under this section, the provisions of section 1223 shall not apply, and the holding period of section 1250 property shall be determined under the following rules: 26 USC 1223.

"(1) BEGINNING OF HOLDING PERIOD.—The holding period of section 1250 property shall be deemed to begin—

"(A) in the case of property acquired by the taxpayer, on the day after the date of acquisition, or

"(B) in the case of property constructed, reconstructed, or erected by the taxpayer, on the first day of the month during which the property is placed in service.

"(2) PROPERTY WITH TRANSFERRED BASIS.—If the basis of property acquired in a transaction described in paragraph (1), (2), (3), or (5) of subsection (d) is determined by reference to its basis in the hands of the transferor, then the holding period of the property in the hands of the transferee shall include the holding period of the property in the hands of the transferor.

"(3) PRINCIPAL RESIDENCE.—If the basis of property acquired in a transaction described in paragraph (7) of subsection (d) is determined by reference to the basis in the hands of the taxpayer of other property, then the holding period of the property acquired shall include the holding period of such other property.

"(f) SPECIAL RULES FOR PROPERTY WHICH IS SUBSTANTIALLY IMPROVED.—

"(1) AMOUNT TREATED AS ORDINARY INCOME.—If, in the case of a disposition of section 1250 property, the property is treated as consisting of more than one element by reason of paragraph

(3), then the amount taken into account under subsection (a)(1) in respect of such section 1250 property as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 shall be the sum of the amounts determined under paragraph (2).

26 USC 1231.

"(2) ORDINARY INCOME ATTRIBUTABLE TO AN ELEMENT.—For purposes of paragraph (1), the amount taken into account for any element shall be the amount determined by multiplying—

"(A) the amount which bears the same ratio to the lower of the amounts specified in subparagraph (A) or (B) of subsection (a)(1) for the section 1250 property as the additional depreciation for such element bears to the sum of the additional depreciation for all elements, by

"(B) the applicable percentage for such element.

For purposes of this paragraph, determinations with respect to any element shall be made as if it were a separate property.

"(3) PROPERTY CONSISTING OF MORE THAN ONE ELEMENT.—In applying this subsection in the case of any section 1250 property, there shall be treated as a separate element—

Ante, p. 101.

"(A) each separate improvement,

"(B) if, before completion of section 1250 property, units thereof (as distinguished from improvements) were placed in service, each such unit of section 1250 property, and

"(C) the remaining property which is not taken into account under subparagraphs (A) and (B).

"(4) PROPERTY WHICH IS SUBSTANTIALLY IMPROVED.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'separate improvement' means each improvement added during the 36-month period ending on the last day of any taxable year to the capital account for the property, but only if the sum of the amounts added to such account during such period exceeds the greatest of—

"(i) 25 percent of the adjusted basis of the property,

"(ii) 10 percent of the adjusted basis of the property, determined without regard to the adjustments provided in paragraphs (2) and (3) of section 1016(a), or

26 USC 1016.

"(iii) $5,000.

For purposes of clauses (i) and (ii), the adjusted basis of the property shall be determined as of the beginning of the first day of such 36-month period, or of the holding period of the property (within the meaning of subsection (e)), whichever is the later.

"(B) EXCEPTION.—Improvements in any taxable year shall be taken into account for purposes of subparagraph (A) only if the sum of the amounts added to the capital account for the property for such taxable year exceeds the greater of—

"(i) $2,000, or

"(ii) one percent of the adjusted basis referred to in subparagraph (A)(ii), determined, however, as of the beginning of such taxable year.

For purposes of this section, if the amount added to the capital account for any separate improvement does not exceed the greater of clause (i) or (ii), such improvement shall be treated as placed in service on the first day, of a calendar month, which is closest to the middle of the taxable year.

"(C) IMPROVEMENT.—The term 'improvement' means, in the case of any section 1250 property, any addition to capital account for such property after the initial acquisition or after completion of the property.

"(g) ADJUSTMENTS TO BASIS.—The Secretary or his delegate shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under subsection (a).

"(h) APPLICATION OF SECTION.—This section shall apply notwithstanding any other provision of this subtitle."

(b) TECHNICAL AMENDMENTS.—

(1) SPECIAL RULE FOR CHARITABLE CONTRIBUTIONS.—

(A) The heading of section 170(e) (relating to special rule for charitable contributions of section 1245 property) is amended by striking out "SECTION 1245 PROPERTY" and inserting in lieu thereof "CERTAIN PROPERTY". 26 USC 170.

(B) The text of such section 170(e) is amended by striking out "section 1245(a)" and inserting in lieu thereof "section 1245(a) or 1250(a)".

(2) CORPORATE DISTRIBUTIONS OF PROPERTY.—Subsections (b) and (d) of section 301 (relating to amount distributed) are each amended by striking out "under section 1245(a)" and inserting in lieu thereof "under section 1245(a) or 1250(a)". 26 USC 301.

(3) EFFECT ON EARNINGS AND PROFITS.—Paragraph (3) of section 312(c) (relating to adjustments of earnings and profits) is amended by striking out "or under section 1245(a)" and inserting in lieu thereof "or under section 1245(a) or 1250(a)". 26 USC 312.

(4) COLLAPSIBLE CORPORATIONS.—Paragraph (12) of section 341(e) (relating to collapsible corporations) is amended by striking out "section 1245(a)" and inserting in lieu thereof "sections 1245(a) and 1250(a)". 26 USC 341.

(5) INSTALLMENT OBLIGATIONS IN CERTAIN LIQUIDATIONS.—Subparagraphs (A) and (B) of section 453(d)(4) (relating to distribution of installment obligations in certain corporate liquidations) are each amended by striking out "section 1245(a)" and inserting in lieu thereof "section 1245(a) or 1250(a)". 26 USC 453.

(6) SPECIAL RULE FOR PARTNERSHIPS.—Section 751(c) (relating to definition of "unrealized receivables" for purposes of subchapter K) is amended by striking out "(as defined in section 1245(a)(3))" and inserting in lieu thereof "(as defined in section 1245 (a)(3)) and section 1250 property (as defined in section 1250(c))" and by striking out "to which section 1245(a)" and inserting in lieu thereof "to which section 1245(a) or 1250(a)". 26 USC 751.

(7) The table of sections for part IV of subchapter P of chapter 1 is amended by adding at the end thereof the following:

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after December 31, 1963, in taxable years ending after such date.

SEC. 232. AVERAGING.

(a) GENERAL RULE.—Part I of subchapter Q of chapter 1 is amended to read as follows:

"PART I—INCOME AVERAGING

"SEC. 1301. LIMITATION ON TAX.

"If an eligible individual has averagable income for the computation year, and if the amount of such income exceeds $3,000, then the tax imposed by section 1 for the computation year which is attributable to averagable income shall be 5 times the increase in tax under such section which would result from adding 20 percent of such income to the sum of—

"(1) 133⅓ percent of average base period income, and

"(2) the amount (if any) of the average base period capital gain net income.

"SEC. 1302. DEFINITION OF AVERAGABLE INCOME; RELATED DEFINITIONS.

"(a) AVERAGABLE INCOME.—For purposes of this part—

"(1) IN GENERAL.—The term 'averagable income' means the amount (if any) by which adjusted taxable income exceeds 133⅓ percent of average base period income.

"(2) ADJUSTMENT IN CERTAIN CASES FOR CAPITAL GAINS.—If—

"(A) the average base period capital gain net income, exceeds

"(B) the capital gain net income for the computation year,

then the term 'averagable income' means the amount determined under paragraph (1), reduced by an amount equal to such excess.

"(b) ADJUSTED TAXABLE INCOME.—For purposes of this part, the term 'adjusted taxable income' means the taxable income for the computation year, decreased by the sum of the following amounts:

"(1) CAPITAL GAIN NET INCOME FOR THE COMPUTATION YEAR.—The amount (if any) of the capital gain net income for the computation year.

"(2) INCOME ATTRIBUTABLE TO GIFTS, BEQUESTS, ETC.—

"(A) IN GENERAL.—The amount of net income attributable to an interest in property where such interest was received by the taxpayer as a gift, bequest, devise, or inheritance during the computation year or any base period year. This paragraph shall not apply to gifts, bequests, devises, or inheritances between husband and wife if they make a joint return, or if one of them makes a return as a surviving spouse (as defined in section 2(b)), for the computation year. 26 USC 2.

"(B) AMOUNT OF NET INCOME.—Unless the taxpayer otherwise establishes to the satisfaction of the Secretary or his delegate, the amount of net income for any taxable year attributable to an interest described in subparagraph (A) shall be deemed to be 6 percent of the fair market value of such interest (as determined in accordance with the provisions of chapter 11 or chapter 12, as the case may be). 26 USC 2001, 2501.

"(C) LIMITATION.—This paragraph shall apply only if the sum of the net incomes attributable to interests described in subparagraph (A) exceeds $3,000.

"(D) NET INCOME.—For purposes of this paragraph, the term 'net income' means, with respect to any interest, the excess of—

"(i) items of gross income attributable to such interest, over

"(ii) the deductions properly allocable to or chargeable against such items.

For purposes of computing such net income, capital gains and losses shall not be taken into account.

"(3) WAGERING INCOME.—The amount (if any) by which the gains from wagering transactions for the computation year exceed the losses from such transactions.

"(4) CERTAIN AMOUNTS RECEIVED BY OWNER-EMPLOYEES.—The amount (if any) to which section 72(m)(5) (relating to penalties applicable to certain amounts received by owner-employees) applies. 26 USC 72.

"(c) AVERAGE BASE PERIOD INCOME.—For purposes of this part—

"(1) IN GENERAL.—The term 'average base period income' means one-fourth of the sum of the base period incomes for the base period.

"(2) BASE PERIOD INCOME.—The base period income for any taxable year is the taxable income for such year first increased and then decreased (but not below zero) in the following order:

"(A) Taxable income shall be increased by an amount equal to the excess of—

"(i) the amount excluded from gross income under section 911 (relating to earned income from sources without the United States) and subpart D of part III of subchapter N (sec. 931 and following, relating to income from sources within possessions of the United States), over 26 USC 911. 26 USC 931.

"(ii) the deductions which would have been properly allocable to or chargeable against such amount but for the exclusion of such amount from gross income.

"(B) Taxable income shall be decreased by the capital gain net income.

"(C) If the decrease provided by paragraph (2) of subsection (b) applies to the computation year, the taxable income shall be decreased under the rules of such paragraph (2) (other than the limitation contained in subparagraph (C) thereof).

"(d) CAPITAL GAIN NET INCOME, ETC.—For purposes of this part—

"(1) CAPITAL GAIN NET INCOME.—The term 'capital gain net income' means the amount equal to 50 percent of the excess of the net long-term capital gain over the net short-term capital loss.

"(2) AVERAGE BASE PERIOD CAPITAL GAIN NET INCOME.—The term 'average base period capital gain net income' means one-fourth of the sum of the capital gain net incomes for the base period. For purposes of the preceding sentence, the capital gain net income for any base period year shall not exceed the base period income for such year computed without regard to subsection (c)(2)(B).

"(e) OTHER RELATED DEFINITIONS.—For purposes of this part—

"(1) COMPUTATION YEAR.—The term 'computation year' means the taxable year for which the taxpayer chooses the benefits of this part.

"(2) BASE PERIOD.—The term 'base period' means the 4 taxable years immediately preceding the computation year.

"(3) BASE PERIOD YEAR.—The term 'base period year' means any of the 4 taxable years immediately preceding the computation year.

"(4) JOINT RETURN.—The term 'joint return' means the return of a husband and wife made under section 6013. 26 USC 6013.

"SEC. 1303. ELIGIBLE INDIVIDUALS.

"(a) GENERAL RULE.—Except as otherwise provided in this section, for purposes of this part the term 'eligible individual' means any individual who is a citizen or resident of the United States throughout the computation year.

"(b) NONRESIDENT ALIEN INDIVIDUALS.—For purposes of this part, an individual shall not be an eligible individual for the computation year if, at any time during such year or the base period, such individual was a nonresident alien.

"(c) INDIVIDUALS RECEIVING SUPPORT FROM OTHERS.—

"(1) IN GENERAL.—For purposes of this part, an individual shall not be an eligible individual for the computation year if, for any base period year, such individual (and his spouse) furnished less than one-half of his support.

"(2) EXCEPTIONS.—Paragraph (1) shall not apply to any computation year if—

"(A) such year ends after the individual attained age 25 and, during at least 4 of his taxable years beginning after he attained age 21 and ending with his computation year, he was not a full-time student,

"(B) more than one-half of the individual's adjusted taxable income for the computation year is attributable to work performed by him in substantial part during 2 or more of the base period years, or

"(C) the individual makes a joint return for the computation year and not more than 25 percent of the aggregate adjusted gross income of such individual and his spouse for the computation year is attributable to such individual.

In applying subparagraph (C), amounts which constitute earned income (within the meaning of section 911(b)) and are community income under community property laws applicable to such income shall be taken into account as if such amounts did not constitute community income.

26 USC 911.

"(d) STUDENT DEFINED.—For purposes of this section, the term 'student' means, with respect to a taxable year, an individual who during each of 5 calendar months during such taxable year—

"(1) was a full-time student at an educational institution (as defined in section 151(e)(4)); or

26 USC 151.

"(2) was pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational institution (as defined in section 151(e)(4)) or of a State or political subdivision of a State.

"SEC. 1304. SPECIAL RULES.

"(a) TAXPAYER MUST CHOOSE BENEFITS.—This part shall apply to the taxable year only if the taxpayer chooses to have the benefits of this part for such taxable year. Such choice may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for the taxable year.

"(b) CERTAIN PROVISIONS INAPPLICABLE.—If the taxpayer chooses the benefits of this part for the taxable year, the following provisions shall not apply to him for such year:

Post, p. 129.

"(1) section 3 (relating to optional tax if adjusted gross income is less than $5,000),

26 USC 72.

"(2) section 72(n)(2) (relating to limitation of tax in case of certain distributions with respect to contributions by self-employed individuals),

"(3) section 911 (relating to earned income from sources without the United States), and

26 USC 931.

"(4) subpart D of part III of subchapter N (sec. 931 and following, relating to income from sources within possessions of the United States).

"(c) FAILURE OF CERTAIN MARRIED INDIVIDUALS TO MAKE JOINT RETURN, ETC.—

"(1) APPLICATION OF SUBSECTION.—Paragraphs (2), (3), and (4) of this subsection shall apply in the case of any individual who was married for any base period year or the computation year; except that—

"(A) such paragraphs shall not apply in respect of a base period year if—

"(i) such individual and his spouse make a joint return, or such individual makes a return as a surviving spouse (as defined in section 2(b)), for the computation year, and 26 USC 2.

"(ii) such individual was not married to any other spouse for such base period year, and

"(B) paragraph (4) shall not apply in respect of the computation year if the individual and his spouse make a joint return for such year.

"(2) MINIMUM BASE PERIOD INCOME.—For purposes of this part, the base period income of an individual for any base period year shall not be less than 50 percent of the base period income which would result from combining his income and deductions for such year—

"(A) with the income and deductions for such year of the individual who is his spouse for the computation year, or

"(B) if greater, with the income and deductions for such year of the individual who was his spouse for such base period year.

"(3) MINIMUM BASE PERIOD CAPITAL GAIN NET INCOME.—For purposes of this part, the capital gain net income of any individual for any base period year shall not be less than 50 percent of the capital gain net income which would result from combining his capital gain net income for such year (determined without regard to this paragraph) with the capital gain net income for such year (similarly determined) of the individual with whom he is required by paragraph (2) to combine his income and deductions for such year.

"(4) COMMUNITY INCOME ATTRIBUTABLE TO SERVICES.—In the case of amounts which constitute earned income (within the meaning of section 911(b)) and are community income under community property laws applicable to such income— 26 USC 911.

"(A) the amount taken into account for any base period year for purposes of determining base period income shall not be less than the amount which would be taken into account if such amounts did not constitute community income, and

"(B) the amount taken into account for purposes of determining adjusted taxable income for the computation year shall not exceed the amount which would be taken into account if such amounts did not constitute community income.

"(5) MARITAL STATUS.—For purposes of this subsection, section 143 shall apply in determining whether an individual is married for any taxable year.

"(d) DOLLAR LIMITATIONS IN CASE OF JOINT RETURNS.—In the case of a joint return, the $3,000 figure contained in section 1301 shall be applied to the aggregate averagable income, and the $3,000 figure contained in section 1302(b)(2)(C) shall be applied to the aggregate net incomes. Ante, p. 106.

"(e) SPECIAL RULES WHERE THERE ARE CAPITAL GAINS.—

"(1) TREATMENT OF CAPITAL GAINS IN COMPUTATION YEAR.—In the case of any taxpayer who has capital gain net income for the computation year, the tax imposed by section 1 for the computation year which is attributable to the amount of such net income shall be computed—

"(A) by adding so much of the amount thereof as does not exceed average base period capital gain net income above 133⅓ percent of average base period income, and

"(B) by adding the remainder (if any) of such net income above the 20 percent of the averagable income as taken into account for purposes of computing the tax imposed by section 1 (and above the amounts (if any) referred to in subsection (f)(1)).

"(2) COMPUTATION OF ALTERNATIVE TAX.—In the case of any taxpayer who has capital gain net income for the computation year, section 1201(b) shall be treated as imposing a tax equal to the tax imposed by section 1, reduced by the amount (if any) by which—

26 USC 1201.

"(A) the tax imposed by section 1 and attributable to the capital gain net income for the computation year (determined under paragraph (1)), exceeds

"(B) an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss.

"(f) TREATMENT OF CERTAIN OTHER ITEMS.—

"(1) GIFT OR WAGERING INCOME.—The tax imposed by section 1 for the computation year which is attributable to the amounts subtracted from taxable income under paragraphs (2) and (3) of section 1302(b) shall equal the increase in tax under section 1 which results from adding such amounts above the 20 percent of the averagable income as taken into account for purposes of computing the tax imposed thereon by section 1.

Ante, p. 106.

"(2) SECTION 72(m)(5).—Section 72(m)(5) (relating to penalties applicable to certain amounts received by owner-employees) shall be applied as if this part had not been enacted.

26 USC 72.

"(3) OTHER ITEMS.—Except as otherwise provided in this part, the order and manner in which items of income shall be taken into account in computing the tax imposed by this chapter on the income of any eligible individual to whom section 1301 applies for any computation year shall be determined under regulations prescribed by the Secretary or his delegate.

"(g) SHORT TAXABLE YEARS.—In the case of any computation year or base period year which is a short taxable year, this part shall be applied in the manner provided in regulations prescribed by the Secretary or his delegate.

"SEC. 1305. REGULATIONS.

"The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this part."

Repeal.
26 USC 72.

(b) REPEAL OF SECTION 72(e)(3).—Section 72(e)(3) (relating to limit on tax attributable to receipt of lump sum) is hereby repealed.

Ante, p. 24.

(c) AMENDMENT OF SECTION 144.—Section 144 (relating to election of standard deduction) is amended by adding after subsection (c) (as added by 112(c)(2) of this Act) the following new subsection:

"(d) INDIVIDUALS ELECTING INCOME AVERAGING.—In the case of a taxpayer who chooses to have the benefits of part I of subchapter Q (relating to income averaging) for the taxable year—

"(1) subsection (a) shall not apply for such taxable year, and

"(2) the standard deduction shall be allowed if the taxpayer so elects in his return for such taxable year.

The Secretary or his delegate shall by regulations prescribe the manner of signifying such election in the return. If the taxpayer on making his return fails to signify, in the manner so prescribed, his election to take the standard deduction, such failure shall be considered his election not to take the standard deduction."

(d) STATUTE OF LIMITATIONS.—Section 6511(d)(2)(B) (relating to special period of limitation with respect to net operating loss carrybacks) is amended to read as follows: 26 USC 6511.

"(B) APPLICABLE RULES.—

"(i) If the allowance of a credit or refund of an overpayment of tax attributable to a net operating loss carryback is otherwise prevented by the operation of any law or rule of law other than section 7122, relating to compromises, such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph. If the allowance of an application, credit, or refund of a decrease in tax determined under section 6411(b) is otherwise prevented by the operation of any law or rule of law other than section 7122, such application, credit, or refund may be allowed or made if application for a tentative carryback adjustment is made within the period provided in section 6411(a). In the case of any such claim for credit or refund or any such application for a tentative carryback adjustment, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to the net operating loss deduction, and the effect of such deduction, to the extent that such deduction is affected by a carryback which was not in issue in such proceeding. 26 USC 7122. 26 USC 6411.

"(ii) A claim for credit or refund for a computation year (as defined in section 1302(c)(1)) shall be determined to relate to an overpayment attributable to a net operating loss carryback when such carryback relates to any base period year (as defined in section 1302(c)(3))." Ante, p. 107

(e) TECHNICAL AMENDMENTS.—The following provisions are amended by striking out "except that section 72(e)(3) shall not apply":

(1) The first sentence of section 402(a)(1) (relating to general rule for taxability of beneficiary of exempt trust). 26 USC 402.

(2) The second sentence of section 402(b) (relating to taxability of beneficiary of non-exempt trust).

(3) The second sentence of section 402(d) (relating to certain employees' annuities).

(4) Section 403(a)(1) (relating to the general rule for taxability of a beneficiary under a qualified annuity plan). 26 USC 403.

(5) The second sentence of section 403(b)(1) (relating to general rule for taxability of beneficiary, etc.).

(6) The second sentence of section 403(c) (relating to taxability of beneficiary under a nonqualified annuity).

(f) CLERICAL AMENDMENTS.—

(1) Subsection (f) of section 4 (relating to cross references to rules for optional tax) is amended by adding at the end thereof the following new paragraph: 26 USC 4.

"(3) For rule that optional tax is not to apply if individual chooses the benefits of income averaging, see section 1304(b)."

(2) Subsection (b) of section 5 (relating to cross references to special limitations on tax) is amended to read as follows: 26 USC 5.

"(b) SPECIAL LIMITATIONS ON TAX.—

"(1) For limitation on surtax attributable to sales of oil or gas properties, see section 632.

"(2) For limitation on tax in case of income of members of Armed Forces on death, see section 692.

"(3) For limitation on tax where an individual chooses the benefits of income averaging, see section 1301.

"(4) For computation of tax where taxpayer restores substantial amount held under claim of right, see section 1341.

"(5) For limitation on surtax attributable to claims against the United States involving acquisitions of property, see section 1347."

(3) The table of parts for subchapter Q of chapter 1 is amended by striking out

"Part I. Income attributable to several taxable years."

and inserting in lieu thereof

"Part I. Income averaging."

(g) EFFECTIVE DATE.—

(1) GENERAL RULE.—Except as provided in paragraph (2), the amendments made by this section shall apply with respect to taxable years beginning after December 31, 1963.

(2) INCOME FROM AN EMPLOYMENT.—If, in a taxable year beginning after December 31, 1963, an individual or partnership receives or accrues compensation from an employment (as defined

68A Stat. 334.

by section 1301(b) of the Internal Revenue Code of 1954 as in effect immediately before the enactment of this Act) and the employment began before February 6, 1963, the tax attributable to such compensation may, at the election of the taxpayer, be computed under the provisions of sections 1301 and 1307 of such Code as in effect immediately before the enactment of this Act. If a taxpayer so elects (at such time and in such manner as the Secretary of the Treasury or his delegate by regulations prescribes), he may not choose for such taxable year the benefits

Ante, p. 105.

provided by part I of subchapter Q of chapter 1 of such Code (relating to income averaging) as amended by this Act and (if he elects to have subsection (e) of such section 1307 apply)

Ante, p. 45.

section 170(b)(5) of such Code as amended by this Act shall not apply to charitable contributions paid in such taxable year.

SEC. 233. SMALL BUSINESS CORPORATIONS.

26 USC 1371.

(a) OWNERSHIP OF CERTAIN STOCK DISREGARDED.—Section 1371 (relating to definition of small business corporation) is amended by adding at the end thereof the following new subsection:

"(d) OWNERSHIP OF CERTAIN STOCK.—For purposes of subsection (a), a corporation shall not be considered a member of an affiliated group at any time during any taxable year by reason of the ownership of stock in another corporation if such other corporation—

"(1) has not begun business at any time on or after the date of its incorporation and before the close of such taxable year, and

"(2) does not have taxable income for the period included within such taxable year."

(b) CERTAIN DISTRIBUTIONS OF MONEY AFTER CLOSE OF TAXABLE

26 USC 1375.

YEAR.—Section 1375 (relating to special rules applicable to distributions of electing small business corporations) is amended by adding at the end thereof the following new subsection:

"(e) CERTAIN DISTRIBUTIONS AFTER CLOSE OF TAXABLE YEAR.—

"(1) IN GENERAL.—For purposes of this chapter, if—

"(A) a corporation makes a distribution of money to its shareholders on or before the 15th day of the third month following the close of a taxable year with respect to which it was an electing small business corporation, and

"(B) such distribution is made pursuant to a resolution of the board of directors of the corporation, adopted before the close of such taxable year, to distribute to its shareholders all or a part of the proceeds of one or more sales of capital assets, or of property described in section 1231(b), made during such taxable year, 26 USC 1231.

such distribution shall, at the election of the corporation, be treated as a distribution of money made on the last day of such taxable year.

"(2) SHAREHOLDERS.—An election under paragraph (1) with respect to any distribution may be made by a corporation only if each person who is a shareholder on the day the distribution is received—

"(A) owns the same proportion of the stock of the corporation on such day as he owned on the last day of the taxable year of the corporation preceding the distribution, and

"(B) consents to such election at such time and in such manner as the Secretary or his delegate shall prescribe by regulations.

"(3) MANNER AND TIME OF ELECTION.—An election under paragraph (1) shall be made in such manner as the Secretary or his delegate shall prescribe by regulations. Such election shall be made not later than the time prescribed by law for filing the return for the taxable year during which the sale was made (including extensions thereof) except that, with respect to any taxable year ending on or before the date of the enactment of the Revenue Act of 1964, such election shall be made within 120 days after such date."

(c) EFFECTIVE DATES.—The amendment made by subsection (a) shall apply with respect to taxable years of corporations beginning after December 31, 1962. The amendment made by subsection (b) shall apply with respect to taxable years of corporations beginning after December 31, 1957.

SEC. 234. REPEAL OF ADDITIONAL 2-PERCENT TAX FOR CORPORATIONS FILING CONSOLIDATED RETURNS.

(a) REPEAL OF TAX.—Subsection (a) of section 1503 (relating to computation and payment of tax in case of consolidated returns) is amended to read as follows: 26 USC 1503.

"(a) GENERAL RULE.—In any case in which a consolidated return is made or is required to be made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under section 1502 prescribed before the last day prescribed by law for the filing of such return." 26 USC 1502.

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Section 1503 is amended by striking out subsections (b) and (c) and by relettering subsection (d) as subsection (b).

(2) Paragraph (3) of section 1503(b) (as relettered by paragraph (1)) is amended to read as follows:

"(3) SPECIAL RULES.—

"(A) For purposes of paragraph (2), a corporation is a regulated public utility only if it is a regulated public utility within the meaning of subparagraph (A) (other than clauses (ii) and (iii) thereof) or (D) of section 7701(a)(33). For purposes of the preceding sentence, the limitation contained in the last two sentences of section 7701(a)(33) shall be applied as if subparagraphs (A) through (F), inclusive, of section 7701(a)(33) were limited to subparagraphs (A)(i) and (D) thereof. Post, p. 114.

"(B) For purposes of paragraph (2), the foreign countries referred to in this subparagraph include only any country from which any public utility referred to in the first sentence of paragraph (2) derives the principal part of its income.

"(C) For purposes of this subsection, the term 'consolidated taxable income' means the consolidated taxable income computed without regard to the deduction provided by section 242 for partially tax-exempt interest."

Ante, p. 30. 26 USC 7701.

(3) Section 7701(a) (relating to definitions) is amended by adding at the end thereof the following new paragraph:

"(33) REGULATED PUBLIC UTILITY.—The term 'regulated public utility' means—

"(A) A corporation engaged in the furnishing or sale of—

"(i) electric energy, gas, water, or sewerage disposal services, or

"(ii) transportation (not included in subparagraph (C)) on an intrastate, suburban, municipal, or interurban electric railroad, on an intrastate, municipal, or suburban trackless trolley system, or on a municipal or suburban bus system, or

"(iii) transportation (not included in clause (ii)) by motor vehicle—

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, by a public service or public utility commission or other similar body of the District of Columbia or of any State or political subdivision thereof, or by a foreign country or an agency or instrumentality or political subdivision thereof.

"(B) A corporation engaged as a common carrier in the furnishing or sale of transportation of gas by pipe line, if subject to the jurisdiction of the Federal Power Commission.

"(C) A corporation engaged as a common carrier (i) in the furnishing or sale of transportation by railroad, if subject to the jurisdiction of the Interstate Commerce Commission, or (ii) in the furnishing or sale of transportation of oil or other petroleum products (including shale oil) by pipe line, if subject to the jurisdiction of the Interstate Commerce Commission or if the rates for such furnishing or sale are subject to the jurisdiction of a public service or public utility commission or other similar body of the District of Columbia or of any State.

"(D) A corporation engaged in the furnishing or sale of telephone or telegraph service, if the rates for such furnishing or sale meet the requirements of subparagraph (A).

"(E) A corporation engaged in the furnishing or sale of transportation as a common carrier by air, subject to the jurisdiction of the Civil Aeronautics Board.

"(F) A corporation engaged in the furnishing or sale of transportation by common carrier by water, subject to the jurisdiction of the Interstate Commerce Commission under part III of the Interstate Commerce Act, or subject to the jurisdiction of the Federal Maritime Board under the Intercoastal Shipping Act, 1933.

54 Stat. 929. 49 USC 901. 47 Stat. 1425. 46 USC 848.

"(G) A railroad corporation subject to part I of the Interstate Commerce Act, if (i) substantially all of its railroad properties have been leased to another such railroad corporation or corporations by an agreement or agreements entered into before January 1, 1954, (ii) each lease is for a term of more than 20 years, and (iii) at least 80 percent or more of its gross income (computed without regard to dividends and capital gains and losses) for the taxable year is derived from such leases and from sources described in subparagraphs (A) through (F), inclusive. For purposes of the preceding sentence, an agreement for lease of railroad properties entered into before January 1, 1954, shall be considered to be a lease including such term as the total number of years of such agreement may, unless sooner terminated, be renewed or continued under the terms of the agreement, and any such renewal or continuance under such agreement shall be considered part of the lease entered into before January 1, 1954.

"(H) A common parent corporation which is a common carrier by railroad subject to part I of the Interstate Commerce Act if at least 80 percent of its gross income (computed without regard to capital gains or losses) is derived directly or indirectly from sources described in subparagraphs (A) through (F), inclusive. For purposes of the preceding sentence, dividends and interest, and income from leases described in subparagraph (G), received from a regulated public utility shall be considered as derived from sources described in subparagraphs (A) through (F), inclusive, if the regulated public utility is a member of an affiliated group (as defined in section 1504) which includes the common parent corporation. 24 Stat. 379. 49 USC 1 et seq.

The term 'regulated public utility' does not (except as provided in subparagraphs (G) and (H)) include a corporation described in subparagraphs (A) through (F), inclusive, unless 80 percent or more of its gross income (computed without regard to dividends and capital gains and losses) for the taxable year is derived from sources described in subparagraphs (A) through (F), inclusive. If the taxpayer establishes to the satisfaction of the Secretary or his delegate that (i) its revenue from regulated rates described in subparagraph (A) or (D) and its revenue derived from unregulated rates are derived from the operation of a single interconnected and coordinated system or from the operation of more than one such system, and (ii) the unregulated rates have been and are substantially as favorable to users and consumers as are the regulated rates, then such revenue from such unregulated rates shall be considered, for purposes of the preceding sentence, as income derived from sources described in subparagraph (A) or (D)."

(4) Section 12(8) (relating to cross reference to additional tax for corporations filing consolidated returns) is hereby repealed. Repeal. 26 USC 12.

(5) Paragraphs (1) and (2) of section 172(j) (relating to carryover of net operating loss for certain regulated transportation corporations) are amended to read as follows: 26 USC 172.

"(1) DEFINITION.—For purposes of subsection (b)(1)(C), the term 'regulated transportation corporation' means a corporation—

"(A) 80 percent or more of the gross income of which (computed without regard to dividends and capital gains and losses) for the taxable year is derived from the furnishing or sale of transportation described in subparagraph (A), (C)(i), (E), or (F) of section 7701(a)(33) and taken into account for purposes of the limitation contained in the last two sentences of section 7701(a)(33), Ante, p. 114.

Ante, p. 114.

"(B) which is described in subparagraph (G) or (H) of section 7701(a)(33), or

"(C) which is a member of a regulated transportation system.

"(2) REGULATED TRANSPORTATION SYSTEM.—For purposes of this subsection, a corporation shall be treated as a member of a regulated transportation system for a taxable year if—

"(A) it is a member of an affiliated group of corporations making a consolidated return for such taxable year, and

"(B) 80 percent or more of the aggregate gross income of the members of such affiliated group (computed without regard to dividends and capital gains and losses) for such taxable year is derived from sources described in paragraph (1)(A).

For purposes of subparagraph (B), income derived by a corporation described in subparagraph (G) or (H) of section 7701(a)(33) from leases described in subparagraph (G) thereof shall be considered as derived from sources described in paragraph (1)(A)."

26 USC 904. (6) Section 904(g)(2) (relating to cross references for purposes of the limitation on the foreign tax credit) is amended by striking out "section 1503(d)" and inserting in lieu thereof "section 1503(b)".

26 USC 1341. (7) Section 1341(b)(2) (relating to special rules for the computation of tax where taxpayer restores substantial amount held under claim of right) is amended by striking out "(as defined in section 1503(c) without regard to paragraph (2) thereof)" and inserting in lieu thereof "(as defined in section 7701(a)(33) without regard to the limitation contained in the last two sentences thereof)".

26 USC 1552. (8) Section 1552(a)(3) (relating to the allocation of tax liability among members of an affiliated group of corporations filing consolidated returns) is amended by striking out "(determined without regard to the 2 percent increase provided by section 1503(a))".

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply with respect to taxable years beginning after December 31, 1963.

SEC. 235. REDUCTION OF SURTAX EXEMPTION IN CASE OF CERTAIN CONTROLLED CORPORATIONS, ETC.

(a) IN GENERAL.—Subchapter B of chapter 6 (related rules for consolidated returns) is amended by adding at the end thereof the following new part:

"PART II—CERTAIN CONTROLLED CORPORATIONS

"SEC. 1561. SURTAX EXEMPTIONS IN CASE OF CERTAIN CONTROLLED CORPORATIONS.

"(a) GENERAL RULE.—If a corporation is a component member of a controlled group of corporations on a December 31, then for purposes of this subtitle the surtax exemption of such corporation for the taxable year which includes such December 31 shall be an amount equal to—

"(1) $25,000 divided by the number of corporations which are component members of such group on such December 31, or

"(2) if all such component members consent (at such time and in such manner as the Secretary or his delegate shall by regulations prescribe) to an apportionment plan, such portion of $25,000 as is apportioned to such member in accordance with such plan.

The sum of the amounts apportioned under paragraph (2) among the component members of any controlled group shall not exceed $25,000.

"(b) CERTAIN SHORT TAXABLE YEARS.—If a corporation—

"(1) has a short taxable year which does not include a December 31, and

"(2) is a component member of a controlled group of corporations with respect to such taxable year,

then for purposes of this subtitle the surtax exemption of such corporation for such taxable year shall be an amount equal to $25,000 divided by the number of corporations which are component members of such group on the last day of such taxable year. For purposes of the preceding sentence, section 1563(b) shall be applied as if such last day were substituted for December 31. Post, p. 120.

"SEC. 1562. PRIVILEGE OF GROUPS TO ELECT MULTIPLE SURTAX EXEMPTIONS.

"(a) ELECTION OF MULTIPLE SURTAX EXEMPTIONS.—

"(1) IN GENERAL.—A controlled group of corporations shall (subject to the provisions of this section) have the privilege of electing to have each of its component members make its returns without regard to section 1561. Such election shall be made with respect to a specified December 31 and shall be valid only if— Ante, p. 116.

"(A) each corporation which is a component member of such group on such December 31, and

"(B) each other corporation which is a component member of such group on any succeeding December 31 before the day on which the election is filed,

consents to such election.

"(2) YEARS FOR WHICH EFFECTIVE.—An election by a controlled group of corporations under paragraph (1) shall be effective with respect to the taxable year of each component member of such group which includes the specified December 31, and each taxable year of each corporation which is a component member of such group (or a successor group) on a succeeding December 31 included within such taxable year, unless the election is terminated under subsection (c).

"(3) EFFECT OF ELECTION.—If an election by a controlled group of corporations under paragraph (1) is effective with respect to any taxable year of a corporation—

"(A) section 1561 shall not apply to such corporation for such taxable year, but

"(B) the additional tax imposed by subsection (b) shall apply to such corporation for such taxable year.

"(b) ADDITIONAL TAX IMPOSED.—

"(1) GENERAL RULE.—If an election under subsection (a)(1) by a controlled group of corporations is effective with respect to the taxable year of a corporation, there is hereby imposed for such taxable year on the taxable income of such corporation a tax equal to 6 percent of so much of such corporation's taxable income for such taxable year as does not exceed $25,000. This paragraph shall not apply to the taxable year of a corporation if—

"(A) such corporation is the only component member of such controlled group on the December 31 included in such corporation's taxable year which has taxable income for a taxable year including such December 31, or

"(B) such corporation's surtax exemption is disallowed for such taxable year under any provision of this subtitle.

Ante, p. 25.

"(2) TAX TREATED AS IMPOSED BY SECTION 11, ETC.—If for the taxable year of a corporation a tax is imposed by section 11 on the taxable income of such corporation, the additional tax imposed by this subsection shall be treated for purposes of this title as a tax imposed by section 11. If for the taxable year of a corporation a tax is imposed on the taxable income of such corporation which is computed under any other section by reference to section 11, the additional tax imposed by this subsection shall be treated for purposes of this title as imposed by such other section.

"(3) TAXABLE INCOME DEFINED.—For purposes of this subsection, the term 'taxable income' means—

26 USC 511, 512.

"(A) in the case of a corporation subject to tax under section 511, its unrelated business taxable income (within the meaning of section 512);

26 USC 802.

"(B) in the case of a life insurance company, its life insurance company taxable income (within the meaning of section 802(b));

26 USC 852, 857.

"(C) in the case of a regulated investment company, its investment company taxable income (within the meaning of section 852(b)(2)); and

"(D) in the case of a real estate investment trust, its real estate investment trust taxable income (within the meaning of section 857(b)(2)).

26 USC 244, 247.
26 USC 804, 922.

"(4) SPECIAL RULES.—If for the taxable year an additional tax is imposed on the taxable income of a corporation by this subsection, then sections 244 (relating to dividends received on certain preferred stock), 247 (relating to dividends paid on certain preferred stock of public utilities), 804(a)(3) (relating to deduction for partially tax-exempt interest in the case of a life insurance company), and 922 (relating to special deduction for Western Hemisphere trade corporations) shall be applied without regard to the additional tax imposed by this subsection.

"(c) TERMINATION OF ELECTION.—An election by a controlled group of corporations under subsection (a) shall terminate with respect to such group—

"(1) CONSENT OF THE MEMBERS.—If such group files a termination of such election with respect to a specified December 31, and—

"(A) each corporation which is a component member of such group on such December 31, and

"(B) each other corporation which is a component member of such group on any succeeding December 31 before the day on which the termination is filed,

consents to such termination.

"(2) REFUSAL BY NEW MEMBER TO CONSENT.—If on December 31 of any year such group includes a component member which—

"(A) on the immediately preceding January 1 was not a member of such group, and

"(B) within the time and in the manner provided by regulations prescribed by the Secretary or his delegate, files a statement that it does not consent to the election.

"(3) CONSOLIDATED RETURNS.—If—

Post, pp. 120, 121.

"(A) a corporation is a component member (determined without regard to section 1563(b)(3)) of such group on a December 31 included within a taxable year ending on or after January 1, 1964, and

"(B) such corporation is a member of an affiliated group of corporations which makes a consolidated return under this chapter (sec. 1501 and following) for such taxable year. 26 USC 1501.

"(4) CONTROLLED GROUP NO LONGER IN EXISTENCE.—If such group is considered as no longer in existence with respect to any December 31.

Such termination shall be effective with respect to the December 31 referred to in paragraph (1)(A), (2), (3), or (4), as the case may be.

"(d) ELECTION AFTER TERMINATION.—If an election by a controlled group of corporations is terminated under subsection (c), such group (and any successor group) shall not be eligible to make an election under subsection (a) with respect to any December 31 before the sixth December 31 after the December 31 with respect to which such termination was effective.

"(e) MANNER AND TIME OF GIVING CONSENT AND MAKING ELECTION, ETC.—An election under subsection (a)(1) or a termination under subsection (c)(1) (and the consent of each member of a controlled group of corporations which is required with respect to such election or termination) shall be made in such manner as the Secretary or his delegate shall by regulations prescribe, and shall be made at any time before the expiration of 3 years after—

"(1) in the case of such an election, the date when the income tax return for the taxable year of the component member of the controlled group which has the taxable year ending first on or after the specified December 31 is required to be filed (without regard to any extensions of time), and

"(2) in the case of such a termination, the specified December 31 with respect to which such termination was made.

Any consent to such an election or termination, and a failure by a component member to file a statement that it does not consent to an election under this section, shall be deemed to be a consent to the application of subsection (g)(1) (relating to tolling of statute of limitations on assessment of deficiencies).

"(f) SPECIAL RULES.—For purposes of this section—

"(1) CONTINUING AND SUCCESSOR CONTROLLED GROUPS.—The determination of whether a controlled group of corporations—

"(A) is considered as no longer in existence with respect to any December 31, or

"(B) is a successor to another controlled group of corporations (and the effect of such determination with respect to any election or termination),

shall be made under regulations prescribed by the Secretary or his delegate. For purposes of subparagraph (B), such regulations shall be based on the continuation (or termination) of predominant equitable ownership.

"(2) CERTAIN SHORT TAXABLE YEARS.—If one or more corporations have short taxable years which do not include a December 31 and are component members of a controlled group of corporations with respect to such taxable years (determined by applying section 1563(b) as if the last day of each such taxable year were substituted for December 31), then an election by such group under this section shall apply with respect to such corporations with respect to such taxable years if— Post, pp. 121.

"(A) such election is in effect with respect to both the December 31 immediately preceding such taxable years and the December 31 immediately succeeding such taxable years, or

"(B) such election is in effect with respect to the December 31 immediately preceding or succeeding such taxable years and each such corporation files a consent to the application of such election to its short taxable year at such time and in such manner as the Secretary or his delegate shall prescribe by regulations.

"(g) TOLLING OF STATUTE OF LIMITATIONS.—In any case in which a controlled group of corporations makes an election or termination under this section, the statutory period—

"(1) for assessment of any deficiency against a corporation which is a component member of such group for any taxable year, to the extent such deficiency is attributable to the application of this part, shall not expire before the expiration of one year after the date such election or termination is made; and

"(2) for allowing or making credit or refund of any overpayment of tax by a corporation which is a component member of such group for any taxable year, to the extent such credit or refund is attributable to the application of this part, shall not expire before the expiration of one year after the date such election or termination is made.

"SEC. 1563. DEFINITIONS AND SPECIAL RULES.

"(a) CONTROLLED GROUP OF CORPORATIONS.—For purposes of this part, the term 'controlled group of corporations' means any group of—

"(1) PARENT-SUBSIDIARY CONTROLLED GROUP.—One or more chains of corporations connected through stock ownership with a common parent corporation if—

"(A) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned (within the meaning of subsection (d)(1)) by one or more of the other corporations; and

"(B) the common parent corporation owns (within the meaning of subsection (d)(1)) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

"(2) BROTHER-SISTER CONTROLLED GROUP.—Two or more corporations if stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations is owned (within the meaning of subsection (d)(2)) by one person who is an individual, estate, or trust.

"(3) COMBINED GROUP.—Three or more corporations each of which is a member of a group of corporations described in paragraph (1) or (2), and one of which—

"(A) is a common parent corporation included in a group of corporations described in paragraph (1), and also

"(B) is included in a group of corporations described in paragraph (2).

"(4) CERTAIN INSURANCE COMPANIES.—Two or more insurance

26 USC 802. companies subject to taxation under section 802 which are members of a controlled group of corporations described in paragraph (1), (2), or (3). Such insurance companies shall be treated as a controlled group of corporations separate from any other corporations which are members of the controlled group of corporations described in paragraph (1), (2), or (3).

"(b) Component Member.—

"(1) General rule.—For purposes of this part, a corporation is a component member of a controlled group of corporations on a December 31 of any taxable year (and with respect to the taxable year which includes such December 31) if such corporation—

"(A) is a member of such controlled group of corporations on the December 31 included in such year and is not treated as an excluded member under paragraph (2), or

"(B) is not a member of such controlled group of corporations on the December 31 included in such year but is treated as an additional member under paragraph (3).

"(2) Excluded members.—A corporation which is a member of a controlled group of corporations on December 31 of any taxable year shall be treated as an excluded member of such group for the taxable year including such December 31 if such corporation—

"(A) is a member of such group for less than one-half the number of days in such taxable year which precede such December 31,

"(B) is exempt from taxation under section 501(a) (except a corporation which is subject to tax on its unrelated business taxable income under section 511) for such taxable year, 26 USC 501, 511.

"(C) is a foreign corporation subject to tax under section 881 for such taxable year,

"(D) is an insurance company subject to taxation under section 802 or section 821 (other than an insurance company which is a member of a controlled group described in subsection (a)(4)), or 26 USC 802, 821.

"(E) is a franchised corporation, as defined in subsection (f)(4).

"(3) Additional members.—A corporation which—

"(A) was a member of a controlled group of corporations at any time during a calendar year,

"(B) is not a member of such group on December 31 of such calendar year, and

"(C) is not described, with respect to such group, in subparagraph (B), (C), (D), or (E) of paragraph (2),

shall be treated as an additional member of such group on December 31 for its taxable year including such December 31 if it was a member of such group for one-half (or more) of the number of days in such taxable year which precede such December 31.

"(4) Overlapping groups.—If a corporation is a component member of more than one controlled group of corporations with respect to any taxable year, such corporation shall be treated as a component member of only one controlled group. The determination as to the group of which such corporation is a component member shall be made under regulations prescribed by the Secretary or his delegate which are consistent with the purposes of this part.

"(c) Certain Stock Excluded.—

"(1) General rule.—For purposes of this part, the term 'stock' does not include—

"(A) nonvoting stock which is limited and preferred as to dividends,

"(B) treasury stock, and

"(C) stock which is treated as 'excluded stock' under paragraph (2).

"(2) STOCK TREATED AS 'EXCLUDED STOCK'.—

"(A) PARENT-SUBSIDIARY CONTROLLED GROUP.—For purposes of subsection (a)(1), if a corporation (referred to in this paragraph as 'parent corporation') owns (within the meaning of subsections (d)(1) and (e)(4)), 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock in another corporation (referred to in this paragraph as 'subsidiary corporation'), the following stock of the subsidiary corporation shall be treated as excluded stock—

"(i) stock in the subsidiary corporation held by a trust which is part of a plan of deferred compensation for the benefit of the employees of the parent corporation or the subsidiary corporation,

"(ii) stock in the subsidiary corporation owned by an individual (within the meaning of subsection (d)(2)) who is a principal stockholder or officer of the parent corporation. For purposes of this clause, the term 'principal stockholder' of a corporation means an individual who owns (within the meaning of subsection (d)(2)) 5 percent or more of the total combined voting power of all classes of stock entitled to vote or 5 percent or more of the total value of shares of all classes of stock in such corporation, or

"(iii) stock in the subsidiary corporation owned (within the meaning of subsection (d)(2)) by an employee of the subsidiary corporation if such stock is subject to conditions which run in favor of such parent (or subsidiary) corporation and which substantially restrict or limit the employee's right (or if the employee constructively owns such stock, the direct owner's right) to dispose of such stock.

"(B) BROTHER-SISTER CONTROLLED GROUP.—For purposes of subsection (a)(2), if a person who is an individual, estate, or trust (referred to in this paragraph as 'common owner') owns (within the meaning of subsection (d)(2)), 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock in a corporation, the following stock of such corporation shall be treated as excluded stock—

"(i) stock in such corporation held by an employees' trust described in section 401(a) which is exempt from tax under section 501(a), if such trust is for the benefit of the employees of such corporation, or

26 USC 401, 501.

"(ii) stock in such corporation owned (within the meaning of subsection (d)(2)) by an employee of the corporation if such stock is subject to conditions which run in favor of such common owner (or such corporation) and which substantially restrict or limit the employee's right (or if the employee constructively owns such stock, the direct owner's right) to dispose of such stock. If a condition which limits or restricts the employee's right (or the direct owner's right) to dispose of such stock also applies to the stock held by the common owner pursuant to a bona fide reciprocal stock purchase arrangement, such condition shall not be treated as one which restricts or limits the employee's right to dispose of such stock.

"(d) Rules for Determining Stock Ownership.—

"(1) Parent-subsidiary controlled group.—For purposes of determining whether a corporation is a member of a parent-subsidiary controlled group of corporations (within the meaning of subsection (a)(1)), stock owned by a corporation means—

"(A) stock owned directly by such corporation, and

"(B) stock owned with the application of subsection (e)(1).

"(2) Brother-sister controlled group.—For purposes of determining whether a corporation is a member of a brother-sister controlled group of corporations (within the meaning of subsection (a)(2)), stock owned by a person who is an individual, estate, or trust means—

"(A) stock owned directly by such person, and

"(B) stock owned with the application of subsection (e).

"(e) Constructive Ownership.—

"(1) Options.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

"(2) Attribution from partnerships.—Stock owned, directly or indirectly, by or for a partnership shall be considered as owned by any partner having an interest of 5 percent or more in either the capital or profits of the partnership in proportion to his interest in capital or profits, whichever such proportion is the greater.

"(3) Attribution from estates or trusts.—

"(A) Stock owned, directly or indirectly, by or for an estate or trust shall be considered as owned by any beneficiary who has an actuarial interest of 5 percent or more in such stock, to the extent of such actuarial interest. For purposes of this subparagraph, the actuarial interest of each beneficiary shall be determined by assuming the maximum exercise of discretion by the fiduciary in favor of such beneficiary and the maximum use of such stock to satisfy his rights as a beneficiary.

"(B) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person. 26 USC 671-678.

"(C) This paragraph shall not apply to stock owned by any employees' trust described in section 401(a) which is exempt from tax under section 501(a).

"(4) Attribution from corporations.—Stock owned, directly or indirectly, by or for a corporation shall be considered as owned by any person who owns (within the meaning of subsection (d)) 5 percent or more in value of its stock in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

"(5) Spouse.—An individual shall be considered as owning stock in a corporation owned, directly or indirectly, by or for his spouse (other than a spouse who is legally separated from the individual under a decree of divorce whether interlocutory or final, or a decree of separate maintenance), except in the case of a corporation with respect to which each of the following conditions is satisfied for its taxable year—

"(A) The individual does not, at any time during such taxable year, own directly any stock in such corporation;

"(B) The individual is not a director or employee and does not participate in the management of such corporation at any time during such taxable year;

"(C) Not more than 50 percent of such corporation's gross income for such taxable year was derived from royalties, rents, dividends, interest, and annuities; and

"(D) Such stock in such corporation is not, at any time during such taxable year, subject to conditions which substantially restrict or limit the spouse's right to dispose of such stock and which run in favor of the individual or his children who have not attained the age of 21 years.

"(6) CHILDREN, GRANDCHILDREN, PARENTS, AND GRANDPARENTS.—

"(A) MINOR CHILDREN.—An individual shall be considered as owning stock owned, directly or indirectly, by or for his children who have not attained the age of 21 years, and, if the individual has not attained the age of 21 years, the stock owned, directly or indirectly, by or for his parents.

"(B) ADULT CHILDREN AND GRANDCHILDREN.—An individual who owns (within the meaning of subsection (d)(2), but without regard to this subparagraph) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock in a corporation shall be considered as owning the stock in such corporation owned, directly or indirectly, by or for his parents, grandparents, grandchildren, and children who have attained the age of 21 years.

"(C) ADOPTED CHILD.—For purposes of this section, a legally adopted child of an individual shall be treated as a child of such individual by blood.

"(f) OTHER DEFINITIONS AND RULES.—

"(1) EMPLOYEE DEFINED.—For purposes of this section the term 'employee' has the same meaning such term is given in section 3306(i).

26 USC 3306.

"(2) OPERATING RULES.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), stock constructively owned by a person by reason of the application of paragraph (1), (2), (3), (4), (5), or (6) of subsection (e) shall, for purposes of applying such paragraphs, be treated as actually owned by such person.

"(B) MEMBERS OF FAMILY.—Stock constructively owned by an individual by reason of the application of paragraph (5) or (6) of subsection (e) shall not be treated as owned by him for purposes of again applying such paragraphs in order to make another the constructive owner of such stock.

"(3) SPECIAL RULES.—For purposes of this section—

"(A) If stock may be considered as owned by a person under subsection (e)(1) and under any other paragraph of subsection (e), it shall be considered as owned by him under subsection (e)(1).

"(B) If stock is owned (within the meaning of subsection (d)) by two or more persons, such stock shall be considered as owned by the person whose ownership of such stock results in the corporation being a component member of a controlled group. If by reason of the preceding sentence, a corporation would (but for this sentence) become a component member of two controlled groups, it shall be treated as a component member of one controlled group. The determination as to the group of which such corporation is a component member shall be made under regulations prescribed by the Secretary or his delegate which are consistent with the purposes of this part.

"(C) If stock is owned by a person within the meaning of subsection (d) and such ownership results in the corporation being a component member of a controlled group, such stock shall not be treated as excluded stock under subsection (c) (2), if by reason of treating such stock as excluded stock the result is that such corporation is not a component member of a controlled group of corporations.

"(4) FRANCHISED CORPORATION.—If—

"(A) a parent corporation (as defined in subsection (c) (2) (A)), or a common owner (as defined in subsection (c) (2) (B)), of a corporation which is a member of a controlled group of corporations is under a duty (arising out of a written agreement) to sell stock of such corporation (referred to in this paragraph as 'franchised corporation') which is franchised to sell the products of another member, or the common owner, of such controlled group;

"(B) such stock is to be sold to an employee (or employees) of such franchised corporation pursuant to a bona fide plan designed to eliminate the stock ownership of the parent corporation or of the common owner in the franchised corporation;

"(C) such plan—

"(i) provides a reasonable selling price for such stock, and

"(ii) requires that a portion of the employee's share of the profits of such corporation (whether received as compensation or as a dividend) be applied to the purchase of such stock (or the purchase of notes, bonds, debentures or other similar evidence of indebtedness of such franchised corporation held by such parent corporation or common owner);

"(D) such employee (or employees) owns directly more than 20 percent of the total value of shares of all classes of stock in such franchised corporation;

"(E) more than 50 percent of the inventory of such franchised corporation is acquired from members of the controlled group, the common owner, or both; and

"(F) all of the conditions contained in subparagraphs (A), (B), (C), (D), and (E) have been met for one-half (or more) of the number of days preceding the December 31 included within the taxable year (or if the taxable year does not include December 31, the last day of such year) of the franchised corporation,

then such franchised corporation shall be treated as an excluded member of such group, under subsection (b) (2), for such taxable year."

(b) DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT.—Section 1551 (relating to disallowance of surtax exemption and accumulated earnings credit) is amended to read as follows: 26 USC 1551.

"SEC. 1551. DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT.

"(a) IN GENERAL.—If—

"(1) any corporation transfers, on or after January 1, 1951, and on or before June 12, 1963, all or part of its property (other than money) to a transferee corporation, "(2) any corporation transfers, directly or indirectly, after June 12, 1963, all or part of its property (other than money) to a transferee corporation, or

"(3) five or fewer individuals who are in control of a corporation transfer, directly or indirectly, after June 12, 1963, property (other than money) to a transferee corporation,

and the transferee corporation was created for the purpose of acquiring such property or was not actively engaged in business at the time of such acquisition, and if after such transfer the transferor or transferors are in control of such transferee corporation during any part of the taxable year of such transferee corporation, then for such taxable year of such transferee corporation the Secretary or his delegate may (except as may be otherwise determined under subsection (d)) disallow the surtax exemption (as defined in section 11(d)), or the $100,000 accumulated earnings credit provided in paragraph (2) or

26 USC 535. (3) of section 535(c), unless such transferee corporation shall establish by the clear preponderance of the evidence that the securing of such exemption or credit was not a major purpose of such transfer.

"(b) CONTROL.—For purposes of subsection (a), the term 'control' means—

"(1) With respect to a transferee corporation described in subsection (a) (1) or (2), the ownership by the transferor corporation, its shareholders, or both, of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock; or

"(2) With respect to each corporation described in subsection (a)(3), the ownership by the five or fewer individuals described in such subsection of stock possessing—

"(A) at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of each corporation, and

"(B) more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such individual only to the extent such stock ownership is identical with respect to each such corporation.

Ante, pp. 120, 123. For purposes of this subsection, section 1563(e) shall apply in determining the ownership of stock.

"(c) AUTHORITY OF THE SECRETARY UNDER THIS SECTION.—The

26 USC 269. provisions of section 269(b), and the authority of the Secretary under such section, shall, to the extent not inconsistent with the provisions of this section, be applicable to this section."

(c) TECHNICAL AMENDMENTS.—

(1) AMENDMENT OF SECTION 802.—The second sentence of

26 USC 802. section 802(a)(1) (relating to tax on life insurance companies) is amended to read as follows: "Such tax shall consist of a normal tax and surtax computed as provided in section 11 as though the life insurance company taxable income were the taxable income referred to in section 11."

(2) AMENDMENT OF SECTION 269.—Section 269(a) (relating to acquisitions made to evade or avoid income tax) is amended by striking out "then such deduction, credit, or other allowance shall not be allowed" at the end of the first sentence and inserting in lieu thereof "then the Secretary or his delegate may disallow such deduction, credit, or other allowance".

(3) SPECIAL RULE FOR 52–53-WEEK YEAR.—Section 441(f)(2)(A) (relating to effective date with respect to special rules for 52–53-week year) is amended by striking out "In any case in which the effective date or the applicability of any provision of this title is expressed in terms of taxable years beginning or ending with reference to a specified date" and inserting in lieu thereof "In any case in which the effective date or the applicability of any provision of this title is expressed in terms of taxable years beginning, including, or ending with reference to a specified date". 26 USC 441.

(4) Subchapter B of chapter 6 is amended by inserting after the heading and before the table of sections the following:

"Part I. In general.
"Part II. Certain controlled corporations.

"PART I—IN GENERAL"

(d) EFFECTIVE DATE.—The amendments made by subsections (a) and (c) shall apply with respect to taxable years ending after December 31, 1963. The amendment made by subsection (b) shall apply with respect to transfers made after June 12, 1963.

SEC. 236. VALIDITY OF TAX LIENS AGAINST PURCHASERS OF MOTOR VEHICLES.

(a) PURCHASERS WITHOUT ACTUAL NOTICE OR KNOWLEDGE OF LIEN.—Section 6323 (relating to validity of liens for Federal taxes) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection: 26 USC 6323.

"(d) EXCEPTION IN CASE OF MOTOR VEHICLES.—

"(1) EXCEPTION.—Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a motor vehicle, as defined in paragraph (2) of this subsection, as against any purchaser of such motor vehicle for an adequate and full consideration in money or money's worth if—

"(A) at the time of the purchase the purchaser is without notice or knowledge of the existence of such lien, and

"(B) before the purchaser obtains such notice or knowledge, he has acquired possession of such motor vehicle and has not thereafter relinquished possession of such motor vehicle to the seller or his agent.

"(2) DEFINITION OF MOTOR VEHICLE.—As used in this subsection, the term 'motor vehicle' means a self-propelled vehicle which is registered for highway use under the laws of any State or foreign country."

(b) LIENS FOR ESTATE AND GIFT TAXES.—Section 6324 (relating to special lien for estate and gift taxes) is amended by adding at the end thereof the following new subsection: 26 USC 6324.

"(d) EXCEPTION IN CASE OF MOTOR VEHICLES.—The lien imposed by subsection (a) or (b) shall not be valid with respect to a motor vehicle, as defined in section 6323(d)(2), as against any purchaser of such motor vehicle for an adequate and full consideration in money or money's worth if—

"(1) at the time of the purchase the purchaser is without notice or knowledge of the existence of such lien, and

"(2) before the purchaser obtains such notice or knowledge, he has acquired possession of such motor vehicle and has not thereafter relinquished possession of such motor vehicle to the seller or his agent."

(c) CLERICAL AMENDMENTS.—

26 USC 6323. (1) Section 6323(a) is amended by striking out "subsection (c)" and inserting in lieu thereof "subsections (c) and (d)".

26 USC 6324. (2) Section 6324 is amended by inserting after "subsection (c) (relating to transfers of securities)" in subsections (a) and (b) the following: "and subsection (d) (relating to purchases of motor vehicles)".

(d) EFFECTIVE DATES.—The amendments made by this section shall apply only with respect to purchases made after the date of the enactment of this Act.

SEC. 237. EXCLUSION OF EARNED INCOME OF CERTAIN UNITED STATES CITIZENS WHO ARE RESIDENTS OF FOREIGN COUNTRIES.

(a) REDUCTION OF LIMITATION.—Subparagraph (B) of section
26 USC 911. 911(c)(1) (relating to limitations on amount of exclusion) is amended by striking out "$35,000" and inserting in lieu thereof "$25,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1964.

SEC. 238. LOSSES ARISING FROM CONFISCATION OF PROPERTY BY CUBA.

26 USC 165. Section 165 (relating to losses) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) CERTAIN PROPERTY CONFISCATED BY CUBA.—For purposes of this chapter, any loss of tangible property, if such loss arises from expropriation, intervention, seizure, or similar taking by the government of Cuba, any political subdivision thereof, or any agency or instrumentality of the foregoing, shall be treated as a loss from a casualty within the meaning of subsection (c)(3)."

SEC. 239. CREDIT OR REFUND OF SELF-EMPLOYMENT TAX.

Ante, p. 111. Section 6511 (relating to limitations on credit or refund) is amended by adding at the end of subsection (d) the following new paragraph:

"(5) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO SELF-EMPLOYMENT TAX IN CERTAIN CASES.—If the claim for credit or refund relates to an overpayment of the tax imposed by chapter 2 (relating to the tax on self-employment income) attributable to an agreement, or modification of an agreement, made pursuant to section 218 of the Social Security Act (relating to coverage of State and local employees), and if the allowance of a credit or refund of such overpayment is otherwise prevented by the operation of any law or rule of law other than section 7122 (relating to compromises), such credit or refund may be allowed or made if claim therefor is filed on or before the later of the following dates: (A) the last day of the second year after the calendar year in which such agreement (or modification) is agreed to by the State and the Secretary of Health, Education, and Welfare, or (B) December 31, 1965."

SEC. 240. EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX ON VALUE OF REVERSIONARY OR REMAINDER INTEREST IN PROPERTY.

(a) EXTENSION UNDER 1954 CODE.—Section 6163(b) (relating to extension of time for paying estate tax on value of reversionary or remainder interest in property to prevent undue hardship) is amended by striking out "not in excess of 2" and inserting in lieu thereof "or periods not in excess of 3". 26 USC 6163.

(b) EXTENSION UNDER 1939 CODE.—Section 925 of the Internal Revenue Code of 1939 (relating to periods of extension of time for paying estate tax attributable to future interests) is amended by striking out "not in excess of 2" and inserting in lieu thereof "or periods not in excess of 3". 53 Stat. 140

(c) EFFECTIVE DATE.—

(1) The amendment made by subsection (a) shall apply in the case of any reversionary or remainder interest only if the time for payment of the tax under chapter 11 of the Internal Revenue Code of 1954 attributable to such interest, including any extensions thereof, has not expired on the date of the enactment of this Act.

(2) The amendment made by subsection (b) shall apply in the case of any reversionary or remainder interest only if the time for payment of the tax under chapter 3 of the Internal Revenue Code of 1939 attributable to such interest, including any extensions thereof, has not expired on the date of the enactment of this Act.

Title III—Optional Tax On Individuals; Collection Of Income Tax At Source On Wages

SEC. 301. OPTIONAL TAX IF ADJUSTED GROSS INCOME IS LESS THAN $5,000.

(a) OPTIONAL TAX.—Section 3 (relating to optional tax if adjusted gross income is less than $5,000) is amended to read as follows: 26 USC 3.

"SEC. 3. OPTIONAL TAX IF ADJUSTED GROSS INCOME IS LESS THAN $5,000.

"(a) TAXABLE YEARS BEGINNING IN 1964.—In lieu of the tax imposed by section 1, there is hereby imposed for each taxable year beginning on or after January 1, 1964, and before January 1, 1965, on the taxable income of every individual whose adjusted gross income for such year is less than $5,000 and who has elected for such year to pay the tax imposed by this section, a tax as follows:

"Table I—Single Person—NOT Head of Household

'Taxable Years Beginning in 1964

If adjusted gross income is—		And the number of exemptions is—			
At least	But less than	1	2	3	4 or more
		The tax is—			
$0	$900	$0	$0	$0	$0
900	925	2	0	0	0
925	950	6	0	0	0
950	975	10	0	0	0
975	1,000	14	0	0	0
1,000	1,025	18	0	0	0
1,025	1,050	22	0	0	0
1,050	1,075	26	0	0	0
1,075	1,100	30	0	0	0
1,100	1,125	34	0	0	0
1,125	1,150	38	0	0	0
1,150	1,175	42	0	0	0
1,175	1,200	46	0	0	0
1,200	1,225	50	0	0	0
1,225	1,250	54	0	0	0
1,250	1,275	58	0	0	0
1,275	1,300	62	0	0	0
1,300	1,325	66	0	0	0
1,325	1,350	70	0	0	0
1,350	1,375	74	0	0	0
1,375	1,400	78	0	0	0
1,400	1,425	82	0	0	0
1,425	1,450	86	0	0	0
1,450	1,475	90	0	0	0
1,475	1,500	94	0	0	0
1,500	1,525	99	0	0	0
1,525	1,550	103	0	0	0
1,550	1,575	107	0	0	0
1,575	1,600	111	0	0	0
1,600	1,625	115	2	0	0
1,625	1,650	119	6	0	0
1,650	1,675	123	10	0	0
1,675	1,700	127	14	0	0
1,700	1,725	132	18	0	0
1,725	1,750	136	22	0	0
1,750	1,775	140	26	0	0
1,775	1,800	144	30	0	0
1,800	1,825	148	34	0	0
1,825	1,850	152	38	0	0
1,850	1,875	156	42	0	0
1,875	1,900	160	46	0	0
1,900	1,925	165	50	0	0
1,925	1,950	169	54	0	0
1,950	1,975	173	58	0	0
1,975	2,000	178	62	0	0
2,000	2,025	182	66	0	0
2,025	2,050	187	70	0	0
2,050	2,075	191	74	0	0
2,075	2,100	195	78	0	0
2,100	2,125	200	82	0	0
2,125	2,150	204	86	0	0
2,150	2,175	208	90	0	0
2,175	2,200	213	94	0	0
2,200	2,225	217	99	0	0
2,225	2,250	222	103	0	0
2,250	2,275	226	107	0	0
2,275	2,300	230	111	0	0
2,300	2,325	235	115	2	0
2,325	2,350	239	119	6	0
2,350	2,375	243	123	10	0
2,375	2,400	248	127	14	0
2,400	2,425	252	132	18	0
2,425	2,450	257	136	22	0

If adjusted gross income is—		And the number of exemptions is—						
At least	But less than	1	2	3	4	5	6	7 or more
		The tax is—						
$2,450	$2,475	$261	$140	$26	$0	$0	$0	$0
2,475	2,500	266	144	30	0	0	0	0
2,500	2,525	270	148	34	0	0	0	0
2,525	2,550	275	152	38	0	0	0	0
2,550	2,575	279	156	42	0	0	0	0
2,575	2,600	284	160	46	0	0	0	0
2,600	2,625	288	165	50	0	0	0	0
2,625	2,650	293	169	54	0	0	0	0
2,650	2,675	297	173	58	0	0	0	0
2,675	2,700	302	178	62	0	0	0	0
2,700	2,725	306	182	66	0	0	0	0
2,725	2,750	311	187	70	0	0	0	0
2,750	2,775	315	191	74	0	0	0	0
2,775	2,800	320	195	78	0	0	0	0
2,800	2,825	324	200	82	0	0	0	0
2,825	2,850	329	204	86	0	0	0	0
2,850	2,875	333	208	90	0	0	0	0
2,875	2,900	338	213	94	0	0	0	0
2,900	2,925	343	217	99	0	0	0	0
2,925	2,950	348	222	103	0	0	0	0
2,950	2,975	353	226	107	0	0	0	0
2,975	3,000	358	230	111	0	0	0	0
3,000	3,050	365	237	117	4	0	0	0
3,050	3,100	374	246	125	12	0	0	0
3,100	3,150	383	255	134	20	0	0	0
3,150	3,200	392	264	142	28	0	0	0
3,200	3,250	401	273	150	36	0	0	0
3,250	3,300	410	282	158	44	0	0	0
3,300	3,350	419	291	167	52	0	0	0
3,350	3,400	428	300	176	60	0	0	0
3,400	3,450	437	309	184	68	0	0	0
3,450	3,500	446	318	193	76	0	0	0
3,500	3,550	455	327	202	84	0	0	0
3,550	3,600	464	336	211	92	0	0	0
3,600	3,650	473	345	219	101	0	0	0
3,650	3,700	482	355	228	109	0	0	0
3,700	3,750	491	365	237	117	4	0	0
3,750	3,800	500	375	246	125	12	0	0
3,800	3,850	509	385	255	134	20	0	0
3,850	3,900	518	395	264	142	28	0	0
3,900	3,950	527	405	273	150	36	0	0
3,950	4,000	536	415	282	158	44	0	0
4,000	4,050	545	425	291	167	52	0	0
4,050	4,100	554	434	300	176	60	0	0
4,100	4,150	563	443	309	184	68	0	0
4,150	4,200	572	452	318	193	76	0	0
4,200	4,250	581	461	327	202	84	0	0
4,250	4,300	590	470	336	211	92	0	0
4,300	4,350	599	479	345	219	101	0	0
4,350	4,400	608	488	355	228	109	0	0
4,400	4,450	617	497	365	237	117	4	0
4,450	4,500	626	506	375	246	125	12	0
4,500	4,550	635	515	385	255	134	20	0
4,550	4,600	644	524	395	264	142	28	0
4,600	4,650	653	533	405	273	150	36	0
4,650	4,700	662	542	415	282	158	44	0
4,700	4,750	671	551	425	291	167	52	0
4,750	4,800	680	560	435	300	176	60	0
4,800	4,850	689	569	445	309	184	68	0
4,850	4,900	698	578	455	318	193	76	0
4,900	4,950	707	587	465	327	202	84	0
4,950	5,000	716	596	475	336	211	92	0

"Table II—Head of Household

"Taxable Years Beginning in 1964

If adjusted gross income is—		And the number of exemptions is—			
At least	But less than	1	2	3	4 or more
		The tax is—			
$0	$900	$0	$0	$0	$0
900	925	2	0	0	0
925	950	6	0	0	0
950	975	10	0	0	0
975	1,000	14	0	0	0
1,000	1,025	18	0	0	0
1,025	1,050	22	0	0	0
1,050	1,075	26	0	0	0
1,075	1,100	30	0	0	0
1,100	1,125	34	0	0	0
1,125	1,150	38	0	0	0
1,150	1,175	42	0	0	0
1,175	1,200	46	0	0	0
1,200	1,225	50	0	0	0
1,225	1,250	54	0	0	0
1,250	1,275	58	0	0	0
1,275	1,300	62	0	0	0
1,300	1,325	66	0	0	0
1,325	1,350	70	0	0	0
1,350	1,375	74	0	0	0
1,375	1,400	78	0	0	0
1,400	1,425	82	0	0	0
1,425	1,450	86	0	0	0
1,450	1,475	90	0	0	0
1,475	1,500	94	0	0	0
1,500	1,525	98	0	0	0
1,525	1,550	102	0	0	0
1,550	1,575	106	0	0	0
1,575	1,600	110	0	0	0
1,600	1,625	114	2	0	0
1,625	1,650	118	6	0	0
1,650	1,675	122	10	0	0
1,675	1,700	126	14	0	0
1,700	1,725	130	18	0	0
1,725	1,750	134	22	0	0
1,750	1,775	138	26	0	0
1,775	1,800	142	30	0	0
1,800	1,825	146	34	0	0
1,825	1,850	150	38	0	0
1,850	1,875	154	42	0	0
1,875	1,900	158	46	0	0
1,900	1,925	162	50	0	0
1,925	1,950	167	54	0	0
1,950	1,975	171	58	0	0
1,975	2,000	175	62	0	0
2,000	2,025	180	66	0	0
2,025	2,050	184	70	0	0
2,050	2,075	188	74	0	0
2,075	2,100	193	78	0	0
2,100	2,125	197	82	0	0
2,125	2,150	202	86	0	0
2,150	2,175	206	90	0	0
2,175	2,200	210	94	0	0
2,200	2,225	215	98	0	0
2,225	2,250	219	102	0	0
2,250	2,275	223	106	0	0
2,275	2,300	228	110	0	0
2,300	2,325	232	114	2	0
2,325	2,350	237	118	6	0
2,350	2,375	241	122	10	0
2,375	2,400	245	126	14	0
2,400	2,425	250	130	18	0
2,425	2,450	254	134	22	0

If adjusted gross income is—		And the number of exemptions is—						
At least	But less than	1	2	3	4	5	6	7 or more
		The tax is—						
$2,450	$2,475	$258	$138	$26	$0	$0	$0	$0
2,475	2,500	263	142	30	0	0	0	0
2,500	2,525	267	146	34	0	0	0	0
2,525	2,550	272	150	38	0	0	0	0
2,550	2,575	276	154	42	0	0	0	0
2,575	2,600	280	158	46	0	0	0	0
2,600	2,625	285	162	50	0	0	0	0
2,625	2,650	289	167	54	0	0	0	0
2,650	2,675	293	171	58	0	0	0	0
2,675	2,700	298	175	62	0	0	0	0
2,700	2,725	302	180	66	0	0	0	0
2,725	2,750	307	184	70	0	0	0	0
2,750	2,775	311	188	74	0	0	0	0
2,775	2,800	315	193	78	0	0	0	0
2,800	2,825	320	197	82	0	0	0	0
2,825	2,850	324	202	86	0	0	0	0
2,850	2,875	328	206	90	0	0	0	0
2,875	2,900	333	210	94	0	0	0	0
2,900	2,925	337	215	98	0	0	0	0
2,925	2,950	342	219	102	0	0	0	0
2,950	2,975	347	223	106	0	0	0	0
2,975	3,000	352	228	110	0	0	0	0
3,000	3,050	358	234	116	4	0	0	0
3,050	3,100	367	243	124	12	0	0	0
3,100	3,150	375	252	132	20	0	0	0
3,150	3,200	384	261	140	28	0	0	0
3,200	3,250	392	269	148	36	0	0	0
3,250	3,300	401	278	156	44	0	0	0
3,300	3,350	410	287	164	52	0	0	0
3,350	3,400	418	296	173	60	0	0	0
3,400	3,450	427	304	182	68	0	0	0
3,450	3,500	435	313	191	76	0	0	0
3,500	3,550	444	322	199	84	0	0	0
3,550	3,600	452	331	208	92	0	0	0
3,600	3,650	461	340	217	100	0	0	0
3,650	3,700	469	349	226	108	0	0	0
3,700	3,750	478	359	234	116	4	0	0
3,750	3,800	487	368	243	124	12	0	0
3,800	3,850	495	378	252	132	20	0	0
3,850	3,900	504	387	261	140	28	0	0
3,900	3,950	512	397	269	148	36	0	0
3,950	4,000	521	406	278	156	44	0	0
4,000	4,050	529	415	287	164	52	0	0
4,050	4,100	538	424	296	173	60	0	0
4,100	4,150	546	432	304	182	68	0	0
4,150	4,200	555	441	313	191	76	0	0
4,200	4,250	563	449	322	199	84	0	0
4,250	4,300	572	458	331	208	92	0	0
4,300	4,350	581	467	340	217	100	0	0
4,350	4,400	589	475	349	226	108	0	0
4,400	4,450	598	484	359	234	116	4	0
4,450	4,500	606	492	368	243	124	12	0
4,500	4,550	615	501	378	252	132	20	0
4,550	4,600	623	509	387	261	140	28	0
4,600	4,650	632	518	397	269	148	36	0
4,650	4,700	640	526	406	278	156	44	0
4,700	4,750	649	535	416	287	164	52	0
4,750	4,800	658	544	425	296	173	60	0
4,800	4,850	666	552	435	304	182	68	0
4,850	4,900	675	561	444	313	191	76	0
4,900	4,950	683	569	454	322	199	84	0
4,950	5,000	692	578	463	331	208	92	0

"Table III—Married Persons Filing JOINT Returns

'Taxable Years Beginning in 1964

If adjusted gross income is—		And the number of exemptions is—		
At least	But less than	2	3	4 or more
		The tax is—		
$0	$1,600	$0	$0	$0
1,600	1,625	2	0	0
1,625	1,650	6	0	0
1,650	1,675	10	0	0
1,675	1,700	14	0	0
1,700	1,725	18	0	0
1,725	1,750	22	0	0
1,750	1,775	26	0	0
1,775	1,800	30	0	0
1,800	1,825	34	0	0
1,825	1,850	38	0	0
1,850	1,875	42	0	0
1,875	1,900	46	0	0
1,900	1,925	50	0	0
1,925	1,950	54	0	0
1,950	1,975	58	0	0
1,975	2,000	62	0	0
2,000	2,025	66	0	0
2,025	2,050	70	0	0
2,050	2,075	74	0	0
2,075	2,100	78	0	0
2,100	2,125	82	0	0
2,125	2,150	86	0	0
2,150	2,175	90	0	0
2,175	2,200	94	0	0
2,200	2,225	98	0	0
2,225	2,250	102	0	0
2,250	2,275	106	0	0
2,275	2,300	110	0	0
2,300	2,325	114	2	0
2,325	2,350	118	6	0
2,350	2,375	122	10	0
2,375	2,400	126	14	0
2,400	2,425	130	18	0
2,425	2,450	134	22	0
2,450	2,475	138	26	0
2,475	2,500	142	30	0
2,500	2,525	146	34	0
2,525	2,550	150	38	0
2,550	2,575	154	42	0
2,575	2,600	158	46	0
2,600	2,625	162	50	0
2,625	2,650	166	54	0
2,650	2,675	170	58	0
2,675	2,700	174	62	0
2,700	2,725	179	66	0
2,725	2,750	183	70	0
2,750	2,775	187	74	0
2,775	2,800	191	78	0

If adjusted gross income is—		And the number of exemptions is—					
At least	But less than	2	3	4	5	6	7 or more
		The tax is—					
$2,800	$2,825	$195	$82	$0	$0	$0	$0
2,825	2,850	199	86	0	0	0	0
2,850	2,875	203	90	0	0	0	0
2,875	2,900	207	94	0	0	0	0
2,900	2,925	212	98	0	0	0	0
2,925	2,950	216	102	0	0	0	0
2,950	2,975	220	106	0	0	0	0
2,975	3,000	224	110	0	0	0	0
3,000	3,050	230	116	4	0	0	0
3,050	3,100	238	124	12	0	0	0
3,100	3,150	247	132	20	0	0	0
3,150	3,200	255	140	28	0	0	0
3,200	3,250	263	148	36	0	0	0
3,250	3,300	271	156	44	0	0	0
3,300	3,350	280	164	52	0	0	0
3,350	3,400	288	172	60	0	0	0
3,400	3,450	296	181	68	0	0	0
3,450	3,500	304	189	76	0	0	0
3,500	3,550	313	197	84	0	0	0
3,550	3,600	321	205	92	0	0	0
3,600	3,650	329	214	100	0	0	0
3,650	3,700	338	222	108	0	0	0
3,700	3,750	347	230	116	4	0	0
3,750	3,800	356	238	124	12	0	0
3,800	3,850	364	247	132	20	0	0
3,850	3,900	373	255	140	28	0	0
3,900	3,950	382	263	148	36	0	0
3,950	4,000	391	271	156	44	0	0
4,000	4,050	399	280	164	52	0	0
4,050	4,100	407	288	172	60	0	0
4,100	4,150	415	296	181	68	0	0
4,150	4,200	423	304	189	76	0	0
4,200	4,250	430	313	197	84	0	0
4,250	4,300	438	321	205	92	0	0
4,300	4,350	446	329	214	100	0	0
4,350	4,400	454	338	222	108	0	0
4,400	4,450	462	347	230	116	4	0
4,450	4,500	470	356	238	124	12	0
4,500	4,550	478	364	247	132	20	0
4,550	4,600	486	373	255	140	28	0
4,600	4,650	493	382	263	148	36	0
4,650	4,700	501	391	271	156	44	0
4,700	4,750	509	399	280	164	52	0
4,750	4,800	518	408	288	172	60	0
4,800	4,850	526	417	296	181	68	0
4,850	4,900	534	426	304	189	76	0
4,900	4,950	542	434	313	197	84	0
4,950	5,000	550	443	321	205	92	0

"Table IV—Married Persons Filing SEPARATE Returns

"10 PERCENT STANDARD DEDUCTION

"Taxable Years Beginning in 1964

If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—							
At least	But less than	1	2	3	4 or more	At least	But less than	1	2	3	4	5	6	7	8 or more
		The tax is—						The tax is—							
$0	$675	$0	$0	$0	$0	$2,325	$2,350	$251	$147	$49	$0	$0	$0	$0	$0
675	700	3	0	0	0	2,350	2,375	255	150	52	0	0	0	0	0
700	725	7	0	0	0	2,375	2,400	259	154	56	0	0	0	0	0
725	750	10	0	0	0	2,400	2,425	263	158	59	0	0	0	0	0
750	775	14	0	0	0	2,425	2,450	267	161	63	0	0	0	0	0
775	800	17	0	0	0	2,450	2,475	271	165	67	0	0	0	0	0
800	825	21	0	0	0	2,475	2,500	275	169	70	0	0	0	0	0
825	850	25	0	0	0	2,500	2,525	279	173	74	0	0	0	0	0
850	875	28	0	0	0	2,525	2,550	283	177	77	0	0	0	0	0
875	900	32	0	0	0	2,550	2,575	287	181	81	0	0	0	0	0
900	925	35	0	0	0	2,575	2,600	291	185	85	0	0	0	0	0
925	950	39	0	0	0	2,600	2,625	295	189	88	0	0	0	0	0
950	975	43	0	0	0	2,625	2,650	299	193	92	0	0	0	0	0
975	1,000	46	0	0	0	2,650	2,675	303	197	96	0	0	0	0	0
1,000	1,025	50	0	0	0	2,675	2,700	307	201	100	3	0	0	0	0
1,025	1,050	53	0	0	0	2,700	2,725	311	205	103	7	0	0	0	0
1,050	1,075	57	0	0	0	2,725	2,750	315	209	107	10	0	0	0	0
1,075	1,100	61	0	0	0	2,750	2,775	320	213	111	14	0	0	0	0
1,100	1,125	64	0	0	0	2,775	2,800	324	217	114	17	0	0	0	0
1,125	1,150	68	0	0	0	2,800	2,825	328	220	118	21	0	0	0	0
1,150	1,175	71	0	0	0	2,825	2,850	332	224	122	25	0	0	0	0
1,175	1,200	75	0	0	0	2,850	2,875	336	228	126	28	0	0	0	0
1,200	1,225	79	0	0	0	2,875	2,900	340	232	129	32	0	0	0	0
1,225	1,250	82	0	0	0	2,900	2,925	344	236	133	35	0	0	0	0
1,250	1,275	86	0	0	0	2,925	2,950	349	240	137	39	0	0	0	0
1,275	1,300	90	0	0	0	2,950	2,975	353	244	140	43	0	0	0	0
1,300	1,325	93	0	0	0	2,975	3,000	358	248	144	46	0	0	0	0
1,325	1,350	97	1	0	0	3,000	3,050	365	254	150	52	0	0	0	0
1,350	1,375	101	4	0	0	3,050	3,100	374	262	157	59	0	0	0	0
1,375	1,400	105	8	0	0	3,100	3,150	383	270	165	66	0	0	0	0
1,400	1,425	108	11	0	0	3,150	3,200	392	278	173	73	0	0	0	0
1,425	1,450	112	15	0	0	3,200	3,250	401	286	180	80	0	0	0	0
1,450	1,475	116	19	0	0	3,250	3,300	410	295	188	88	0	0	0	0
1,475	1,500	119	22	0	0	3,300	3,350	419	303	196	95	0	0	0	0
1,500	1,525	123	26	0	0	3,350	3,400	428	311	204	103	6	0	0	0
1,525	1,550	127	29	0	0	3,400	3,450	437	319	212	110	13	0	0	0
1,550	1,575	131	33	0	0	3,450	3,500	446	327	220	118	20	0	0	0
1,575	1,600	134	37	0	0	3,500	3,550	455	335	228	125	28	0	0	0
1,600	1,625	138	40	0	0	3,550	3,600	464	344	236	132	35	0	0	0
1,625	1,650	142	44	0	0	3,600	3,650	473	353	243	140	42	0	0	0
1,650	1,675	145	47	0	0	3,650	3,700	482	362	251	147	49	0	0	0
1,675	1,700	149	51	0	0	3,700	3,750	491	371	259	155	56	0	0	0
1,700	1,725	153	55	0	0	3,750	3,800	500	380	268	162	64	0	0	0
1,725	1,750	157	58	0	0	3,800	3,850	509	389	276	170	71	0	0	0
1,750	1,775	160	62	0	0	3,850	3,900	518	398	284	178	78	0	0	0
1,775	1,800	164	65	0	0	3,900	3,950	527	407	292	186	85	0	0	0
1,800	1,825	168	69	0	0	3,950	4,000	536	416	300	194	93	0	0	0
1,825	1,850	172	73	0	0	4,000	4,050	545	425	308	201	100	4	0	0
1,850	1,875	176	76	0	0	4,050	4,100	554	434	316	209	108	11	0	0
1,875	1,900	180	80	0	0	4,100	4,150	563	443	324	217	115	18	0	0
1,900	1,925	184	84	0	0	4,150	4,200	572	452	332	225	122	25	0	0
1,925	1,950	188	87	0	0	4,200	4,250	581	461	341	233	130	32	0	0
1,950	1,975	192	91	0	0	4,250	4,300	590	470	350	241	137	40	0	0
1,975	2,000	196	95	0	0	4,300	4,350	599	479	359	249	145	47	0	0
2,000	2,025	199	98	2	0	4,350	4,400	608	488	368	257	152	54	0	0
2,025	2,050	203	102	5	0	4,400	4,450	617	497	377	265	160	61	0	0
2,050	2,075	207	106	9	0	4,450	4,500	626	506	386	273	167	68	0	0
2,075	2,100	211	109	13	0	4,500	4,550	635	515	395	281	175	76	0	0
2,100	2,125	215	113	16	0	4,550	4,600	644	524	404	289	183	83	0	0
2,125	2,150	219	117	20	0	4,600	4,650	653	533	413	297	191	90	0	0
2,150	2,175	223	121	23	0	4,650	4,700	662	542	422	305	199	98	1	0
2,175	2,200	227	124	27	0	4,700	4,750	671	551	431	313	207	105	8	0
2,200	2,225	231	128	31	0	4,750	4,800	680	560	440	322	215	113	16	0
2,225	2,250	235	132	34	0	4,800	4,850	689	569	449	330	222	120	23	0
2,250	2,275	239	135	38	0	4,850	4,900	698	578	458	338	230	127	30	0
2,275	2,300	243	139	41	0	4,900	4,950	707	587	467	347	238	135	37	0
2,300	2,325	247	143	45	0	4,950	5,000	716	596	476	356	246	142	44	0

"Table V—Married Persons Filing SEPARATE Returns

"MINIMUM STANDARD DEDUCTION

"Taxable Years Beginning in 1964

If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—							
At least	But less than	1	2	3	4 or more	At least	But less than	1	2	3	4	5	6	7	8 or more
		The tax is—						The tax is—							
$0	$800	$0	$0	$0	$0	$2,400	$2,425	$270	$148	$34	$0	$0	$0	$0	$0
800	825	2	0	0	0	2,425	2,450	275	152	38	0	0	0	0	0
825	850	6	0	0	0	2,450	2,475	279	156	42	0	0	0	0	0
850	875	10	0	0	0	2,475	2,500	284	160	46	0	0	0	0	0
875	900	14	0	0	0	2,500	2,525	288	165	50	0	0	0	0	0
900	925	18	0	0	0	2,525	2,550	293	169	54	0	0	0	0	0
925	950	22	0	0	0	2,550	2,575	297	173	58	0	0	0	0	0
950	975	26	0	0	0	2,575	2,600	302	178	62	0	0	0	0	0
975	1,000	30	0	0	0	2,600	2,625	306	182	66	0	0	0	0	0
1,000	1,025	34	0	0	0	2,625	2,650	311	187	70	0	0	0	0	0
1,025	1,050	38	0	0	0	2,650	2,675	315	191	74	0	0	0	0	0
1,050	1,075	42	0	0	0	2,675	2,700	320	195	78	0	0	0	0	0
1,075	1,100	46	0	0	0	2,700	2,725	324	200	82	0	0	0	0	0
1,100	1,125	50	0	0	0	2,725	2,750	329	204	86	0	0	0	0	0
1,125	1,150	54	0	0	0	2,750	2,775	333	208	90	0	0	0	0	0
1,150	1,175	58	0	0	0	2,775	2,800	338	213	94	0	0	0	0	0
1,175	1,200	62	0	0	0	2,800	2,825	343	217	99	0	0	0	0	0
1,200	1,225	66	0	0	0	2,825	2,850	348	222	103	0	0	0	0	0
1,225	1,250	70	0	0	0	2,850	2,875	353	226	107	0	0	0	0	0
1,250	1,275	74	0	0	0	2,875	2,900	358	230	111	0	0	0	0	0
1,275	1,300	78	0	0	0	2,900	2,925	363	235	115	2	0	0	0	0
1,300	1,325	82	0	0	0	2,925	2,950	368	239	119	6	0	0	0	0
1,325	1,350	86	0	0	0	2,950	2,975	373	243	123	10	0	0	0	0
1,350	1,375	90	0	0	0	2,975	3,000	378	248	127	14	0	0	0	0
1,375	1,400	94	0	0	0	3,000	3,050	385	255	134	20	0	0	0	0
1,400	1,425	99	0	0	0	3,050	3,100	395	264	142	28	0	0	0	0
1,425	1,450	103	0	0	0	3,100	3,150	405	273	150	36	0	0	0	0
1,450	1,475	107	0	0	0	3,150	3,200	415	282	158	44	0	0	0	0
1,475	1,500	111	0	0	0	3,200	3,250	425	291	167	52	0	0	0	0
1,500	1,525	115	2	0	0	3,250	3,300	435	300	176	60	0	0	0	0
1,525	1,550	119	6	0	0	3,300	3,350	445	309	184	68	0	0	0	0
1,550	1,575	123	10	0	0	3,350	3,400	455	318	193	76	0	0	0	0
1,575	1,600	127	14	0	0	3,400	3,450	465	327	202	84	0	0	0	0
1,600	1,625	132	18	0	0	3,450	3,500	475	336	211	92	0	0	0	0
1,625	1,650	136	22	0	0	3,500	3,550	485	345	219	101	4	0	0	0
1,650	1,675	140	26	0	0	3,550	3,600	495	355	228	109	12	0	0	0
1,675	1,700	144	30	0	0	3,600	3,650	505	365	237	117	20	0	0	0
1,700	1,725	148	34	0	0	3,650	3,700	515	375	246	125	28	0	0	0
1,725	1,750	152	38	0	0	3,700	3,750	525	385	255	134	36	0	0	0
1,750	1,775	156	42	0	0	3,750	3,800	535	395	264	142	44	0	0	0
1,775	1,800	160	46	0	0	3,800	3,850	545	405	273	150	52	0	0	0
1,800	1,825	165	50	0	0	3,850	3,900	555	415	282	158	60	0	0	0
1,825	1,850	169	54	0	0	3,900	3,950	565	425	291	167	68	0	0	0
1,850	1,875	173	58	0	0	3,950	4,000	575	435	300	176	76	0	0	0
1,875	1,900	178	62	0	0	4,000	4,050	585	445	309	184	84	0	0	0
1,900	1,925	182	66	0	0	4,050	4,100	595	455	318	193	92	0	0	0
1,925	1,950	187	70	0	0	4,100	4,150	605	465	327	202	101	4	0	0
1,950	1,975	191	74	0	0	4,150	4,200	615	475	336	211	109	12	0	0
1,975	2,000	195	78	0	0	4,200	4,250	625	485	345	219	117	20	0	0
2,000	2,025	200	82	0	0	4,250	4,300	635	495	355	228	125	28	0	0
2,025	2,050	204	86	0	0	4,300	4,350	645	505	365	237	134	36	0	0
2,050	2,075	208	90	0	0	4,350	4,400	655	515	375	246	142	44	0	0
2,075	2,100	213	94	0	0	4,400	4,450	665	525	385	255	150	52	0	0
2,100	2,125	217	99	0	0	4,450	4,500	675	535	395	264	158	60	0	0
2,125	2,150	222	103	0	0	4,500	4,550	685	545	405	273	167	68	0	0
2,150	2,175	226	107	0	0	4,550	4,600	695	555	415	282	176	76	0	0
2,175	2,200	230	111	0	0	4,600	4,650	705	565	425	291	184	84	0	0
2,200	2,225	235	115	2	0	4,650	4,700	715	575	435	300	193	92	0	0
2,225	2,250	239	119	6	0	4,700	4,750	725	585	445	309	202	101	4	0
2,250	2,275	243	123	10	0	4,750	4,800	735	595	455	318	211	109	12	0
2,275	2,300	248	127	14	0	4,800	4,850	746	605	465	327	219	117	20	0
2,300	2,325	252	132	18	0	4,850	4,900	758	615	475	336	228	125	28	0
2,325	2,350	257	136	22	0	4,900	4,950	769	625	485	345	237	134	36	0
2,350	2,375	261	140	26	0	4,950	5,000	781	635	495	355	246	142	44	0
2,375	2,400	266	144	30	0										

"(b) TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1964.—In lieu of the tax imposed by section 1, there is hereby imposed for each taxable year beginning after December 31, 1964, on the taxable income of every individual whose adjusted gross income for such year is less than $5,000 and who has elected for such year to pay the tax imposed by this section a tax as follows:

"Table I—Single Person—NOT Head of Household

"Taxable Years Beginning After December 31, 1964

If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—						
At least	But less than	1	2	3	4 or more	At least	But less than	1	2	3	4	5	6	7 or more
		The tax is—						The tax is—						
$0	$900	$0	$0	$0	$0	$2,450	$2,475	$236	$124	$23	$0	$0	$0	$0
900	925	2	0	0	0	2,475	2,500	240	128	26	0	0	0	0
925	950	5	0	0	0	2,500	2,525	244	132	30	0	0	0	0
950	975	9	0	0	0	2,525	2,550	248	136	33	0	0	0	0
975	1,000	12	0	0	0	2,550	2,575	253	139	37	0	0	0	0
1,000	1,025	16	0	0	0	2,575	2,600	257	143	40	0	0	0	0
1,025	1,050	19	0	0	0	2,600	2,625	261	147	44	0	0	0	0
1,050	1,075	23	0	0	0	2,625	2,650	265	151	47	0	0	0	0
1,075	1,100	26	0	0	0	2,650	2,675	270	155	51	0	0	0	0
1,100	1,125	30	0	0	0	2,675	2,700	274	159	54	0	0	0	0
1,125	1,150	33	0	0	0	2,700	2,725	278	163	58	0	0	0	0
1,150	1,175	37	0	0	0	2,725	2,750	282	167	61	0	0	0	0
1,175	1,200	40	0	0	0	2,750	2,775	287	171	65	0	0	0	0
1,200	1,225	44	0	0	0	2,775	2,800	291	175	68	0	0	0	0
1,225	1,250	47	0	0	0	2,800	2,825	295	179	72	0	0	0	0
1,250	1,275	51	0	0	0	2,825	2,850	299	183	76	0	0	0	0
1,275	1,300	54	0	0	0	2,850	2,875	304	187	79	0	0	0	0
1,300	1,325	58	0	0	0	2,875	2,900	308	191	83	0	0	0	0
1,325	1,350	61	0	0	0	2,900	2,925	312	195	87	0	0	0	0
1,350	1,375	65	0	0	0	2,925	2,950	317	199	91	0	0	0	0
1,375	1,400	68	0	0	0	2,950	2,975	322	203	94	0	0	0	0
1,400	1,425	72	0	0	0	2,975	3,000	327	207	98	0	0	0	0
1,425	1,450	76	0	0	0	3,000	3,050	333	213	104	4	0	0	0
1,450	1,475	79	0	0	0	3,050	3,100	342	221	111	11	0	0	0
1,475	1,500	83	0	0	0	3,100	3,150	350	229	119	18	0	0	0
1,500	1,525	87	0	0	0	3,150	3,200	359	238	126	25	0	0	0
1,525	1,550	91	0	0	0	3,200	3,250	367	246	134	32	0	0	0
1,550	1,575	94	0	0	0	3,250	3,300	376	255	141	39	0	0	0
1,575	1,600	98	0	0	0	3,300	3,350	385	263	149	46	0	0	0
1,600	1,625	102	2	0	0	3,350	3,400	393	272	157	53	0	0	0
1,625	1,650	106	5	0	0	3,400	3,450	402	280	165	60	0	0	0
1,650	1,675	109	9	0	0	3,450	3,500	410	289	173	67	0	0	0
1,675	1,700	113	12	0	0	3,500	3,550	419	297	181	74	0	0	0
1,700	1,725	117	16	0	0	3,550	3,600	427	306	189	81	0	0	0
1,725	1,750	121	19	0	0	3,600	3,650	436	315	197	89	0	0	0
1,750	1,775	124	23	0	0	3,650	3,700	444	324	205	96	0	0	0
1,775	1,800	128	26	0	0	3,700	3,750	453	334	213	104	4	0	0
1,800	1,825	132	30	0	0	3,750	3,800	462	343	221	111	11	0	0
1,825	1,850	136	33	0	0	3,800	3,850	470	353	229	119	18	0	0
1,850	1,875	139	37	0	0	3,850	3,900	479	362	238	126	25	0	0
1,875	1,900	143	40	0	0	3,900	3,950	487	372	246	134	32	0	0
1,900	1,925	147	44	0	0	3,950	4,000	496	381	255	141	39	0	0
1,925	1,950	151	47	0	0	4,000	4,050	504	390	263	149	46	0	0
1,950	1,975	155	51	0	0	4,050	4,100	513	399	272	157	53	0	0
1,975	2,000	159	54	0	0	4,100	4,150	521	407	280	165	60	0	0
2,000	2,025	163	58	0	0	4,150	4,200	530	416	289	173	67	0	0
2,025	2,050	167	61	0	0	4,200	4,250	538	424	297	181	74	0	0
2,050	2,075	171	65	0	0	4,250	4,300	547	433	306	189	81	0	0
2,075	2,100	175	68	0	0	4,300	4,350	556	442	315	197	89	0	0
2,100	2,125	179	72	0	0	4,350	4,400	564	450	324	205	96	0	0
2,125	2,150	183	76	0	0	4,400	4,450	573	459	334	213	104	4	0
2,150	2,175	187	79	0	0	4,450	4,500	581	467	343	221	111	11	0
2,175	2,200	191	83	0	0	4,500	4,550	590	476	353	229	119	18	0
2,200	2,225	195	87	0	0	4,550	4,600	598	484	362	238	126	25	0
2,225	2,250	199	91	0	0	4,600	4,650	607	493	372	246	134	32	0
2,250	2,275	203	94	0	0	4,650	4,700	615	501	381	255	141	39	0
2,275	2,300	207	98	0	0	4,700	4,750	624	510	391	263	149	46	0
2,300	2,325	211	102	2	0	4,750	4,800	633	519	400	272	157	53	0
2,325	2,350	215	106	5	0	4,800	4,850	641	527	410	280	165	60	0
2,350	2,375	219	109	9	0	4,850	4,900	650	536	419	289	173	67	0
2,375	2,400	223	113	12	0	4,900	4,950	658	544	429	297	181	74	0
2,400	2,425	227	117	16	0	4,950	5,000	667	553	438	306	189	81	0
2,425	2,450	231	121	19	0									

"Table II—Head of Household

"Taxable Years Beginning After December 31, 1964

If adjusted gross income is—		And the number of exemptions is—			
At least	But less than	1	2	3	4 or more
		The tax is—			
$0	$900	$0	$0	$0	$0
900	925	2	0	0	0
925	950	5	0	0	0
950	975	9	0	0	0
975	1,000	12	0	0	0
1,000	1,025	16	0	0	0
1,025	1,050	19	0	0	0
1,050	1,075	23	0	0	0
1,075	1,100	26	0	0	0
1,100	1,125	30	0	0	0
1,125	1,150	33	0	0	0
1,150	1,175	37	0	0	0
1,175	1,200	40	0	0	0
1,200	1,225	44	0	0	0
1,225	1,250	47	0	0	0
1,250	1,275	51	0	0	0
1,275	1,300	54	0	0	0
1,300	1,325	58	0	0	0
1,325	1,350	61	0	0	0
1,350	1,375	65	0	0	0
1,375	1,400	68	0	0	0
1,400	1,425	72	0	0	0
1,425	1,450	75	0	0	0
1,450	1,475	79	0	0	0
1,475	1,500	82	0	0	0
1,500	1,525	86	0	0	0
1,525	1,550	89	0	0	0
1,550	1,575	93	0	0	0
1,575	1,600	96	0	0	0
1,600	1,625	100	2	0	0
1,625	1,650	103	5	0	0
1,650	1,675	107	9	0	0
1,675	1,700	110	12	0	0
1,700	1,725	114	16	0	0
1,725	1,750	117	19	0	0
1,750	1,775	121	23	0	0
1,775	1,800	124	26	0	0
1,800	1,825	128	30	0	0
1,825	1,850	131	33	0	0
1,850	1,875	135	37	0	0
1,875	1,900	138	40	0	0
1,900	1,925	142	44	0	0
1,925	1,950	146	47	0	0
1,950	1,975	150	51	0	0
1,975	2,000	154	54	0	0
2,000	2,025	158	58	0	0
2,025	2,050	162	61	0	0
2,050	2,075	166	65	0	0
2,075	2,100	170	68	0	0
2,100	2,125	174	72	0	0
2,125	2,150	178	75	0	0
2,150	2,175	182	79	0	0
2,175	2,200	186	82	0	0
2,200	2,225	190	86	0	0
2,225	2,250	194	89	0	0
2,250	2,275	198	93	0	0
2,275	2,300	202	96	0	0
2,300	2,325	206	100	2	0
2,325	2,350	210	103	5	0
2,350	2,375	214	107	9	0
2,375	2,400	218	110	12	0
2,400	2,425	222	114	16	0
2,425	2,450	226	117	19	0

If adjusted gross income is—		And the number of exemptions is—						
At least	But less than	1	2	3	4	5	6	7 or more
		The tax is—						
$2,450	$2,475	$230	$121	$23	$0	$0	$0	$0
2,475	2,500	234	124	26	0	0	0	0
2,500	2,525	238	128	30	0	0	0	0
2,525	2,550	242	131	33	0	0	0	0
2,550	2,575	246	135	37	0	0	0	0
2,575	2,600	250	138	40	0	0	0	0
2,600	2,625	254	142	44	0	0	0	0
2,625	2,650	258	146	47	0	0	0	0
2,650	2,675	262	150	51	0	0	0	0
2,675	2,700	266	154	54	0	0	0	0
2,700	2,725	270	158	58	0	0	0	0
2,725	2,750	274	162	61	0	0	0	0
2,750	2,775	278	166	65	0	0	0	0
2,775	2,800	282	170	68	0	0	0	0
2,800	2,825	286	174	72	0	0	0	0
2,825	2,850	290	178	75	0	0	0	0
2,850	2,875	294	182	79	0	0	0	0
2,875	2,900	298	186	82	0	0	0	0
2,900	2,925	302	190	86	0	0	0	0
2,925	2,950	307	194	89	0	0	0	0
2,950	2,975	311	198	93	0	0	0	0
2,975	3,000	316	202	96	0	0	0	0
3,000	3,050	322	208	102	4	0	0	0
3,050	3,100	330	216	109	11	0	0	0
3,100	3,150	338	224	116	18	0	0	0
3,150	3,200	346	232	123	25	0	0	0
3,200	3,250	354	240	130	32	0	0	0
3,250	3,300	363	248	137	39	0	0	0
3,300	3,350	371	256	144	46	0	0	0
3,350	3,400	379	264	152	53	0	0	0
3,400	3,450	387	272	160	60	0	0	0
3,450	3,500	395	280	168	67	0	0	0
3,500	3,550	403	288	176	74	0	0	0
3,550	3,600	411	296	184	81	0	0	0
3,600	3,650	419	305	192	88	0	0	0
3,650	3,700	427	314	200	95	0	0	0
3,700	3,750	435	323	208	102	4	0	0
3,750	3,800	444	332	216	109	11	0	0
3,800	3,850	452	341	224	116	18	0	0
3,850	3,900	460	350	232	123	25	0	0
3,900	3,950	468	359	240	130	32	0	0
3,950	4,000	476	368	248	137	39	0	0
4,000	4,050	484	376	256	144	46	0	0
4,050	4,100	492	384	264	152	53	0	0
4,100	4,150	500	393	272	160	60	0	0
4,150	4,200	508	400	280	168	67	0	0
4,200	4,250	516	408	288	176	74	0	0
4,250	4,300	525	417	296	184	81	0	0
4,300	4,350	533	425	305	192	88	0	0
4,350	4,400	541	433	314	200	95	0	0
4,400	4,450	549	441	323	208	102	4	0
4,450	4,500	557	449	332	216	109	11	0
4,500	4,550	565	457	341	224	116	18	0
4,550	4,600	573	465	350	232	123	25	0
4,600	4,650	581	473	359	240	130	32	0
4,650	4,700	589	481	368	248	137	39	0
4,700	4,750	597	489	377	256	144	46	0
4,750	4,800	606	498	386	264	152	53	0
4,800	4,850	614	506	395	272	160	60	0
4,850	4,900	622	514	404	280	168	67	0
4,900	4,950	630	522	413	288	176	74	0
4,950	5,000	638	530	422	296	184	81	0

"Table III—Married Persons Filing JOINT Returns

"Taxable Years Beginning After December 31, 1964

If adjusted gross income is—		And the number of exemptions is—			If adjusted gross income is—		And the number of exemptions is—					
At least	But less than	2	3	4 or more	At least	But less than	2	3	4	5	6	7 or more
		The tax is—					The tax is—					
$0	$1,600	$0	$0	$0	$2,800	$2,825	$172	$72	$0	$0	$0	$0
1,600	1,625	2	0	0	2,825	2,850	176	75	0	0	0	0
1,625	1,650	5	0	0	2,850	2,875	179	79	0	0	0	0
1,650	1,675	9	0	0	2,875	2,900	183	82	0	0	0	0
1,675	1,700	12	0	0	2,900	2,925	187	86	0	0	0	0
1,700	1,725	16	0	0	2,925	2,950	191	89	0	0	0	0
1,725	1,750	19	0	0	2,950	2,975	194	93	0	0	0	0
1,750	1,775	23	0	0	2,975	3,000	198	96	0	0	0	0
1,775	1,800	26	0	0	3,000	3,050	204	102	4	0	0	0
1,800	1,825	30	0	0	3,050	3,100	211	109	11	0	0	0
1,825	1,850	33	0	0	3,100	3,150	219	116	18	0	0	0
1,850	1,875	37	0	0	3,150	3,200	226	123	25	0	0	0
1,875	1,900	40	0	0	3,200	3,250	234	130	32	0	0	0
1,900	1,925	44	0	0	3,250	3,300	241	137	39	0	0	0
1,925	1,950	47	0	0	3,300	3,350	249	144	46	0	0	0
1,950	1,975	51	0	0	3,350	3,400	256	151	53	0	0	0
1,975	2,000	54	0	0	3,400	3,450	264	159	60	0	0	0
2,000	2,025	58	0	0	3,450	3,500	271	166	67	0	0	0
2,025	2,050	61	0	0	3,500	3,550	279	174	74	0	0	0
2,050	2,075	65	0	0	3,550	3,600	286	181	81	0	0	0
2,075	2,100	68	0	0	3,600	3,650	294	189	88	0	0	0
2,100	2,125	72	0	0	3,650	3,700	302	196	95	0	0	0
2,125	2,150	75	0	0	3,700	3,750	310	204	102	4	0	0
2,150	2,175	79	0	0	3,750	3,800	318	211	109	11	0	0
2,175	2,200	82	0	0	3,800	3,850	326	219	116	18	0	0
2,200	2,225	86	0	0	3,850	3,900	334	226	123	25	0	0
2,225	2,250	89	0	0	3,900	3,950	342	234	130	32	0	0
2,250	2,275	93	0	0	3,950	4,000	350	241	137	39	0	0
2,275	2,300	96	0	0	4,000	4,050	358	249	144	46	0	0
2,300	2,325	100	2	0	4,050	4,100	365	256	151	53	0	0
2,325	2,350	103	5	0	4,100	4,150	372	264	159	60	0	0
2,350	2,375	107	9	0	4,150	4,200	379	271	166	67	0	0
2,375	2,400	110	12	0	4,200	4,250	386	279	174	74	0	0
2,400	2,425	114	16	0	4,250	4,300	394	286	181	81	0	0
2,425	2,450	117	19	0	4,300	4,350	401	294	189	88	0	0
2,450	2,475	121	23	0	4,350	4,400	408	302	196	95	0	0
2,475	2,500	124	26	0	4,400	4,450	415	310	204	102	4	0
2,500	2,525	128	30	0	4,450	4,500	422	318	211	109	11	0
2,525	2,550	131	33	0	4,500	4,550	430	326	219	116	18	0
2,550	2,575	135	37	0	4,550	4,600	437	334	226	123	25	0
2,575	2,600	138	40	0	4,600	4,650	444	342	234	130	32	0
2,600	2,625	142	44	0	4,650	4,700	451	350	241	137	39	0
2,625	2,650	146	47	0	4,700	4,750	459	358	249	144	46	0
2,650	2,675	149	51	0	4,750	4,800	467	366	256	151	53	0
2,675	2,700	153	54	0	4,800	4,850	474	374	264	159	60	0
2,700	2,725	157	58	0	4,850	4,900	482	382	271	166	67	0
2,725	2,750	161	61	0	4,900	4,950	490	390	279	174	74	0
2,750	2,775	164	65	0	4,950	5,000	497	398	286	181	81	0
2,775	2,800	168	68	0								

"Table IV—Married Persons Filing SEPARATE Returns

"10 PERCENT STANDARD DEDUCTION

"Taxable Years Beginning After December 31, 1964

If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—							
At least	But less than	1	2	3	4 or more	At least	But less than	1	2	3	4	5	6	7	8 or more
		The tax is—						The tax is—							
$0	$675	$0	$0	$0	$0	$2,325	$2,350	$226	$131	$43	$0	$0	$0	$0	$0
675	700	3	0	0	0	2,350	2,375	229	134	46	0	0	0	0	0
700	725	6	0	0	0	2,375	2,400	233	137	49	0	0	0	0	0
725	750	9	0	0	0	2,400	2,425	237	141	52	0	0	0	0	0
750	775	12	0	0	0	2,425	2,450	241	144	55	0	0	0	0	0
775	800	15	0	0	0	2,450	2,475	245	148	58	0	0	0	0	0
800	825	18	0	0	0	2,475	2,500	249	151	61	0	0	0	0	0
825	850	22	0	0	0	2,500	2,525	252	155	65	0	0	0	0	0
850	875	25	0	0	0	2,525	2,550	256	158	68	0	0	0	0	0
875	900	28	0	0	0	2,550	2,575	260	162	71	0	0	0	0	0
900	925	31	0	0	0	2,575	2,600	264	166	74	0	0	0	0	0
925	950	34	0	0	0	2,600	2,625	268	169	78	0	0	0	0	0
950	975	37	0	0	0	2,625	2,650	272	173	81	0	0	0	0	0
975	1,000	40	0	0	0	2,650	2,675	275	176	84	0	0	0	0	0
1,000	1,025	44	0	0	0	2,675	2,700	279	180	88	3	0	0	0	0
1,025	1,050	47	0	0	0	2,700	2,725	283	184	91	0	0	0	0	0
1,050	1,075	50	0	0	0	2,725	2,750	287	187	95	9	0	0	0	0
1,075	1,100	53	0	0	0	2,750	2,775	291	191	98	12	0	0	0	0
1,100	1,125	56	0	0	0	2,775	2,800	294	194	101	15	0	0	0	0
1,125	1,150	59	0	0	0	2,800	2,825	298	198	105	18	0	0	0	0
1,150	1,175	62	0	0	0	2,825	2,850	302	202	108	22	0	0	0	0
1,175	1,200	66	0	0	0	2,850	2,875	306	205	111	25	0	0	0	0
1,200	1,225	69	0	0	0	2,875	2,900	310	209	115	28	0	0	0	0
1,225	1,250	72	0	0	0	2,900	2,925	314	212	118	31	0	0	0	0
1,250	1,275	75	0	0	0	2,925	2,950	318	216	122	34	0	0	0	0
1,275	1,300	79	0	0	0	2,950	2,975	323	220	125	37	0	0	0	0
1,300	1,325	82	0	0	0	2,975	3,000	327	223	128	40	0	0	0	0
1,325	1,350	86	1	0	0	3,000	3,050	333	229	133	45	0	0	0	0
1,350	1,375	89	4	0	0	3,050	3,100	342	236	140	51	0	0	0	0
1,375	1,400	92	7	0	0	3,100	3,150	350	244	147	58	0	0	0	0
1,400	1,425	96	10	0	0	3,150	3,200	359	252	154	64	0	0	0	0
1,425	1,450	99	13	0	0	3,200	3,250	367	259	161	70	0	0	0	0
1,450	1,475	102	16	0	0	3,250	3,300	376	267	169	77	0	0	0	0
1,475	1,500	106	19	0	0	3,300	3,350	385	275	176	84	0	0	0	0
1,500	1,525	109	23	0	0	3,350	3,400	393	282	183	91	5	0	0	0
1,525	1,550	113	26	0	0	3,400	3,450	402	290	190	97	12	0	0	0
1,550	1,575	116	29	0	0	3,450	3,500	410	298	197	104	18	0	0	0
1,575	1,600	119	32	0	0	3,500	3,550	419	305	205	111	24	0	0	0
1,600	1,625	123	35	0	0	3,550	3,600	427	313	212	118	30	0	0	0
1,625	1,650	126	38	0	0	3,600	3,650	436	322	219	124	37	0	0	0
1,650	1,675	129	41	0	0	3,650	3,700	444	330	226	131	43	0	0	0
1,675	1,700	133	45	0	0	3,700	3,750	453	339	234	138	49	0	0	0
1,700	1,725	136	48	0	0	3,750	3,800	462	348	242	145	56	0	0	0
1,725	1,750	140	51	0	0	3,800	3,850	470	356	249	152	62	0	0	0
1,750	1,775	143	54	0	0	3,850	3,900	479	365	257	159	68	0	0	0
1,775	1,800	146	57	0	0	3,900	3,950	487	373	265	166	75	0	0	0
1,800	1,825	150	60	0	0	3,950	4,000	496	382	272	173	82	0	0	0
1,825	1,850	154	64	0	0	4,000	4,050	504	390	280	181	88	3	0	0
1,850	1,875	157	67	0	0	4,050	4,100	513	399	287	188	95	9	0	0
1,875	1,900	161	70	0	0	4,100	4,150	521	407	295	195	102	16	0	0
1,900	1,925	164	73	0	0	4,150	4,200	530	416	303	202	109	22	0	0
1,925	1,950	168	77	0	0	4,200	4,250	538	424	310	209	115	28	0	0
1,950	1,975	172	80	0	0	4,250	4,300	547	433	319	217	122	35	0	0
1,975	2,000	175	83	0	0	4,300	4,350	556	442	328	224	129	41	0	0
2,000	2,025	179	87	2	0	4,350	4,400	564	450	336	231	136	47	0	0
2,025	2,050	182	90	5	0	4,400	4,450	573	459	345	239	142	54	0	0
2,050	2,075	186	93	8	0	4,450	4,500	581	467	353	247	149	60	0	0
2,075	2,100	190	97	11	0	4,500	4,550	590	476	362	254	157	66	0	0
2,100	2,125	193	100	14	0	4,550	4,600	598	484	370	262	164	73	0	0
2,125	2,150	197	104	17	0	4,600	4,650	607	493	379	270	171	79	0	0
2,150	2,175	200	107	20	0	4,650	4,700	615	501	387	277	178	86	1	0
2,175	2,200	204	110	24	0	4,700	4,750	624	510	396	285	185	93	7	0
2,200	2,225	208	114	27	0	4,750	4,800	633	519	405	293	193	100	14	0
2,225	2,250	211	117	30	0	4,800	4,850	641	527	413	300	200	106	20	0
2,250	2,275	215	120	33	0	4,850	4,900	650	536	422	308	207	113	26	0
2,275	2,300	218	124	36	0	4,900	4,950	658	544	430	316	214	120	33	0
2,300	2,325	222	127	39	0	4,950	5,000	667	553	439	325	221	127	39	0

"Table V—Married Persons Filing SEPARATE Returns

"MINIMUM STANDARD DEDUCTION

"Taxable Years Beginning After December 31, 1964

If adjusted gross income is—		And the number of exemptions is—				If adjusted gross income is—		And the number of exemptions is—							
At least	But less than	1	2	3	4 or more	At least	But less than	1	2	3	4	5	6	7	8 or more
		The tax is—						The tax is—							
$0	$800	$0	$0	$0	$0	$2,400	$2,425	$244	$132	$30	$0	$0	$0	$0	$0
800	825	2	0	0	0	2,425	2,450	248	136	33	0	0	0	0	0
825	850	5	0	0	0	2,450	2,475	253	139	37	0	0	0	0	0
850	875	9	0	0	0	2,475	2,500	257	143	40	0	0	0	0	0
875	900	12	0	0	0	2,500	2,525	261	147	44	0	0	0	0	0
900	925	16	0	0	0	2,525	2,550	265	151	47	0	0	0	0	0
925	950	19	0	0	0	2,550	2,575	270	155	51	0	0	0	0	0
950	975	23	0	0	0	2,575	2,600	274	159	54	0	0	0	0	0
975	1,000	26	0	0	0	2,600	2,625	278	163	58	0	0	0	0	0
1,000	1,025	30	0	0	0	2,625	2,650	282	167	61	0	0	0	0	0
1,025	1,050	33	0	0	0	2,650	2,675	287	171	65	0	0	0	0	0
1,050	1,075	37	0	0	0	2,675	2,700	291	175	68	0	0	0	0	0
1,075	1,100	40	0	0	0	2,700	2,725	295	179	72	0	0	0	0	0
1,100	1,125	44	0	0	0	2,725	2,750	299	183	76	0	0	0	0	0
1,125	1,150	47	0	0	0	2,750	2,775	304	187	79	0	0	0	0	0
1,150	1,175	51	0	0	0	2,775	2,800	308	191	83	0	0	0	0	0
1,175	1,200	54	0	0	0	2,800	2,825	312	195	87	0	0	0	0	0
1,200	1,225	58	0	0	0	2,825	2,850	317	199	91	0	0	0	0	0
1,225	1,250	61	0	0	0	2,850	2,875	322	203	94	0	0	0	0	0
1,250	1,275	65	0	0	0	2,875	2,900	327	207	98	0	0	0	0	0
1,275	1,300	68	0	0	0	2,900	2,925	331	211	102	2	0	0	0	0
1,300	1,325	72	0	0	0	2,925	2,950	336	215	106	5	0	0	0	0
1,325	1,350	76	0	0	0	2,950	2,975	341	219	109	9	0	0	0	0
1,350	1,375	79	0	0	0	2,975	3,000	346	223	113	12	0	0	0	0
1,375	1,400	83	0	0	0	3,000	3,050	353	229	119	18	0	0	0	0
1,400	1,425	87	0	0	0	3,050	3,100	362	238	126	25	0	0	0	0
1,425	1,450	91	0	0	0	3,100	3,150	372	246	134	32	0	0	0	0
1,450	1,475	94	0	0	0	3,150	3,200	381	255	141	39	0	0	0	0
1,475	1,500	98	0	0	0	3,200	3,250	391	263	149	46	0	0	0	0
1,500	1,525	102	2	0	0	3,250	3,300	400	272	157	53	0	0	0	0
1,525	1,550	106	5	0	0	3,300	3,350	410	280	165	60	0	0	0	0
1,550	1,575	109	9	0	0	3,350	3,400	419	289	173	67	0	0	0	0
1,575	1,600	113	12	0	0	3,400	3,450	429	297	181	74	0	0	0	0
1,600	1,625	117	16	0	0	3,450	3,500	438	306	189	81	0	0	0	0
1,625	1,650	121	19	0	0	3,500	3,550	448	315	197	89	4	0	0	0
1,650	1,675	124	23	0	0	3,550	3,600	457	324	205	96	11	0	0	0
1,675	1,700	128	26	0	0	3,600	3,650	467	334	213	104	18	0	0	0
1,700	1,725	132	30	0	0	3,650	3,700	476	343	221	111	25	0	0	0
1,725	1,750	136	33	0	0	3,700	3,750	486	353	229	119	32	0	0	0
1,750	1,775	139	37	0	0	3,750	3,800	495	362	238	126	39	0	0	0
1,775	1,800	143	40	0	0	3,800	3,850	505	372	246	134	46	0	0	0
1,800	1,825	147	44	0	0	3,850	3,900	514	381	255	141	53	0	0	0
1,825	1,850	151	47	0	0	3,900	3,950	524	391	263	149	60	0	0	0
1,850	1,875	155	51	0	0	3,950	4,000	533	400	272	157	67	0	0	0
1,875	1,900	159	54	0	0	4,000	4,050	543	410	280	165	74	0	0	0
1,900	1,925	163	58	0	0	4,050	4,100	552	419	289	173	81	0	0	0
1,925	1,950	167	61	0	0	4,100	4,150	562	429	297	181	89	4	0	0
1,950	1,975	171	65	0	0	4,150	4,200	571	438	306	189	96	11	0	0
1,975	2,000	175	68	0	0	4,200	4,250	581	448	315	197	104	18	0	0
2,000	2,025	179	72	0	0	4,250	4,300	590	457	324	205	111	25	0	0
2,025	2,050	183	76	0	0	4,300	4,350	600	467	334	213	119	32	0	0
2,050	2,075	187	79	0	0	4,350	4,400	609	476	343	221	126	39	0	0
2,075	2,100	191	83	0	0	4,400	4,450	619	486	353	229	134	46	0	0
2,100	2,125	195	87	0	0	4,450	4,500	628	495	362	238	141	53	0	0
2,125	2,150	199	91	0	0	4,500	4,550	638	505	372	246	149	60	0	0
2,150	2,175	203	94	0	0	4,550	4,600	647	514	381	255	157	67	0	0
2,175	2,200	207	98	0	0	4,600	4,650	657	524	391	263	165	74	0	0
2,200	2,225	211	102	2	0	4,650	4,700	666	533	400	272	173	81	0	0
2,225	2,250	215	106	5	0	4,700	4,750	676	543	410	280	181	89	4	0
2,250	2,275	219	109	9	0	4,750	4,800	685	552	419	289	189	96	11	0
2,275	2,300	223	113	12	0	4,800	4,850	696	562	429	297	197	104	18	0
2,300	2,325	227	117	16	0	4,850	4,900	707	571	438	306	205	111	25	0
2,325	2,350	231	121	19	0	4,900	4,950	718	581	448	315	213	119	32	0
2,350	2,375	236	124	23	0	4,950	5,000	729	590	457	324	221	126	39	0"
2,375	2,400	240	128	26	0										

(b) RULES FOR OPTIONAL TAX.—

26 USC 4. (1) HUSBAND OR WIFE FILING SEPARATE RETURNS.—Subsection (c) of section 4 (relating to rules for optional tax) is amended to read as follows:

"(c) HUSBAND OR WIFE FILING SEPARATE RETURN.—

Ante, p. 129. "(1) A husband or wife may not elect to pay the optional tax imposed by section 3 if the tax of the other spouse is determined under section 1 on the basis of taxable income computed without regard to the standard deduction.

"(2) Except as otherwise provided in this subsection, in the case of a husband or wife filing a separate return the tax imposed by section 3 shall be—

"(A) for taxable years beginning in 1964, the lesser of the tax shown in Table IV or Table V of section 3(a), and

"(B) for taxable years beginning after December 31, 1964, the lesser of the tax shown in Table IV or Table V of section 3(b).

Ante, p. 23. "(3) Neither Table V of section 3(a) nor Table V of section 3(b) shall apply in the case of a husband or wife filing a separate return if the tax of the other spouse is determined with regard to the 10-percent standard deduction; except that an individual described in section 141(d)(2) may elect (under regulations prescribed by the Secretary or his delegate)—

"(A) to pay the tax shown in Table V of section 3(a) in lieu of the tax shown in Table IV of section 3(a), and

"(B) to pay the tax shown in Table V of section 3(b) in lieu of the tax shown in Table IV of section 3(b).

For purposes of this title, an election under the preceding sentence shall be treated as an election made under section 141(d)(2).

26 USC 143. "(4) For purposes of this subsection, determination of marital status shall be made under section 143."

26 USC 6014. (2) AMENDMENT OF SECTION 6014.—Section 6014(a) (relating to income tax return—tax not computed by taxpayer) is amended by adding at the end thereof the following new sentence: "In the case of a married individual filing a separate return and electing the benefits of this subsection, neither Table V in section 3(a) nor Table V in section 3(b) shall apply."

(3) TECHNICAL AMENDMENTS.—

(A) Subsection (a) of section 4 (relating to rules for optional tax) is amended by striking out "table" and inserting in lieu thereof "tables".

(B) Section 4(f) (relating to cross references) is amended by adding at the end thereof the following new paragraph:

"(4) For nonapplicability of Table V in section 3(a) and Table V in section 3(b) in case where tax is not computed by taxpayer, see section 6014(a)."

26 USC 21. (c) EFFECTIVE DATE.—Except for purposes of section 21 of the Internal Revenue Code of 1954 (relating to effect of changes in rates during a taxable year), the amendments made by this section shall apply to taxable years beginning after December 31, 1963.

SEC. 302. INCOME TAX COLLECTED AT SOURCE.

26 USC 3402. (a) PERCENTAGE METHOD OF WITHHOLDING.—Subsection (a) of section 3402 (relating to requirement of withholding) is amended by striking out "18 percent" and inserting in lieu thereof "14 percent".

(b) WAGE BRACKET WITHHOLDING.—Paragraph (1) of section 3402(c) (relating to wage bracket withholding) is amended to read as follows:

"(1) At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee a tax determined in accordance with the following tables, which shall be in lieu of the tax required to be deducted and withheld under subsection (a):

"If the payroll period with respect to an employee is weekly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$13	14% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$13	$14	$1.90	.10	0	0	0	0	0	0	0	0	0
$14	$15	2.00	.20	0	0	0	0	0	0	0	0	0
$15	$16	2.20	.40	0	0	0	0	0	0	0	0	0
$16	$17	2.30	.50	0	0	0	0	0	0	0	0	0
$17	$18	2.50	.70	0	0	0	0	0	0	0	0	0
$18	$19	2.60	.80	0	0	0	0	0	0	0	0	0
$19	$20	2.70	.90	0	0	0	0	0	0	0	0	0
$20	$21	2.90	1.10	0	0	0	0	0	0	0	0	0
$21	$22	3.00	1.20	0	0	0	0	0	0	0	0	0
$22	$23	3.20	1.40	0	0	0	0	0	0	0	0	0
$23	$24	3.30	1.50	0	0	0	0	0	0	0	0	0
$24	$25	3.40	1.60	0	0	0	0	0	0	0	0	0
$25	$26	3.60	1.80	0	0	0	0	0	0	0	0	0
$26	$27	3.70	1.90	.10	0	0	0	0	0	0	0	0
$27	$28	3.90	2.10	.30	0	0	0	0	0	0	0	0
$28	$29	4.00	2.20	.40	0	0	0	0	0	0	0	0
$29	$30	4.10	2.30	.50	0	0	0	0	0	0	0	0
$30	$31	4.30	2.50	.70	0	0	0	0	0	0	0	0
$31	$32	4.40	2.60	.80	0	0	0	0	0	0	0	0
$32	$33	4.60	2.80	1.00	0	0	0	0	0	0	0	0
$33	$34	4.70	2.90	1.10	0	0	0	0	0	0	0	0
$34	$35	4.80	3.00	1.20	0	0	0	0	0	0	0	0
$35	$36	5.00	3.20	1.40	0	0	0	0	0	0	0	0
$36	$37	5.10	3.30	1.50	0	0	0	0	0	0	0	0
$37	$38	5.30	3.50	1.70	0	0	0	0	0	0	0	0
$38	$39	5.40	3.60	1.80	0	0	0	0	0	0	0	0
$39	$40	5.50	3.70	1.90	.10	0	0	0	0	0	0	0
$40	$41	5.70	3.90	2.10	.30	0	0	0	0	0	0	0
$41	$42	5.80	4.00	2.20	.40	0	0	0	0	0	0	0
$42	$43	6.00	4.20	2.40	.60	0	0	0	0	0	0	0
$43	$44	6.10	4.30	2.50	.70	0	0	0	0	0	0	0
$44	$45	6.20	4.40	2.60	.80	0	0	0	0	0	0	0
$45	$46	6.40	4.60	2.80	1.00	0	0	0	0	0	0	0
$46	$47	6.50	4.70	2.90	1.10	0	0	0	0	0	0	0
$47	$48	6.70	4.90	3.10	1.30	0	0	0	0	0	0	0
$48	$49	6.80	5.00	3.20	1.40	0	0	0	0	0	0	0
$49	$50	6.90	5.10	3.30	1.50	0	0	0	0	0	0	0
$50	$51	7.10	5.30	3.50	1.70	0	0	0	0	0	0	0
$51	$52	7.20	5.40	3.60	1.80	0	0	0	0	0	0	0
$52	$53	7.40	5.60	3.80	2.00	.20	0	0	0	0	0	0
$53	$54	7.50	5.70	3.90	2.10	.30	0	0	0	0	0	0
$54	$55	7.60	5.80	4.00	2.20	.50	0	0	0	0	0	0
$55	$56	7.80	6.00	4.20	2.40	.60	0	0	0	0	0	0
$56	$57	7.90	6.10	4.30	2.50	.70	0	0	0	0	0	0
$57	$58	8.10	6.30	4.50	2.70	.90	0	0	0	0	0	0
$58	$59	8.20	6.40	4.60	2.80	1.00	0	0	0	0	0	0
$59	$60	8.30	6.50	4.70	2.90	1.20	0	0	0	0	0	0
$60	$62	8.50	6.70	5.00	3.20	1.40	0	0	0	0	0	0
$62	$64	8.80	7.00	5.20	3.40	1.60	0	0	0	0	0	0
$64	$66	9.10	7.30	5.50	3.70	1.90	.10	0	0	0	0	0
$66	$68	9.40	7.60	5.80	4.00	2.20	.40	0	0	0	0	0
$68	$70	9.70	7.90	6.10	4.30	2.50	.70	0	0	0	0	0
$70	$72	9.90	8.10	6.40	4.60	2.80	1.00	0	0	0	0	0
$72	$74	10.20	8.40	6.60	4.80	3.00	1.20	0	0	0	0	0
$74	$76	10.50	8.70	6.90	5.10	3.30	1.50	0	0	0	0	0
$76	$78	10.80	9.00	7.20	5.40	3.60	1.80	0	0	0	0	0
$78	$80	11.10	9.30	7.50	5.70	3.90	2.10	.30	0	0	0	0
$80	$82	11.30	9.50	7.80	6.00	4.20	2.40	.60	0	0	0	0
$82	$84	11.60	9.80	8.00	6.20	4.40	2.60	.90	0	0	0	0
$84	$86	11.90	10.10	8.30	6.50	4.70	2.90	1.10	0	0	0	0
$86	$88	12.20	10.40	8.60	6.80	5.00	3.20	1.40	0	0	0	0
$88	$90	12.50	10.70	8.90	7.10	5.30	3.50	1.70	0	0	0	0
$90	$92	12.70	10.90	9.20	7.40	5.60	3.80	2.00	.20	0	0	0
$92	$94	13.00	11.20	9.40	7.60	5.80	4.00	2.30	.50	0	0	0
$94	$96	13.30	11.50	9.70	7.90	6.10	4.30	2.50	.70	0	0	0
$96	$98	13.60	11.80	10.00	8.20	6.40	4.60	2.80	1.00	0	0	0
$98	$100	13.90	12.10	10.30	8.50	6.70	4.90	3.10	1.30	0	0	0
$100	$105	14.40	12.60	10.80	9.00	7.20	5.40	3.60	1.80	0	0	0
$105	$110	15.10	13.30	11.50	9.70	7.90	6.10	4.30	2.50	.70	0	0
$110	$115	15.80	14.00	12.20	10.40	8.60	6.80	5.00	3.20	1.40	0	0
$115	$120	16.50	14.70	12.90	11.10	9.30	7.50	5.70	3.90	2.10	.30	0
$120	$125	17.20	15.40	13.60	11.80	10.00	8.20	6.40	4.60	2.80	1.00	0
$125	$130	17.90	16.10	14.30	12.50	10.70	8.90	7.10	5.30	3.50	1.70	0
$130	$135	18.60	16.80	15.00	13.20	11.40	9.60	7.80	6.00	4.20	2.40	.60
$135	$140	19.30	17.50	15.70	13.90	12.10	10.30	8.50	6.70	4.90	3.10	1.30
$140	$145	20.00	18.20	16.40	14.60	12.80	11.00	9.20	7.40	5.60	3.80	2.00
$145	$150	20.70	18.90	17.10	15.30	13.50	11.70	9.90	8.10	6.30	4.50	2.70
$150	$160	21.70	19.90	18.10	16.30	14.50	12.70	10.90	9.10	7.30	5.50	3.80
$160	$170	23.10	21.30	19.50	17.70	15.90	14.10	12.30	10.50	8.70	6.90	5.20
$170	$180	24.50	22.70	20.90	19.10	17.30	15.50	13.70	11.90	10.10	8.30	6.60
$180	$190	25.90	24.10	22.30	20.50	18.70	16.90	15.10	13.30	11.50	9.70	8.00
$190	$200	27.30	25.50	23.70	21.90	20.10	18.30	16.50	14.70	12.90	11.10	9.40
		14 percent of the excess over $200 plus—										
$200 and over		28.00	26.20	24.40	22.60	20.80	19.00	17.20	15.40	13.60	11.80	10.10

"If the payroll period with respect to an employee is biweekly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$26	14% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$26	$28	$3.80	.20	0	0	0	0	0	0	0	0	0
$28	$30	4.10	.50	0	0	0	0	0	0	0	0	0
$30	$32	4.30	.80	0	0	0	0	0	0	0	0	0
$32	$34	4.60	1.00	0	0	0	0	0	0	0	0	0
$34	$36	4.90	1.30	0	0	0	0	0	0	0	0	0
$36	$38	5.20	1.60	0	0	0	0	0	0	0	0	0
$38	$40	5.50	1.90	0	0	0	0	0	0	0	0	0
$40	$42	5.70	2.20	0	0	0	0	0	0	0	0	0
$42	$44	6.00	2.40	0	0	0	0	0	0	0	0	0
$44	$46	6.30	2.70	0	0	0	0	0	0	0	0	0
$46	$48	6.60	3.00	0	0	0	0	0	0	0	0	0
$48	$50	6.90	3.30	0	0	0	0	0	0	0	0	0
$50	$52	7.10	3.60	0	0	0	0	0	0	0	0	0
$52	$54	7.40	3.80	.20	0	0	0	0	0	0	0	0
$54	$56	7.70	4.10	.50	0	0	0	0	0	0	0	0
$56	$58	8.00	4.40	.80	0	0	0	0	0	0	0	0
$58	$60	8.30	4.70	1.10	0	0	0	0	0	0	0	0
$60	$62	8.50	5.00	1.40	0	0	0	0	0	0	0	0
$62	$64	8.80	5.20	1.60	0	0	0	0	0	0	0	0
$64	$66	9.10	5.50	1.90	0	0	0	0	0	0	0	0
$66	$68	9.40	5.80	2.20	0	0	0	0	0	0	0	0
$68	$70	9.70	6.10	2.50	0	0	0	0	0	0	0	0
$70	$72	9.90	6.40	2.80	0	0	0	0	0	0	0	0
$72	$74	10.20	6.60	3.00	0	0	0	0	0	0	0	0
$74	$76	10.50	6.90	3.30	0	0	0	0	0	0	0	0
$76	$78	10.80	7.20	3.60	0	0	0	0	0	0	0	0
$78	$80	11.10	7.50	3.90	.30	0	0	0	0	0	0	0
$80	$82	11.30	7.80	4.20	.60	0	0	0	0	0	0	0
$82	$84	11.60	8.00	4.40	.90	0	0	0	0	0	0	0
$84	$86	11.90	8.30	4.70	1.10	0	0	0	0	0	0	0
$86	$88	12.20	8.60	5.00	1.40	0	0	0	0	0	0	0
$88	$90	12.50	8.90	5.30	1.70	0	0	0	0	0	0	0
$90	$92	12.70	9.20	5.60	2.00	0	0	0	0	0	0	0
$92	$94	13.00	9.40	5.80	2.30	0	0	0	0	0	0	0
$94	$96	13.30	9.70	6.10	2.50	0	0	0	0	0	0	0
$96	$98	13.60	10.00	6.40	2.80	0	0	0	0	0	0	0
$98	$100	13.90	10.30	6.70	3.10	0	0	0	0	0	0	0
$100	$102	14.10	10.60	7.00	3.40	0	0	0	0	0	0	0
$102	$104	14.40	10.80	7.20	3.70	.10	0	0	0	0	0	0
$104	$106	14.70	11.10	7.50	3.90	.30	0	0	0	0	0	0
$106	$108	15.00	11.40	7.80	4.20	.60	0	0	0	0	0	0
$108	$110	15.30	11.70	8.10	4.50	.90	0	0	0	0	0	0
$110	$112	15.50	12.00	8.40	4.80	1.20	0	0	0	0	0	0
$112	$114	15.80	12.20	8.60	5.10	1.50	0	0	0	0	0	0
$114	$116	16.10	12.50	8.90	5.30	1.70	0	0	0	0	0	0
$116	$118	16.40	12.80	9.20	5.60	2.00	0	0	0	0	0	0
$118	$120	16.70	13.10	9.50	5.90	2.30	0	0	0	0	0	0
$120	$124	17.10	13.50	9.90	6.30	2.70	0	0	0	0	0	0
$124	$128	17.60	14.10	10.50	6.90	3.30	0	0	0	0	0	0
$128	$132	18.20	14.60	11.00	7.40	3.80	.30	0	0	0	0	0
$132	$136	18.80	15.20	11.60	8.00	4.40	.80	0	0	0	0	0
$136	$140	19.30	15.70	12.10	8.60	5.00	1.40	0	0	0	0	0
$140	$144	19.90	16.30	12.70	9.10	5.50	1.90	0	0	0	0	0
$144	$148	20.40	16.90	13.30	9.70	6.10	2.50	0	0	0	0	0
$148	$152	21.00	17.40	13.80	10.20	6.60	3.10	0	0	0	0	0
$152	$156	21.60	18.00	14.40	10.80	7.20	3.60	0	0	0	0	0
$156	$160	22.10	18.50	14.90	11.40	7.80	4.20	.60	0	0	0	0
$160	$164	22.70	19.10	15.50	11.90	8.30	4.70	1.10	0	0	0	0
$164	$168	23.20	19.70	16.10	12.50	8.90	5.30	1.70	0	0	0	0
$168	$172	23.80	20.20	16.60	13.00	9.40	5.90	2.30	0	0	0	0
$172	$176	24.40	20.80	17.20	13.60	10.00	6.40	2.80	0	0	0	0
$176	$180	24.90	21.30	17.70	14.20	10.60	7.00	3.40	0	0	0	0
$180	$184	25.50	21.90	18.30	14.70	11.10	7.50	3.90	.40	0	0	0
$184	$188	26.00	22.50	18.90	15.30	11.70	8.10	4.50	.90	0	0	0
$188	$192	26.60	23.00	19.40	15.80	12.20	8.70	5.10	1.50	0	0	0
$192	$196	27.20	23.60	20.00	16.40	12.80	9.20	5.60	2.00	0	0	0
$196	$200	27.70	24.10	20.50	17.00	13.40	9.80	6.20	2.60	0	0	0
$200	$210	28.70	25.10	21.50	17.90	14.30	10.80	7.20	3.60	0	0	0
$210	$220	30.10	26.50	22.90	19.30	15.70	12.20	8.60	5.00	1.40	0	0
$220	$230	31.50	27.90	24.30	20.70	17.10	13.60	10.00	6.40	2.80	0	0
$230	$240	32.90	29.30	25.70	22.10	18.50	15.00	11.40	7.80	4.20	.60	0
$240	$250	34.30	30.70	27.10	23.50	19.90	16.40	12.80	9.20	5.60	2.00	0
$250	$260	35.70	32.10	28.50	24.90	21.30	17.80	14.20	10.60	7.00	3.40	0
$260	$270	37.10	33.50	29.90	26.30	22.70	19.20	15.60	12.00	8.40	4.80	1.20
$270	$280	38.50	34.90	31.30	27.70	24.10	20.60	17.00	13.40	9.80	6.20	2.60
$280	$290	39.90	36.30	32.70	29.10	25.50	22.00	18.40	14.80	11.20	7.60	4.00
$290	$300	41.30	37.70	34.10	30.50	26.90	23.40	19.80	16.20	12.60	9.00	5.40
$300	$320	43.40	39.80	36.20	32.60	29.00	25.50	21.90	18.30	14.70	11.10	7.50
$320	$340	46.20	42.60	39.00	35.40	31.80	28.30	24.70	21.10	17.50	13.90	10.30
$340	$360	49.00	45.40	41.80	38.20	34.60	31.10	27.50	23.90	20.30	16.70	13.10
$360	$380	51.80	48.20	44.60	41.00	37.40	33.90	30.30	26.70	23.10	19.50	15.90
$380	$400	54.60	51.00	47.40	43.80	40.20	36.70	33.10	29.50	25.90	22.30	18.70
		14 percent of the excess over $400 plus—										
$400 and over		56.00	52.40	48.80	45.20	41.60	38.10	34.50	30.90	27.30	23.70	20.10

"If the payroll period with respect to an employee is semimonthly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$28	14% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$28	$30	$4.10	.20	0	0	0	0	0	0	0	0	0
$30	$32	4.30	.50	0	0	0	0	0	0	0	0	0
$32	$34	4.60	.70	0	0	0	0	0	0	0	0	0
$34	$36	4.90	1.00	0	0	0	0	0	0	0	0	0
$36	$38	5.20	1.30	0	0	0	0	0	0	0	0	0
$38	$40	5.50	1.60	0	0	0	0	0	0	0	0	0
$40	$42	5.70	1.90	0	0	0	0	0	0	0	0	0
$42	$44	6.00	2.10	0	0	0	0	0	0	0	0	0
$44	$46	6.30	2.40	0	0	0	0	0	0	0	0	0
$46	$48	6.60	2.70	0	0	0	0	0	0	0	0	0
$48	$50	6.90	3.00	0	0	0	0	0	0	0	0	0
$50	$52	7.10	3.30	0	0	0	0	0	0	0	0	0
$52	$54	7.40	3.50	0	0	0	0	0	0	0	0	0
$54	$56	7.70	3.80	0	0	0	0	0	0	0	0	0
$56	$58	8.00	4.10	.20	0	0	0	0	0	0	0	0
$58	$60	8.30	4.40	.50	0	0	0	0	0	0	0	0
$60	$62	8.50	4.70	.80	0	0	0	0	0	0	0	0
$62	$64	8.80	4.90	1.00	0	0	0	0	0	0	0	0
$64	$66	9.10	5.20	1.30	0	0	0	0	0	0	0	0
$66	$68	9.40	5.50	1.60	0	0	0	0	0	0	0	0
$68	$70	9.70	5.80	1.90	0	0	0	0	0	0	0	0
$70	$72	9.90	6.10	2.20	0	0	0	0	0	0	0	0
$72	$74	10.20	6.30	2.40	0	0	0	0	0	0	0	0
$74	$76	10.50	6.60	2.70	0	0	0	0	0	0	0	0
$76	$78	10.80	6.90	3.00	0	0	0	0	0	0	0	0
$78	$80	11.10	7.20	3.30	0	0	0	0	0	0	0	0
$80	$82	11.30	7.50	3.60	0	0	0	0	0	0	0	0
$82	$84	11.60	7.70	3.80	0	0	0	0	0	0	0	0
$84	$86	11.90	8.00	4.10	.20	0	0	0	0	0	0	0
$86	$88	12.20	8.30	4.40	.50	0	0	0	0	0	0	0
$88	$90	12.50	8.60	4.70	.80	0	0	0	0	0	0	0
$90	$92	12.70	8.90	5.00	1.10	0	0	0	0	0	0	0
$92	$94	13.00	9.10	5.20	1.40	0	0	0	0	0	0	0
$94	$96	13.30	9.40	5.50	1.60	0	0	0	0	0	0	0
$96	$98	13.60	9.70	5.80	1.90	0	0	0	0	0	0	0
$98	$100	13.90	10.00	6.10	2.20	0	0	0	0	0	0	0
$100	$102	14.10	10.30	6.40	2.50	0	0	0	0	0	0	0
$102	$104	14.40	10.50	6.60	2.80	0	0	0	0	0	0	0
$104	$106	14.70	10.80	6.90	3.00	0	0	0	0	0	0	0
$106	$108	15.00	11.10	7.20	3.30	0	0	0	0	0	0	0
$108	$110	15.30	11.40	7.50	3.60	0	0	0	0	0	0	0
$110	$112	15.50	11.70	7.80	3.90	0	0	0	0	0	0	0
$112	$114	15.80	11.90	8.00	4.20	.30	0	0	0	0	0	0
$114	$116	16.10	12.20	8.30	4.40	.50	0	0	0	0	0	0
$116	$118	16.40	12.50	8.60	4.70	.80	0	0	0	0	0	0
$118	$120	16.70	12.80	8.90	5.00	1.10	0	0	0	0	0	0
$120	$124	17.10	13.20	9.30	5.40	1.50	0	0	0	0	0	0
$124	$128	17.60	13.80	9.90	6.00	2.10	0	0	0	0	0	0
$128	$132	18.20	14.30	10.40	6.50	2.60	0	0	0	0	0	0
$132	$136	18.80	14.90	11.00	7.10	3.20	0	0	0	0	0	0
$136	$140	19.30	15.40	11.50	7.70	3.80	0	0	0	0	0	0
$140	$144	19.90	16.00	12.10	8.20	4.30	.40	0	0	0	0	0
$144	$148	20.40	16.60	12.70	8.80	4.90	1.00	0	0	0	0	0
$148	$152	21.00	17.10	13.20	9.30	5.40	1.60	0	0	0	0	0
$152	$156	21.60	17.70	13.80	9.90	6.00	2.10	0	0	0	0	0
$156	$160	22.10	18.20	14.30	10.50	6.60	2.70	0	0	0	0	0
$160	$164	22.70	18.80	14.90	11.00	7.10	3.20	0	0	0	0	0
$164	$168	23.20	19.40	15.50	11.60	7.70	3.80	0	0	0	0	0
$168	$172	23.80	19.90	16.00	12.10	8.20	4.40	.50	0	0	0	0
$172	$176	24.40	20.50	16.60	12.70	8.80	4.90	1.00	0	0	0	0
$176	$180	24.90	21.00	17.10	13.30	9.40	5.50	1.60	0	0	0	0
$180	$184	25.50	21.60	17.70	13.80	9.90	6.00	2.10	0	0	0	0
$184	$188	26.00	22.20	18.30	14.40	10.50	6.60	2.70	0	0	0	0
$188	$192	26.60	22.70	18.80	14.90	11.00	7.20	3.30	0	0	0	0
$192	$196	27.20	23.30	19.40	15.50	11.60	7.70	3.80	0	0	0	0
$196	$200	27.70	23.80	19.90	16.10	12.20	8.30	4.40	.50	0	0	0
$200	$210	28.70	24.80	20.90	17.00	13.10	9.30	5.40	1.50	0	0	0
$210	$220	30.10	26.20	22.30	18.40	14.50	10.70	6.80	2.90	0	0	0
$220	$230	31.50	27.60	23.70	19.80	15.90	12.10	8.20	4.30	.40	0	0
$230	$240	32.90	29.00	25.10	21.20	17.30	13.50	9.60	5.70	1.80	0	0
$240	$250	34.30	30.40	26.50	22.60	18.70	14.90	11.00	7.10	3.20	0	0
$250	$260	35.70	31.80	27.90	24.00	20.10	16.30	12.40	8.50	4.60	.70	0
$260	$270	37.10	33.20	29.30	25.40	21.50	17.70	13.80	9.90	6.00	2.10	0
$270	$280	38.50	34.60	30.70	26.80	22.90	19.10	15.20	11.30	7.40	3.50	0
$280	$290	39.90	36.00	32.10	28.20	24.30	20.50	16.60	12.70	8.80	4.90	1.00
$290	$300	41.30	37.40	33.50	29.60	25.70	21.90	18.00	14.10	10.20	6.30	2.40
$300	$320	43.40	39.50	35.60	31.70	27.80	24.00	20.10	16.20	12.30	8.40	4.50
$320	$340	46.20	42.30	38.40	34.50	30.60	26.80	22.90	19.00	15.10	11.20	7.30
$340	$360	49.00	45.10	41.20	37.30	33.40	29.60	25.70	21.80	17.90	14.00	10.10
$360	$380	51.80	47.90	44.00	40.10	36.20	32.40	28.50	24.60	20.70	16.80	12.90
$380	$400	54.60	50.70	46.80	42.90	39.00	35.20	31.30	27.40	23.50	19.60	15.70
$400	$420	57.40	53.50	49.60	45.70	41.80	38.00	34.10	30.20	26.30	22.40	18.50
$420	$440	60.20	56.30	52.40	48.50	44.60	40.80	36.90	33.00	29.10	25.20	21.30
$440	$460	63.00	59.10	55.20	51.30	47.40	43.60	39.70	35.80	31.90	28.00	24.10
$460	$480	65.80	61.90	58.00	54.10	50.20	46.40	42.50	38.60	34.70	30.80	26.90
$480	$500	68.60	64.70	60.80	56.90	53.00	49.20	45.30	41.40	37.50	33.60	29.70
		14 percent of the excess over $500 plus—										
$500 and over		70.00	66.10	62.20	58.30	54.40	50.60	46.70	42.80	38.90	35.00	31.10

"If the payroll period with respect to an employee is monthly—

And the wages are—		And the number of withholding exemptions claimed is—										
At least—	But less than—	0	1	2	3	4	5	6	7	8	9	10 or more
		The amount of income tax to be withheld shall be—										
$0	$56	14% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$56	$60	$8.10	.30	0	0	0	0	0	0	0	0	0
$60	$64	8.70	.90	0	0	0	0	0	0	0	0	0
$64	$68	9.20	1.50	0	0	0	0	0	0	0	0	0
$68	$72	9.80	2.00	0	0	0	0	0	0	0	0	0
$72	$76	10.40	2.60	0	0	0	0	0	0	0	0	0
$76	$80	10.90	3.10	0	0	0	0	0	0	0	0	0
$80	$84	11.50	3.70	0	0	0	0	0	0	0	0	0
$84	$88	12.00	4.30	0	0	0	0	0	0	0	0	0
$88	$92	12.60	4.80	0	0	0	0	0	0	0	0	0
$92	$96	13.20	5.40	0	0	0	0	0	0	0	0	0
$96	$100	13.70	5.90	0	0	0	0	0	0	0	0	0
$100	$104	14.30	6.50	0	0	0	0	0	0	0	0	0
$104	$108	14.80	7.10	0	0	0	0	0	0	0	0	0
$108	$112	15.40	7.60	0	0	0	0	0	0	0	0	0
$112	$116	16.00	8.20	.40	0	0	0	0	0	0	0	0
$116	$120	16.50	8.70	1.00	0	0	0	0	0	0	0	0
$120	$124	17.10	9.30	1.50	0	0	0	0	0	0	0	0
$124	$128	17.60	9.90	2.10	0	0	0	0	0	0	0	0
$128	$132	18.20	10.40	2.60	0	0	0	0	0	0	0	0
$132	$136	18.80	11.00	3.20	0	0	0	0	0	0	0	0
$136	$140	19.30	11.50	3.70	0	0	0	0	0	0	0	0
$140	$144	19.90	12.10	4.30	0	0	0	0	0	0	0	0
$144	$148	20.40	12.70	4.90	0	0	0	0	0	0	0	0
$148	$152	21.00	13.20	5.40	0	0	0	0	0	0	0	0
$152	$156	21.60	13.80	6.00	0	0	0	0	0	0	0	0
$156	$160	22.10	14.30	6.60	0	0	0	0	0	0	0	0
$160	$164	22.70	14.90	7.10	0	0	0	0	0	0	0	0
$164	$168	23.20	15.50	7.70	0	0	0	0	0	0	0	0
$168	$172	23.80	16.00	8.20	.50	0	0	0	0	0	0	0
$172	$176	24.40	16.60	8.80	1.00	0	0	0	0	0	0	0
$176	$180	24.90	17.10	9.40	1.60	0	0	0	0	0	0	0
$180	$184	25.50	17.70	9.90	2.10	0	0	0	0	0	0	0
$184	$188	26.00	18.30	10.50	2.70	0	0	0	0	0	0	0
$188	$192	26.60	18.80	11.00	3.30	0	0	0	0	0	0	0
$192	$196	27.20	19.40	11.60	3.80	0	0	0	0	0	0	0
$196	$200	27.70	19.90	12.20	4.40	0	0	0	0	0	0	0
$200	$204	28.30	20.50	12.70	4.90	0	0	0	0	0	0	0
$204	$208	28.80	21.10	13.30	5.50	0	0	0	0	0	0	0
$208	$212	29.40	21.60	13.80	6.10	0	0	0	0	0	0	0
$212	$216	30.00	22.20	14.40	6.60	0	0	0	0	0	0	0
$216	$220	30.50	22.70	15.00	7.20	0	0	0	0	0	0	0
$220	$224	31.10	23.30	15.50	7.70	0	0	0	0	0	0	0
$224	$228	31.60	23.90	16.10	8.30	.50	0	0	0	0	0	0
$228	$232	32.20	24.40	16.60	8.90	1.10	0	0	0	0	0	0
$232	$236	32.80	25.00	17.20	9.40	1.60	0	0	0	0	0	0
$236	$240	33.30	25.50	17.80	10.00	2.20	0	0	0	0	0	0
$240	$248	34.20	26.40	18.60	10.80	3.00	0	0	0	0	0	0
$248	$256	35.30	27.50	19.70	11.90	4.20	0	0	0	0	0	0
$256	$264	36.40	28.60	20.80	13.10	5.30	0	0	0	0	0	0
$264	$272	37.50	29.70	22.00	14.20	6.40	0	0	0	0	0	0
$272	$280	38.60	30.90	23.10	15.30	7.50	0	0	0	0	0	0
$280	$288	39.80	32.00	24.20	16.40	8.60	.90	0	0	0	0	0
$288	$296	40.90	33.10	25.30	17.50	9.80	2.00	0	0	0	0	0
$296	$304	42.00	34.20	26.40	18.70	10.90	3.10	0	0	0	0	0
$304	$312	43.10	35.30	27.60	19.80	12.00	4.20	0	0	0	0	0
$312	$320	44.20	36.50	28.70	20.90	13.10	5.40	0	0	0	0	0
$320	$328	45.40	37.60	29.80	22.00	14.20	6.50	0	0	0	0	0
$328	$336	46.50	38.70	30.90	23.10	15.40	7.60	0	0	0	0	0
$336	$344	47.60	39.80	32.00	24.30	16.50	8.70	.90	0	0	0	0
$344	$352	48.70	40.90	33.20	25.40	17.60	9.80	2.10	0	0	0	0
$352	$360	49.80	42.10	34.30	26.50	18.70	11.00	3.20	0	0	0	0
$360	$368	51.00	43.20	35.40	27.60	19.80	12.10	4.30	0	0	0	0
$368	$376	52.10	44.30	36.50	28.70	21.00	13.20	5.40	0	0	0	0
$376	$384	53.20	45.40	37.60	29.90	22.10	14.30	6.50	0	0	0	0
$384	$392	54.30	46.50	38.80	31.00	23.20	15.40	7.70	0	0	0	0
$392	$400	55.40	47.70	39.90	32.10	24.30	16.60	8.80	1.00	0	0	0
$400	$420	57.40	49.60	41.80	34.10	26.30	18.50	10.70	3.00	0	0	0
$420	$440	60.20	52.40	44.60	36.90	29.10	21.30	13.50	5.80	0	0	0
$440	$460	63.00	55.20	47.40	39.70	31.90	24.10	16.30	8.60	.80	0	0
$460	$480	65.80	58.00	50.20	42.50	34.70	26.90	19.10	11.40	3.60	0	0
$480	$500	68.60	60.80	53.00	45.30	37.50	29.70	21.90	14.20	6.40	0	0
$500	$520	71.40	63.60	55.80	48.10	40.30	32.50	24.70	17.00	9.20	1.40	0
$520	$540	74.20	66.40	58.60	50.90	43.10	35.30	27.50	19.80	12.00	4.20	0
$540	$560	77.00	69.20	61.40	53.70	45.90	38.10	30.30	22.60	14.80	7.00	0
$560	$580	79.80	72.00	64.20	56.50	48.70	40.90	33.10	25.40	17.60	9.80	2.00
$580	$600	82.60	74.80	67.00	59.30	51.50	43.70	35.90	28.20	20.40	12.60	4.80
$600	$640	86.80	79.00	71.20	63.50	55.70	47.90	40.10	32.40	24.60	16.80	9.00
$640	$680	92.40	84.60	76.80	69.10	61.30	53.50	45.70	38.00	30.20	22.40	14.60
$680	$720	98.00	90.20	82.40	74.70	66.90	59.10	51.30	43.60	35.80	28.00	20.20
$720	$760	103.60	95.80	88.00	80.30	72.50	64.70	56.90	49.20	41.40	33.60	25.80
$760	$800	109.20	101.40	93.60	85.90	78.10	70.30	62.50	54.80	47.00	39.20	31.40
$800	$840	114.80	107.00	99.20	91.50	83.70	75.90	68.10	60.40	52.60	44.80	37.00
$840	$880	120.40	112.60	104.80	97.10	89.30	81.50	73.70	66.00	58.20	50.40	42.60
$880	$920	126.00	118.20	110.40	102.70	94.90	87.10	79.30	71.60	63.80	56.00	48.20
$920	$960	131.60	123.80	116.00	108.30	100.50	92.70	84.90	77.20	69.40	61.60	53.80
$960	$1,000	137.20	129.40	121.60	113.90	106.10	98.30	90.50	82.80	75.00	67.20	59.40
		14 percent of the excess over $1,000 plus—										
$1,000 and over		140.00	132.20	124.40	116.70	108.90	101.10	93.30	85.60	77.80	70.00	62.20

"If the payroll period with respect to an employee is a daily payroll period or a miscellaneous payroll period—

And the wages divided by the number of days in such period are—		And the number of withholding exemptions claimed is—										
		0	1	2	3	4	5	6	7	8	9	10 or more
At least—	But less than—	The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period—										
$0	$2.00	14% of wages	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
$2.00	$2.25	$.30	.05	0	0	0	0	0	0	0	0	0
$2.25	$2.50	.35	.10	0	0	0	0	0	0	0	0	0
$2.50	$2.75	.35	.10	0	0	0	0	0	0	0	0	0
$2.75	$3.00	.40	.15	0	0	0	0	0	0	0	0	0
$3.00	$3.25	.45	.20	0	0	0	0	0	0	0	0	0
$3.25	$3.50	.45	.20	0	0	0	0	0	0	0	0	0
$3.50	$3.75	.50	.25	0	0	0	0	0	0	0	0	0
$3.75	$4.00	.55	.30	.05	0	0	0	0	0	0	0	0
$4.00	$4.25	.60	.30	.05	0	0	0	0	0	0	0	0
$4.25	$4.50	.60	.35	.10	0	0	0	0	0	0	0	0
$4.50	$4.75	.65	.40	.15	0	0	0	0	0	0	0	0
$4.75	$5.00	.70	.45	.15	0	0	0	0	0	0	0	0
$5.00	$5.25	.70	.45	.20	0	0	0	0	0	0	0	0
$5.25	$5.50	.75	.50	.25	0	0	0	0	0	0	0	0
$5.50	$5.75	.80	.55	.30	0	0	0	0	0	0	0	0
$5.75	$6.00	.80	.55	.30	.05	0	0	0	0	0	0	0
$6.00	$6.25	.85	.60	.35	.10	0	0	0	0	0	0	0
$6.25	$6.50	.90	.65	.40	.15	0	0	0	0	0	0	0
$6.50	$6.75	.95	.65	.40	.15	0	0	0	0	0	0	0
$6.75	$7.00	.95	.70	.45	.20	0	0	0	0	0	0	0
$7.00	$7.25	1.00	.75	.50	.25	0	0	0	0	0	0	0
$7.25	$7.50	1.05	.80	.50	.25	0	0	0	0	0	0	0
$7.50	$7.75	1.05	.80	.55	.30	.05	0	0	0	0	0	0
$7.75	$8.00	1.10	.85	.60	.35	.10	0	0	0	0	0	0
$8.00	$8.25	1.15	.90	.65	.35	.10	0	0	0	0	0	0
$8.25	$8.50	1.15	.90	.65	.40	.15	0	0	0	0	0	0
$8.50	$8.75	1.20	.95	.70	.45	.20	0	0	0	0	0	0
$8.75	$9.00	1.25	1.00	.75	.50	.20	0	0	0	0	0	0
$9.00	$9.25	1.30	1.00	.75	.50	.25	0	0	0	0	0	0
$9.25	$9.50	1.30	1.05	.80	.55	.30	.05	0	0	0	0	0
$9.50	$9.75	1.35	1.10	.85	.60	.30	.05	0	0	0	0	0
$9.75	$10.00	1.40	1.15	.85	.60	.35	.10	0	0	0	0	0
$10.00	$10.50	1.45	1.20	.90	.65	.40	.15	0	0	0	0	0
$10.50	$11.00	1.50	1.25	1.00	.75	.50	.25	0	0	0	0	0
$11.00	$11.50	1.60	1.30	1.05	.80	.55	.30	.05	0	0	0	0
$11.50	$12.00	1.65	1.40	1.15	.90	.60	.35	.10	0	0	0	0
$12.00	$12.50	1.70	1.45	1.20	.95	.70	.45	.20	0	0	0	0
$12.50	$13.00	1.80	1.55	1.25	1.00	.75	.50	.25	0	0	0	0
$13.00	$13.50	1.85	1.60	1.35	1.10	.85	.60	.30	.05	0	0	0
$13.50	$14.00	1.95	1.65	1.40	1.15	.90	.65	.40	.15	0	0	0
$14.00	$14.50	2.00	1.75	1.50	1.23	.95	.70	.45	.20	0	0	0
$14.50	$15.00	2.05	1.80	1.55	1.30	1.05	.80	.55	.30	0	0	0
$15.00	$15.50	2.15	1.90	1.60	1.35	1.10	.85	.60	.35	.10	0	0
$15.50	$16.00	2.20	1.95	1.70	1.45	1.20	.95	.65	.40	.15	0	0
$16.00	$16.50	2.30	2.00	1.75	1.50	1.25	1.00	.75	.50	.25	0	0
$16.50	$17.00	2.35	2.10	1.85	1.60	1.30	1.05	.80	.55	.30	.05	0
$17.00	$17.50	2.40	2.15	1.90	1.65	1.40	1.15	.90	.65	.35	.10	0
$17.50	$18.00	2.50	2.25	1.95	1.70	1.45	1.20	.95	.70	.45	.20	0
$18.00	$18.50	2.55	2.30	2.05	1.80	1.55	1.30	1.00	.75	.50	.25	0
$18.50	$19.00	2.65	2.35	2.10	1.85	1.60	1.35	1.10	.85	.60	.30	.05
$19.00	$19.50	2.70	2.45	2.20	1.95	1.65	1.40	1.15	.90	.65	.40	.15
$19.50	$20.00	2.75	2.50	2.25	2.00	1.75	1.50	1.25	1.00	.70	.45	.20
$20.00	$21.00	2.85	2.60	2.35	2.10	1.85	1.60	1.35	1.10	.80	.55	.30
$21.00	$22.00	3.00	2.75	2.50	2.25	2.00	1.75	1.50	1.20	.95	.70	.45
$22.00	$23.00	3.15	2.90	2.65	2.40	2.15	1.85	1.60	1.35	1.10	.85	.60
$23.00	$24.00	3.30	3.05	2.80	2.50	2.25	2.00	1.75	1.50	1.25	1.00	.75
$24.00	$25.00	3.45	3.15	2.90	2.65	2.40	2.15	1.90	1.65	1.40	1.15	.85
$25.00	$26.00	3.55	3.30	3.05	2.80	2.55	2.30	2.05	1.80	1.50	1.25	1.00
$26.00	$27.00	3.70	3.45	3.20	2.95	2.70	2.45	2.20	1.90	1.65	1.40	1.15
$27.00	$28.00	3.85	3.60	3.35	3.10	2.85	2.55	2.30	2.05	1.80	1.55	1.30
$28.00	$29.00	4.00	3.75	3.50	3.20	2.95	2.70	2.45	2.20	1.95	1.70	1.45
$29.00	$30.00	4.15	3.85	3.60	3.35	3.10	2.85	2.60	2.35	2.10	1.85	1.55
		14 percent of the excess over $30 plus—										
$30 and over		4.20	3.95	3.70	3.45	3.20	2.90	2.65	2.40	2.15	1.90	1.65"

(c) WITHHOLDING OF TAX ON CERTAIN NONRESIDENT ALIENS.—Subsections (a) and (b) of section 1441 (relating to withholding of tax on nonresident aliens) are amended by striking out "18 percent" and inserting in lieu thereof "14 percent".

26 USC 1441.

Effective date.

(d) EFFECTIVE DATES.—The amendments made by subsections (a) and (b) of this section shall apply with respect to remuneration paid after the seventh day following the date of the enactment of this Act. The amendment made by subsection (c) of this section shall apply with respect to payments made after the seventh day following the date of the enactment of this Act.

Approved February 26, 1964.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 749 (Comm. on Ways and Means) and No. 1149 (Comm. of Conference).
SENATE REPORTS: No. 830, No. 830 pt. 2 (Comm. on Finance).
CONGRESSIONAL RECORD:
Vol. 109 (1963): Sept. 24, 25, considered in House.
Sept. 25, passed House.
Vol. 110 (1964): Jan. 30, 31, Feb. 3-7, considered in Senate.
Feb. 7, passed Senate, amended.
Feb. 25, House agreed to conference report.
Feb. 26, Senate agreed to conference report.