REVENUE ACT OF 1963

1616

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

NOVEMBER 12-15, 21, AND 22, 1963

PART 4

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE
24-532 WASHINGTON : 1963

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C., 20402 - Price $1.50

COMMITTEE ON FINANCE

HARRY FLOOD BYRD, Virginia, *Chairman*

RUSSELL B. LONG, Louisiana
GEORGE A. SMATHERS, Florida
CLINTON P. ANDERSON, New Mexico
PAUL H. DOUGLAS, Illinois
ALBERT GORE, Tennessee
HERMAN E. TALMADGE, Georgia
EUGENE J. McCARTHY, Minnesota
VANCE HARTKE, Indiana
J. W. FULBRIGHT, Arkansas
ABRAHAM A. RIBICOFF, Connecticut

JOHN J. WILLIAMS, Delaware
FRANK CARLSON, Kansas
WALLACE F. BENNETT, Utah
CARL T. CURTIS, Nebraska
THRUSTON B. MORTON, Kentucky
EVERETT McKINLEY DIRKSEN, Illinois

ELIZABETH B. SPRINGER, *Chief Clerk*

CONTENTS

WITNESSES

Page

Barker, Richard B., attorney 2004

Bonbright, James C., professor emeritus of finance, School of Business, Columbia University 1863

Supplementary statements 1867

Bray, Francis G., National Association of Life Underwriters; accompanied by Carlysle M. Dunaway, general counsel 1946

Briley, Hon. C. Beverly, county mayor, Metropolitan Government of Nashville, Davidson County, Tenn.; accompanied by C. D. Ward, general counsel, National Association of Counties 1989

Prepared statement 1991

Brown, Harry L., president, Georgia Farm Bureau Federation 1691

Buchanan, W. Evans, president, National Association of Home Builders, as presented by Leonard Silverstein, tax counsel; accompanied by Herbert S. Colton, general counsel 1983

Prepared statement 1985

Burger, George J., vice president, National Federation of Independent Business, Washington, D.C 1767

Supplemental statement 1768

Colbert, Asel R., chief of accounts and finance department, Public Service Commission of Wisconsin 1855

Delano, Robert B., president, Virginia Farm Bureau Federation, Inc 1731

Dyer, John K., Jr., vice president and actuary, Towers, Perrin, Forster & Crosby, Inc 1932

Ellis, Otis H., general counsel, National Oil Jobbers, Inc 2029

Prepared statement 2032

Foulk, Richard N., Insurance Brokers' Association of the State of New York, Inc 1925

Grover, George G., Public Utilities Commission of the State of California 1841

Prepared statement 1849

Harrar, William H., 42d Street Association, Inc 1853

Heller, Walter W., chairman, Council of Economic Advisers; accompanied by Gardner Ackley and John P. Lewis, members 1579

Jackman, William, president, Investors League, Inc.; as presented by Robert A. Gilbert, chairman, International Division, Investors League, Inc 1733

Javits, Benjamin A., president, United Shareowners of America, Inc 1693

Leach, William F., Associated Industries of New York State, Inc 1929

Lentz, Hover T., Denver, Colo 2010

MacKay, Archibald E., Financial Executives Institute 1915

Nagle, John F., chief, Washington office, National Federation of the Blind 1979

Peterson, William H., professor of economics, New York University Graduate School of Business Administration 1695

Prepared statement 1713

Reed, A. L., member, Public Information Committee of the Cotton Industries 1720

Prepared statement 1722

Siegfried, Charles A., on behalf of the American Life Convention, the Life Insurers Conference, and the Life Insurance Association of America 1906

Singer, Russell E., executive vice president, American Automobile Association: Accompanied by Fleming Bomar, tax council; and Kermit B. Rykken, director, highway and legal department 2000

Slavinski, Walter A., attorney; accompanied by John Outland, president, Club Managers' Association, and William Amlong, executive director, National Club Association 1750

Sparkman, Hon. John, a Senator from the State of Alabama 1760

Swidler, Joseph C., Chairman, Federal Power Commission; accompanied by Russell C. Rainwater, chief accountant ..... Page 1797
Prepared statement 1801
Todd, John O., on behalf of the Association of Advanced Life Underwriters; accompanied by Leonard L. Silverstein and Gerald H. Sherman, counsel 1937
Tucker, Robert H., vice president and secretary, Minnesota Mining & Manufacturing Co.; accompanied by Richard Brust, manager, tax department 1739

COMMUNICATIONS

Akron Automobile Club, The, Akron, Ohio, letter of Roger T. McCloskey, secretary-manager, to Hon. Frank J. Lausche 2047
Alabama Petroleum Jobbers Association, Inc., Montgomery, Ala., letter of Richard C. Belser to the chairman 2054
Allegheny Power System, Inc., New York, N.Y., letters of J. Lee Rice, Jr., president, to the chairman 1953, 2051
Allott, Hon. Gordon, letter to the chairman 2028
Aluminum Co. of America, statement 1956
American Gas Association, New York, N.Y., letter and enclosure of R. P. Briggs, chairman, committee of executives on taxation, to the chairman 2041
American Life Convention, Chicago, Ill., letter of Glendon E. Johnson to the chairman 1977
American Telephone & Telegraph Co., statement of John J. Scanlon, vice president and treasurer 1683
Arizona Automobile Association, Phoenix, Ariz., letter of Fred O. Adams, president, to the chairman 2052
Automobile Club of New York, Inc., New York, N.Y., letter of Wm. J. Gottlieb, president, to the chairman 2048
Blair County Motor Club, Altoona, Pa., resolution 2050
Buffalo Forge Co., Buffalo, N.Y., letter of W. R. Heath, president, to the chairman 1952
Chapman, Norris E., Denver, Colo., letter to the chairman 1967
Cincinnati Automobile Club, Cincinnati, Ohio, letter of Otis R. Hess, vice president, to the chairman 2004
City of Stanton, Stanton, Calif., letter of Richard F. McCarthy, Mayor, to the chairman 1959
Cleveland Automobile Club, The, Cleveland, Ohio, letter of Frederick T. McGuire, Jr., president, to Hon. Frank J. Lausche 2052
Commerce & Industry Association of New York, Inc., statement of Arthur M. Arnold, tax counsel 2056
Consolidated Edison Co. of New York, Inc., New York, N.Y., letter of B. E. Gallagher, vice president, to the chairman 1965
Dillon, Hon. Douglas, Secretary of the Treasury, letters to the chairman 1755, 1905
Dominick, Hon. Peter H., letter to the chairman 2028
Dynalectron Corp., Washington, D.C., letter of C. G. Gulledge, president, to the chairman 2049
Edison Electric Institute, statement of Walter Bouldin, president 1885
E. I. du Pont de Nemours & Co., statement of R. R. Pippin, treasurer 1960
Eisner, Robert, professor of economics, Northeastern University, statement 1871
Eli Lilly & Co., Indianapolis, Ind., letter of J. E. Marmon, group vice president, manufacturing and administration, to the chairman 1957
General Motors Corp., statement 1963
General Telephone Co. of the Northwest, Spokane, Wash., letter of A. J. Barran, president, to the chairman 1958
Greater Hartford Chamber of Commerce, Hartford, Conn., letter of James E. Bent, president, to Hon. Abraham A. Ribicoff 2043
Harclerode, Albert P., Salt Lake City, Utah, letter to Hon. Frank E. Moss 2054
Hawaiian Telephone Co., Washington, D.C., letter of Omar L. Crook, its attorney, to the chairman 1883
Health Insurance Association of America, letter and enclosures of Paul M. Hawkins, Washington counsel, to the chairman 1974
Hicks, Paul DeForest, New York, N.Y., letter to the chairman 1964
Hodges, Hon. Luther H., letter to the chairman 1883

	Page
Illinois Commerce Commission, Chicago, Ill., letter and enclosure of Henry A. Tacon, chief accountant, to chairman	1868
Illinois State Chamber of Commerce, letter and enclosure of Raymond A. Hoffman, chairman, Federal taxation committee, to the chairman	2037
Independent National Gas Association of America, statements of Laurence H. Gall, executive director	2046
James S. O'Bryan, CLU, insurance, Van Nuys, Calif., letter of James S. O'Bryan to the chairman	1958
Keyserling, Leon H., Washington, D.C., letter to chairman	1756
Life Insurance Association of America, letter of Eugene M. Thoré, vice president and general counsel, to the chairman	1977
Lowrimore, Charles S., Wilmington, N.C., letter to the chairman	1882
Magill, Roswell, New York, N.Y., letter to the chairman	1953
Massachusetts Department of Public Utilities, statement of Norman Mason, chairman	1840
Methodist Hospital of Southern California, Arcadia, Calif., letter of Walter R. Hoefflin, Jr., administrator, to the chairman	1955
Miller Electric Manufacturing Co., Appleton, Wis., letter of G. K. Willecke, director of research, member of executive committee, to the chairman	1966
National Association of Wholesalers, The, statement of Col. James W. Roberts	1687
National Metal Trades Association, letter of Guy Farmer, general counsel, to the chairman	2051
New York Chamber of Commerce, statement of Mark E. Richardson	1681
New York State Automobile Association, Albany, N.Y., letter of George M. Frauenheim, president, to the chairman	2049
Norman F. Dacey & Associates, Inc., statement of Norman F. Dacey, president	1969
Ohio Crankshaft Co., The, Cleveland, Ohio, letter of Paul T. Koenig, secretary and treasurer, to Hon. Frank J. Lausche	1968
Peck Co., The, Michigan City, Ind., letter of James O. Peck, Industrial Marketing Council, to the chairman	1727
Pennsylvania Power & Light Co., statement of Charles E. Oakes, chairman of the board	1569
Plans, Inc., Washington-New York, letter and enclosure of Lewis C. Burwell, Jr., chairman, to the committee	1912
Public Service Commission of Indiana, statement of Merton Stanley, chairman	1903
Public Service Commission of New York, letter of James A. Lundy, chairman, to committee	1855
Richmond, David W., Washington, D.C., letter and enclosure to the chairman	1887
Saltonstall, Hon. Leverett, letter to chairman	1766
Spacek, Leonard, Chicago, Ill., statement	1870
Standish, Alexander, Canterbury, N.H., letter to Hon. Norris Cotton	2044
Strathmore Paper Co., West Springfield, Mass., letter of H. D. Johnston, president, to the chairman	1952
Swidler, Joseph C., Chairman, Federal Power Commission, letter and enclosure to Hon. Wilbur D. Mills	1806
Toledo Automobile Club, The, Toledo, Ohio, letter of E. L. Bowsher, secretary-manager, to Hon. Frank J. Lausche	2053
Transportation Association of America, statement of Robert E. Pedding, vice president and general counsel	1890
United States Independent Telephone Association, Washington, D.C., letter of Clyde S. Bailey, executive vice president, to the chairman	1884
Wayne Hummer & Co., Chicago, Ill., letter of George E. Barnes, partner, to the chairman	2045
Western Diversified Services, Inc., Chicago, Ill., statement of J. Milton Edelstein	1954
York & Co., investment securities, San Francisco, Calif., letter of Palmer York, Jr., to the chairman	1957

ADDITIONAL INFORMATION

Page

Amounts received from employer on sale of residence of employee in connection with transfer to place of work, submitted by Richard B. Barker.. 2009
Analysis of administration's example concerning the use of cash values as collateral, submitted by the Association of Advanced Life Underwriting.. 1944
Analysis of increased cost incurred through financing of insurance contract, submitted by the Association for Advanced Life Underwriting........ 1944
Analysis of Secretary of the Treasury's example comparing purchase of term insurance to purchase of what is described as "typical minimum deposit insurance plan," submitted by the Association for Advanced Life Underwriting........ 1944
Areas of witness testimony on H.R. 8363 before Senate Finance Committee, submitted by Senator Hartke........ 1785
"Budget Makers Are Not Budget Cutters," article in the Wall Street Journal, November 1, 1963, submitted by Investors League, Inc........ 1737
Changes in 1964 administrative budget expenditures for programs other than defense, space, and interest, submitted by the Council of Economic Advisers........ 1610
Distribution of tax levies, all levels of Government, fiscal year, 1960, submitted by Investors League, Inc........ 1739
Federal Government receipts, submitted by the Council of Economic Advisers........ 1602
Federal tax revenues, expenditures, and purchases of goods and services, as percentage of GNP: 1948, 1957, and 1963, submitted by the Council of Economic Advisers........ 1582
History of special treatment of dividends to eliminate or ameliorate double taxation, submitted by The Minnesota Mining & Manufacturing Co........ 1742
Identification of sections of H.R. 8363, submitted by Senator Hartke........ 1782
Illustrations of problems produced by the bill, submitted by the Insurance Brokers' Association of the State of New York, Inc........ 1928
"Interest Deduction Clause Could Hurt," article in the Insurance Field, Oct. 25 1963, submitted by the Association of Advanced Life Underwriting........ 1942
Opinion of the General Counsel re Federal Power Commission Authority over cooperative borrowers from the Rural Electrification Administration, submitted by the Federal Power Commission........ 1814
Order to show cause why respondents should not be required to comply with requirements of the Federal Power Act, submitted by the Federal Power Commission........ 1828
Public witnesses before Senate Finance Committee on H.R. 8363, submitted by Senator Hartke........ 1782
Questions of Senator Carlson to Joseph C. Swidler, Chairman of the Federal Power Commission, and replies thereto........ 1837
Relationship of corporate profits and gross national product (GNP), profits before taxes and after taxes, and ratios of the profits to GNP, submitted by Senator Bennett........ 1657
Rise in the average number of civilians unemployed in 1958 and 1961, report issued by the Bureau of Family Services, Department of Health, Education, and Welfare, submitted by Senator Hartke........ 1646
Scheduled witnesses already in House committee record, submitted by Senator Hartke........ 1783
Statement made by Dr. Walter Heller on October 28, 1963, before the Subcommittee on Employment and Manpower of the Senate Committee on Labor and Public Welfare, submitted by Senator Douglas........ 1662
Tax-free dividend payments by private power companies, submitted by Senator Gore........ 1808
Technical memorandum concerning Federal income tax treatment of Moffatt Tunnel Improvement District taxes, submitted by Hover T. Lentz, Denver, Colo........ 2013
Three times earnings' formula integrated with social security, submitted by the Associated Industries of New York State, Inc........ 1931
We, the salesmen—Interest Deduction Clause Could Hurt, article in the Insurance Field Act, Oct. 25, 1963, submitted by the Association of Life Underwriting........ 1942
Will these sniffles develop into pneumonia? submitted by the National Association of Counties........ 1999

REVENUE ACT OF 1963

TUESDAY, NOVEMBER 12, 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), Smathers, Gore, Talmadge, Hartke, Ribicoff, Williams, Carlson, Bennett, Morton, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The Chair desires to insert in the record a statement by Mr. Charles E. Oakes, chairman of the board of the Pennsylvania Power & Light Co.

(The statement referred to follows:)

STATEMENT OF CHARLES E. OAKES, CHAIRMAN OF THE BOARD OF PENNSYLVANIA POWER & LIGHT CO. RE H.R. 8363

As chairman of the board of Pennsylvania Power & Light Co., Allentown, Pa., I wish to place on record before the members of the Senate Finance Committee, the following statement.

My statement is made on behalf of and in the interest of the more than 96,000 people who are the direct owners of the stock of that company. These people, along with over 17 million owners of stock in American corporate enterprise, are vitally concerned with the manner in which the returns they receive on their invested savings are subjected to the imposition of the Federal income tax. Also, there is the effect which any change in the tax treatment of such dividends will have on the future marketing and salability of equity securities in this country as against the flight of American capital into foreign countries for investment.

H.R. 8363, as passed by the House and now under consideration by your committee, proposes, over a 2-year period, to remove completely the 4 percent tax credit on dividends received in excess of $100 exclusion from such dividends which has been raised from the present exclusion of $50.

This proposed tax treatment of dividends fails to meet a twofold need, that is—

1. To stimulate the use of equity funds in the building of a sound and vigorous domestic economy, and
2. To reverse the trend of American capital movement abroad.

A prime tax reform needed now to encourage investors to furnish new capital to stimulate a growing and expanding economy and to provide jobs, is not only to retain the 4 percent tax credit but to expand the present $50 dividend exclusion to $200.

There is much to be gained and broad benefits to be derived by enlarging the exclusion further to $200 and in retaining the 4 percent tax credit.

This will be beneficial:

A. To the national economy because it will—

1. To the extent that a greater use of equities is encouraged, additional taxable sources would be created, thus producing an increase in Treasury tax revenues, thereby helping to offset the effect of proposed reductions in the present 52 percent corporate tax rate.

2. Reverse the downward trend of industrial Federal income tax corporate receipts by the Treasury.

3. Provide a soundly conceived means of meeting the Nation's capital needs for growth and strengthened industrial expansion.

4. Be a further step toward correcting a tax system which, in the President's words, still "reduces the incentive for risk, investment, and effort—thereby aborting our recoveries and stifling our national growth rate."

5. Greatly simplify the auditing problem of tax returns.

B. At the individual taxpayer's level because it will—

1. Encourage a large number of present noninvestors to direct some of their savings into equities, especially those at the lower income levels.

2. Encourage many present small investors to put more of their savings into equities.

3. Provide a measure of income tax relief on a greater portion of savings already subject to tax at the source of corporate earnings.

4. Provide a greater proportion of tax relief to the small investor than to those with larger incomes than under the present tax law.

5. Grant complete relief for over half of the people with dividend income.

6. Provide a greater share of tax relief than at present to taxpayers over 65 years old who have sacrificed over the years to provide themselves with a source of income at compulsory retirement.

7. Enable more people to participate as owners in American industrial enterprise and thus encourage and strengthen private investment which has always been the basis of the Nation's economic well-being.

C. At the corporate level because it will—

1. Stimulate greater use of equity financing for new construction capital needs.

2. Encourage the use of corporate equity capital which is a tax-producing source as against tax-reducing debt financing. For many years the existing Federal tax structure has tended to stimulate the use of debt financing. This is a deterrent to the utilization of equity money, largely because of the size of the tax imposed on earnings at the corporate level.

3. Reduce substantially the volume of reported dividend disbursements to the Treasury.

4. Promote a greater payout of earnings to attract more investors to provide a greater flow of equity money with a consequent lessened use of retained earnings for financing now construction.

In the President's message to the Congress January 24 last, relative to a revision of the tax structure, these beneficial results were recognized when he pointed out that:

"The most urgent task facing our Nation at home today is to end the tragic waste of unemployment and unused resources—to step up the growth and vigor of our national economy—to increase job and investment opportunities * * *.

"Originally designed to hold back war and post-war inflation, our present income tax structure now holds back consumer demand, initiative, and investment."

"Despite the improvements from last year's depreciation reform and investment credit * * * our tax system still * * * reduces the incentive for risk, investment, and effort—thereby aborting our recoveries and stifling our national growth rate."

"Investment and productivity improvement will be spurred by more intensive use of our present productive potential; and the added incentives to risk taking will speed the modernization of American industry. Additional dollars * * * invested by producers will lead to more jobs, more plant capacity, more markets, and thus still more dollars for consumption and investment."

In commenting on the tax program and its relation to the balance-of-payments deficit, which the Commerce Department has recently estimated at an annual deficiency of around $2 billion, the Treasury Department emphasized that we had been losing gold at a much faster rate than we could afford and stated that steps should be taken to restore our position to make the United States a more attractive place in which to invest long-term capital.

Thus, the Treasury has noted that with too many dollars going abroad, the administration has felt it necessary to propose a special tax on the purchase of foreign securities to discourage the outward flow of American capital. Yet, while recognizing the instrument of taxes as a means of discouraging foreign investment, there would seem to have been a disregard of the import of taxes as a deterrent to invest in venturesome American enterprise. I refer to the

proposed substantial reduction in the meager encouragement given in the 1954 Tax Act to investors in equity securities through the exclusion of $50 in dividends received and the 4 percent tax credit on the remainder.

Rather than reducing this incentive to invest in venture-type securities, what is needed are positive measures to improve—to make more attractive the climate for domestic investment; a more appropriate method and potentially more effective method to retain investment in America than negative measures to discourage American investments abroad. We need to encourage, not discourage, our people to put their dollars to work through equity investments in our domestic enterprise—thereby creating more jobs—boosting our productivity—strengthening the competitive power of American industry in world markets.

There is general agreement that the demands for funds for new capital formation will be very great over the next decade. For the 10-year period from 1960 to 1970, $500 billion of funds must be forthcoming to take care of the new construction which is necessary.

To finance this huge construction program, the cash needed can only come from three sources:

1. Cash generation from the day-to-day operations of business through depreciation reserves and retained earnings.
2. Debt financing.
3. Equity financing.

Debt and equity securities—the latter, preferred and common stocks—must be sold in the free market. New capital formation must be developed in order that these securities can be marketed at reasonable rates. Equity financing is especially important as it forms the base upon which the credit of the enterprise is established and thus is necessary so that debt securities can be marketed at reasonable cost.

The record of equity security financing for all corporations during the 5-year period ended in 1962 shows an average of $2.4 billion per year. It is evident that a construction program of $500 billion will require a very large increase in equity security sales and presents industry with a very great task.

The need to provide incentive for venture-type investments was clearly recognized at the time the 1954 Tax Act was passed by Congress as the key to modernization of our productive capacity. At that time it was proposed that $50 of dividends received by individuals would be excluded in 1954 and $100 thereafter, with a 5-percent tax credit for 1954 and then 10 percent in subsequent years. Later passage of the bill lowered these amounts to the present $50 exclusion and 4-percent tax credit. Yet in spite of the claim that this has not met the objective of stimulating investment in equities, the record shows that even with the slightly beneficial changes then adopted, the number of people owning stock has risen 162 percent from 6½ million in 1952 to the present total of over 17 million. So, given encouragement to invest in job-creating economic growth equity measures, effective results have ensued from the judicious congressional forethought exercised in the passage of the 1954 legislation. It may, therefore, reasonably be expected that the greater this form of tax adjustment, the greater will be the numbers of people who will be willing to provide the capital funds for growth of the economy.

But the House bill just passed and now before this committee does not offer our people sufficient incentive to participate in our Nation's industrial growth and progress by putting their money into job-producing, venture enterprise. Nor does it encourage those who already have invested. These people can find little satisfaction in policies whereby as much as $3.5 billion or more can be given in foreign aid to the people of foreign nations, worthy as this may be, while, at the same time, the Nation's tax policies discourage them from saving and investing in job-producing enterprise here at home.

The Treasury could well afford to commit $221.7 million for additional tax relief, especially with much of this directed to the low and median income taxpayers who are investors, of the total of $11.1 billion reduction in taxes effective under H.R. 8363. Tax exemption of dividends is a powerful inducement to individuals for investment in equity securities. It would be most constructive when making income tax revisions to give some added advantage to low and median income taxpayers who are also investors.

What results were obtained by the dividend taxation relief granted by Congress in the 1954 act?

The 1960 records of the U.S. Treasury Department show a reduction resulting: (1) From the $50 exclusion of $91,333,000; (2) from the 4-percent tax credit of $301,672,000; and (3) a total of $393,005,000.

How do the income groups receiving the benefits of these two relief measures compare? Analysis shows the following picture:

Adjusted gross income classes	Amount of tax loss to the Treasury Department by reason of—			
	$50 dividend exclusion		4-percent tax credit	
	Amount	Percent	Amount	Percent
Below $5,000	$12,200,000	13.4	$16,664,000	5.5
$5,000 to $10,000	25,030,000	27.4	38,083,000	12.6
$10,000 to $20,000	28,729,000	31.5	61,778,000	20.5
$20,000 to $50,000	19,173,000	21.0	81,393,000	27.0
Over $50,000	6,201,000	6.7	103,754,000	34.4
Total	91,333,000	100.0	301,672,000	100.0

These figures show, by income groups, the relief that the recipients of the two tax benefits received. Note that 40.8 percent of the total benefits from the $50 dividend exclusion were realized by those whose returns showed adjusted gross income of less than $10,000, compared with 18.1 percent from the 4-percent tax credit. But also to be noted is that these lower income groups benefit dollarwise substantially more from the 4-percent credit than from the $50 exclusion.

This suggests that while an increase in the dividend exclusion would be of great help to the taxpayers in the lower income brackets, they also have a very real interest in the retention of the 4-percent credit.

While substantial increases have taken place in the number of taxpaying stockholders, there is a vast number of people who remain as potential investors.

Chart I shows the number of people who do not report dividends, broken down by adjusted gross income classes. There were 78,847,301 people who filed taxable income returns in 1960; 69½ million did not report dividends. Of this group, there were 63,575,882 who had taxable incomes of less than $10,000. These do not now own stock.

Evidently, the big field for potential investors in equities is the over 63 million people with taxable income of less than $10,000 who do not now own stock.

If a better tax incentive were provided, a substantial number of these noninvestors would be stimulated to use some of their savings to buy equity securities in a cross section of industry. There is no doubt tax exemption of dividends is a powerful influence for equity investment by the small investor. If only a small proportion of these nonstockholding people were to become stockholders, the money so realized would supply a very substantial amount of the vitally needed capital for future industrial expansion.

For example, if only 10 percent of these 63,575,382 people, and the 3,393,275 with dividends below $200, could be induced to become stockholders by each one purchasing an average of $200 of stock each year over a 5-year period, about $6.7 billion of needed capital would be available, an average of $1⅓ billion each year.

An additional $1⅓ billion of equity capital is equal to over one-half of all the equity capital sold annually for the past 5 years. The availability of this amount of new equity capital would be the single most important stimulus to the industrial growth so desirable at this time.

Chart II gives an indication of what can be expected from raising the $50 exclusion as suggested.

In 1960—6,385,299 individual tax returns had dividend receipts. Of this number, 1,452,349 were completely excluded from taxation of dividends by the present $50 dividend exclusion. This left 4,932,950 with some dividends left in their adjusted gross income.

The chart shows the distribution of these remaining 4,932,950 taxpayers by amounts of their dividends. The percentages of the total are shown on the right of the stack.

Raising the $50 exclusion to $200 could be expected to include about all of those in the under-$100 dividend group, with 26.3 percent of the total now paying taxes on part of their dividends received. The addition of the $100–$200 group gives a total of 39.3 percent for the $0–$200 grouping. The $0–$200 group totals 1,940,926 returns which, added to the 1,452,349 returns protected by the present $50 dividend exclusion, gives a grand total of 3,393,275 returns. Thus, over one-

half of the total would be completely relieved of taxation of their dividends by raising the exclusion to $200.

What is most important, by raising the exemption to $200, 63.9 percent of the 4,932,950 taxable returns now reporting dividends would be in the group with adjusted gross incomes of less than $10,000.

Encouraging equity investment by this potentially large group of people in the lower income brackets is important from another consideration. The availability of anything like $6.7 billion for equity-type investments would be a major influence in the marketing of such securities. The bulk of the funds required to finance the postwar growth has largely come from current operations, a part from retained earnings, with additional sums from depreciation.

If equity capital was in greater supply, more of the capital requirements of industry could be expected to come from investors. Thus the need to conserve cash for expansion by retention of earnings would be lessened and more of the industry's earnings would be available to pay out to investors in the form of dividends, much of which could be expected to be spent for goods and services with a considerable portion over and above the exclusion and tax credit coming back to the Federal Treasury in the form of taxes. Also productive of taxes at the corporate level would be the greater use of equities in the place of tax-favored debt issues.

Substantial encouragement to take this important step can be given the people in these lower income brackets especially by extending the exclusion to $200. The greater this form of tax encouragement offered for this group, the greater it may be expected will be their incentive to become new owners of equity-type securities. Not only will such tax relief release substantial sums of money for investment in equities, but also it will do much to stimulate interest in the ownership of American industry on a broader basis, bringing with it the inherent advantages entailed by such a course.

As a further advantage, raising the amount of the exclusion to $200 would remove completely from tax on dividends a very substantial number of people whose yearly dividends would be wholly below the $200 limit. This would greatly simplify the auditing problem on their returns. It would make unnecessary the establishment of the low limit of $10 for reporting dividends paid and permit raising the limit to say $50, thus removing millions of names from the list of required reporting.

The best way to provide this relief for the investor in the lower income brackets is to increase the $50 dividend exclusion. By raising the $50 exclusion to $200, tax-free investment opportunities would be increased four times for the small investor. Not only would this attract new investors, but it would enable many of the existing small investors to add to their holdings on a tax-exempt basis.

With reduction in income tax rates applicable to both the corporate and individual rates, other changes have had the objective of raising some additional funds for the Treasury. The question is then, Would the generation of additional tax revenues ensue if new equity investment of $1⅓ billion per year would be made?

First, what is the effect of change of the $50 exclusion to $200, but with the tax credit remaining at 4 percent?

The cost in 1960 to the Treasury of the $50 exclusion and the 4-percent credit was $393 millilon.

With a $200 exclusion, and a 4-percent tax credit, the tax savings to these taxpayers would be $614.7 million, a difference of $221.7 million.

The following table shows the effect of this change by income classes:

Adjusted gross income classes	Amount of tax loss to the Treasury Department by reason of—			
	$200 dividend exclusion		4-percent tax credit	
	Amount	Percent	Amount	Percent
Below $5,000	$39,800,000	11.4	$10,864,000	4.1
$5,000 to $10,000	91,400,000	26.3	26,783,000	10.0
$10,000 to $20,000	108,700,000	31.3	50,578,000	18.9
$20,000 to $50,000	81,200,000	23.3	75,993,000	28.5
Over $50,000	26,800,000	7.7	102,554,000	38.5
Total	347,900,000	100.0	266,772,000	100.0

Comparing the existing provision of the tax law with the proposed change shows there is a substantial benefit to those in the lower income classes:

Total effect of dividend tax benefits under $200 exclusion versus present $50 exclusion with retention of 4 percent tax credit

Adjusted gross income classes	$50 exclusion and 4-percent tax credit	$200 exclusion and 4-percent tax credit	Increase in benefit to taxpayers	
			Amount	Percent
Below $5,000	$28,864,000	$50,664,000	$21,800,000	75.5
$5,000 to $10,000	63,113,000	118,183,000	55,070,000	87.3
$10,000 to $20,000	90,507,000	159,278,000	68,771,000	76.0
$20,000 to $50,000	100,566,000	157,193,000	56,627,000	56.3
Over $50,000	109,955,000	129,354,000	19,399,000	17.6
Total	393,005,000	614,672,000	221,667,000	56.4

Chart III shows that the taxpayers in the lower adjusted gross income classes receive the greatest percentage increase in the benefits under the larger dividend exclusion compared to the present provision. In the income class under $5,000, the additional benefit is 75.5 percent; those with incomes from $5,000 to $10,000 are helped by an 87.3-percent improvement. In the income class of over $50,000, the improvement is only 17.6 percent.

Is there an offset?

If only one-tenth of the 63.6 million nondividend receiving taxpayers, and the 3.4 million who report dividends under $200, would invest $200 each year for 5 years, $6.7 billion of new equity money would become available. What new taxes would accrue to the Treasury from this new additional equity capital?

Assume that the dividends received on the $6.7 billion would be at the rate of only 4 percent—this would amount to $268 million. With a 60-percent payout of earnings, $413 million in additional corporate Federal income taxes would pour into the Treasury. Offsetting the $221.7 million loss to the Treasury by reason of the change from $50 to $200 exclusion would be this $413 million gain in tax revenues from the increased investment by taxpayers in equity securities. Thus, after the fifth year the net estimated gain to the Treasury would be $191.3 million if the exclusion is raised from $50 to $200 and the 4-percent tax credit retained.

Let us look at another important area of impact—the elder citizen group. The 1960 statistics by the Internal Revenue Service give for the first time dividend data for individuals over 65. This chart IV shows, for 1960, individual income tax returns of $9,913,670,000 of dividends received by individual taxpayers, or $9,530,143,000 after exclusion. This is the amount of such dividends received by all age groups. Of this total, 45.4 percent is represented by returns where at least one taxpayer was 65 years old or over.

The tax returns on this chart V, from those taxpayers where at least one taxpayer was 65 years old or over, show a total adjusted gross income of $24,-273,073,000. Dividends received, after exclusions, amounted to 17.8 percent of this total income.

Investors with substantial financial resources can escape the taxation of investment income by the tax-exempt bond route. The small investor usually is not in position to do this. Raising the exemption to $200 would offer some semblance of equal opportunity to realize a small amount of income wholly tax exempt—and at the same time provide additional income to the older group of our citizens who have looked to their invested savings for income in the declining years.

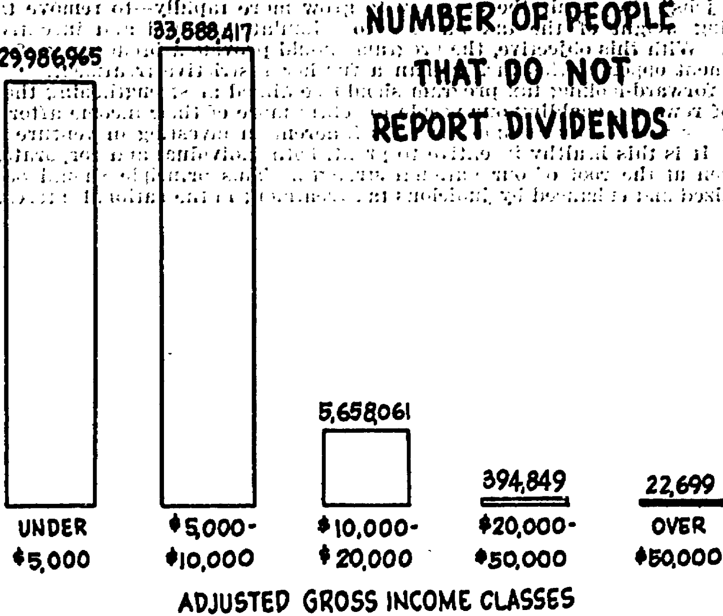
What is proposed here is of vital concern and importance to all industry, large and small. It would be especially important to the small investors in this country, for it would afford them, in large numbers, an opportunity to become owners of the Nation's industries, to invest in the venture funds needed now by American industry, and to profit by their efforts. This, in turn, would be of constructive value to the whole country, and be of material aid in realizing the desired growth in the Nation's economy.

The changes proposed are constructive and should be included in any tax revisions now to be made.

In the words of the Treasury, the "principal reason for the tax program is to create jobs"—to permit the economy to grow more rapidly—to remove the restraining weight of the tax burden—to stimulate demand and incentives to invest. With this objective, the program should provide a broadening of equity investment opportunities rather than a further restrictive treatment.

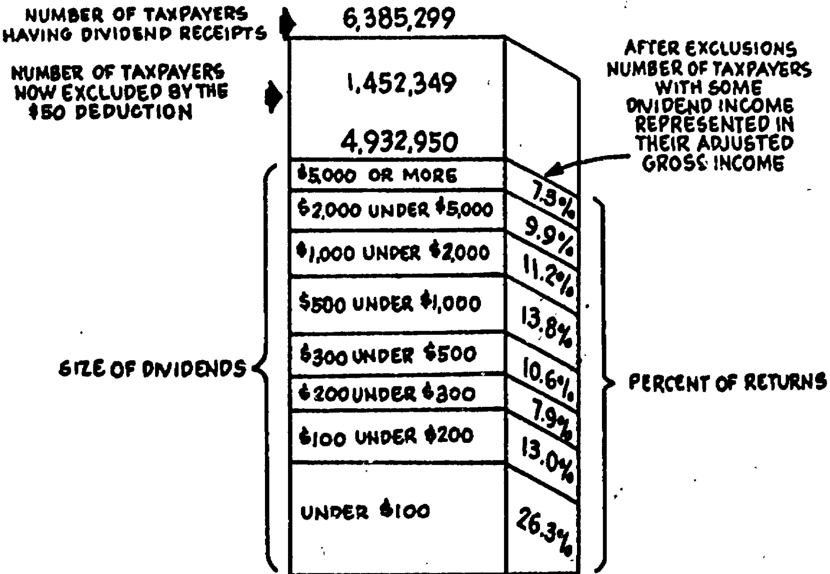
Any forward-looking tax program should be aimed at strengthening the principle of rewards, enabling our people to retain more of their income after taxes when they voluntarily assume the risks inherent in investing in venture enterprise. It is this healthy incentive to profit, both individual and corporate, that has been at the root of our national strength. This principle should be fully recognized and enhanced by judicious tax treatment in the national interest.

CHART I



SOURCE-U.S. TREASURY-INTERNAL REVENUE SERVICE-1960

CHART II



SOURCE-U.S. TREASURY-INTERNAL REVENUE SERVICE-1960

CHART III

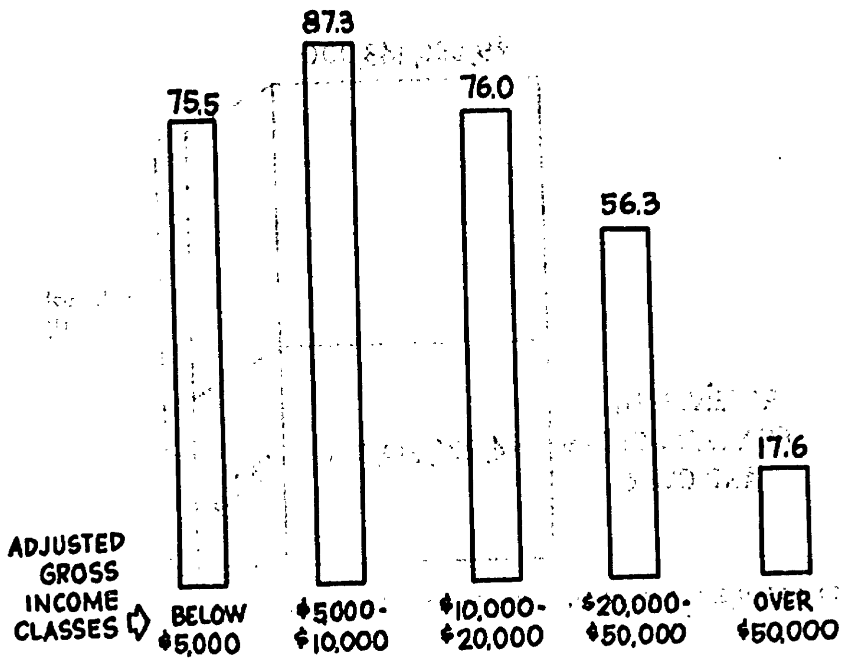
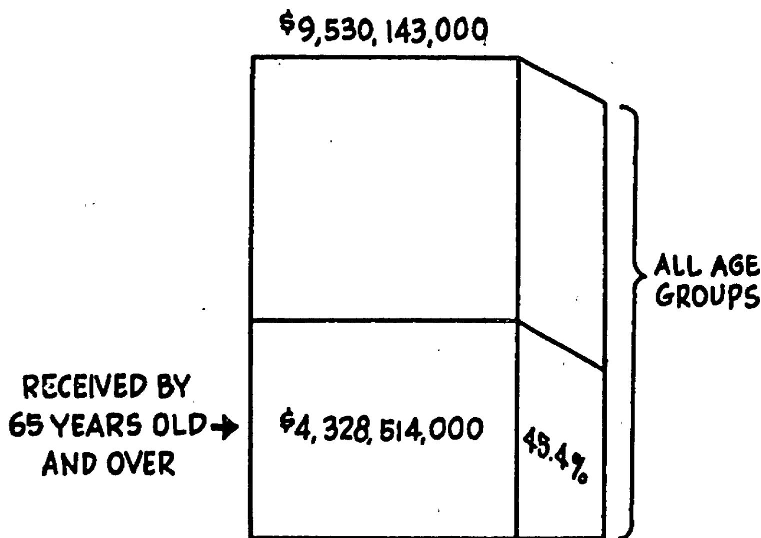


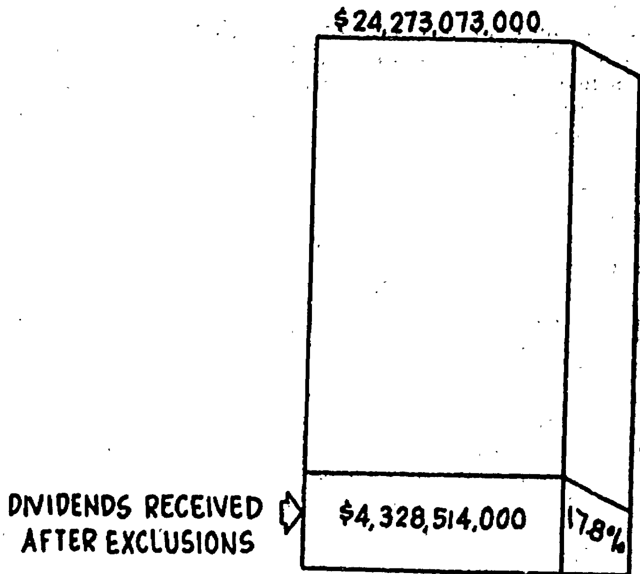
CHART IV

TOTAL DIVIDENDS RECEIVED AFTER EXCLUSIONS



SOURCE - U.S. TREASURY - INTERNAL REVENUE SERVICE - 1960

CHART V



The CHAIRMAN. The only witness at this session is Mr. Walter W. Heller, Chairman of the Council of Economic Advisers.

Mr. Heller, please proceed.

STATEMENT OF WALTER W. HELLER, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS; ACCOMPANIED BY GARDNER ACKLEY AND JOHN P. LEWIS, MEMBERS

Mr. HELLER. Mr. Chairman, and members of the committee, we are pleased to have this opportunity to appear before you to urge your approval of H.R. 8363, subject to the one change relating to capital gains taxation that has been recommended by Secretary Dillon.

The basic case for this major revision of our income tax legislation has been frequently presented by the President, and by Secretary Dillon and other members of the administration. The Council of Economic Advisers, Mr. Chairman, including my colleagues, Mr. Ackley on my right and Mr. Lewis on my left, has, on a number of occasions, developed the economic case for this crucially important piece of legislation—in our annual report for 1963, in testimony before the Joint Economic Committee, and in other public presentations.

We shall not, therefore, impose on the committee's time by presenting that affirmative case again in detail. We assume that you would prefer a summary of the economic case for tax reduction, leaving

time for an examination of the questions and objections that have been raised concerning it.

I. THE PROBLEMS OF PERSISTENT UNEMPLOYMENT, EXCESS CAPACITY, AND DEFICITS

The Nation today needs, and can afford, a major reduction in Federal income taxes for both individuals and corporations. H.R. 8363 would meet this need by a balanced income tax reduction of $11.1 billion. This would be a permanent reduction designed to deal with the persistent problem of underutilization of the Nation's manpower and industrial capacity. At the same time, it offers, as an important byproduct, our best hope for putting an end to a distressing series of Federal deficits.

The nature of our problem is familiar. Since about 1957 our advances in employment and production have not been sufficient to provide the jobs required to employ our growing labor force and to make full use of the American economy's tremendous productive potential. Over the 6 years 1958–63, our needless loss in output will total almost $200 billion. In 1963 alone, this loss is about $30 billion. During the same 6 years, our unemployment rate has averaged 6 percent, or nearly 50 percent higher than it did in the 1957–57 period. This is also 50 percent higher than our interim unemployment target of 4 percent which, in our view, is the least ambitious employment goal that this Nation, in good conscience, can set itself. Even in the first 10 months of 1963, the unemployment rate has averaged 5.7 percent, and still stands at 5½ percent.

A reflection of this inadequate performance of our economy since 1957 is found in our Federal budget, which has shown a cash deficit in 5 of the last 6 fiscal years for a cumulative deficit of $26 billion. The reason has not been an excessive growth of public expenditures, but an inadequate growth of revenues associated with economic slack.

Although not free of other economic problems—notably, several periods of rising prices—the years from 1947 through 1957 set an excellent overall record of production and employment. The end of World War II did not, as many feared it would, restore the dismal problems of the 1930's, when our economy seemed chronically unable to create enough jobs for its workers, and when many feared that it was structurally incapable of generating enough incomes to permit us to buy all we could produce. Instead, the first postwar decade was characterized by high and growing employment, rapid expansion of incomes and output, and high levels of investment—investment that provided the growing capacity needed to meet swelling demands by consumers, by private business, by Federal, State, and local governments, and by the rest of the world.

As a byproduct of this prosperous economy, we were able to maintain a balance in our Federal accounts. Over the 11 fiscal years from 1947 through 1957, there were seven cash surpluses and four cash deficits, for a net cash surplus of $20 billion.

In retrospect, the reasons for our excellent postwar performance in production and employment are clear enough: During a decade and a half of depression and war, vast backlogs of demand had been built up by consumers, farmers, businesses, and State and local governments—for more and better durable goods, for houses, for farm machinery, for plant and equipment, and for roads and schools. The Korean conflict imposed new requirements before these backlogs had been fully worked off. And after Korea, high consumer and investment demands were supported for several years by the tax reduction

of 1954, a surge of automobile buying and homebuilding, and a widening conviction that our economy could sustain indefinite expansion.

Then we failed to achieve full recovery from the 1957 recession, and slid off into recession again in 1960. Talk of the "soaring sixties" began to turn a little sour. But the unusual speed of our recovery in 1961, giving promise of further gains to come, delayed recognition that the underlying situation had really changed. It is clear now that we passed a watershed in the 1955–57 period.

Despite the prolonged expansion beginning early in 1961—an expansion that will soon achieve a $100 billion rise in GNP, and that has already raised industrial production 22 percent, profits 40 percent, and employment by 2½ million—our economy has not grown fast enough to eliminate excessive unemployment and unused productive capacity. Nor is there any reasonable prospect that, without new major measures of policy, the current expansion can be sufficiently accelerated and prolonged to achieve the maximum employment, production, and purchasing power which are the Nation's stated economic goals in the Employment Act of 1946.

The performance of the U.S. economy in the past year demonstrates how fast we have to run merely to stand still. From the third quarter of 1962 to the third quarter of 1963, our GNP rose nearly $32 billion, or an average of some $600 for every U.S. family. And yet unemployment did not change—it averaged 5½ percent in both periods. In other words, such advances in GNP and income are big enough to enable us to hold our own; to absorb the yearly increases in the labor force and the rise in labor productivity; but they are not big enough to bring unemployment down to our modest interim target of 4 percent. Even crossing the $600 billion GNP line early in 1964, while dramatic and impressive, will leave us well short of the accepted goals and aspirations of the American people. Unemployment will still be around 5½ percent of the labor force. Operating rates in industry will still be well short of capacity. And the economy's annual output of goods and services will still be about $30 billion short of its potential.

The primary reason for this unsatisfactory performance is a lack of adequate total demand. A general strengthening of consumer markets and investment demands will go a long way toward solving our major economic problems. It will provide the basic incentive for business to produce more goods and services and hire more workers. And by thus accelerating the growth of production, jobs, and incomes, it can enlarge the tax base sufficiently to permit a restoration of balance in our Federal accounts. Our whole postwar history demonstrates that full employment breeds budgetary surpluses, while a slack economy generates deficits.

The Federal budget, in turn, is a powerful instrument for affecting the level of total market demand: Federal buying currently provides a market for some 11 to 12 percent of our total output of goods and services; and Federal taxes (and transfer payments) determine how large a share of the incomes earned by consumers and businesses will be left in private hands to finance and motivate consumer buying and business investment.

There is no doubt that a massive expansion of Government spending would raise output and reduce unemployment. It did so in World War II and in the Korean conflict; and a rapid continuing expansion of public demand has made a major contribution to the remarkable

postwar production and employment record of Western Europe. But the administration is convinced that under present circumstances no massive substitution of public for private spending could generate the incentives for private creativity and initiative which are basic to a renewal of our economic vitality. It therefore proposes to strengthen private market demands and to create new private jobs through an $11 billion reduction in income taxes.

Tax reduction will not only release purchasing power and raise private buying, but it is also an effective way to achieve the combined stimulus, through higher demand and sharpened business incentives, which is needed to step up private investment for modernization and new products, to accelerate the growth of productivity of U.S. industry, and to cut costs of production. Through this method we will not only speed our domestic economic growth, but, at the same time, we will make American goods more competitive in world markets and make American investment more attractive than investment overseas, thereby helping to overcome our persistent balance-of-payments deficits. Indeed, our balance-of-payments situation provides one of the strongest reasons both for stimulating our economic growth, and for doing it by way of tax reduction and revision.

II. THE BASIC CASE FOR TAX REDUCTION

Federal tax revenues, including payroll taxes, have risen materially as a proportion of the GNP since 1948. As the following table indicates, they rose from 16.7 to 18.5 percent of GNP between 1948 and 1957. Given the pent-up demands of the postwar years, the pressures of the Korean conflict, and the healthy business optimism of the 1954–57 expansion, such a rise was consistent with high employment and served to restrain, if not to prevent, inflation. During the same period, Federal purchases of goods and services rose from 7.4 percent of GNP in 1948 to 11.2 percent in 1957, and total Federal expenditures (including social security benefits and other trust fund payments) rose from 13.6 to 18 percent of GNP, and that is shown, summarized, in the following table.

(The table referred to follows:)

Federal tax revenues, expenditures, and purchases of goods and services, as percentage of GNP: 1948, 1957, and 1963 [1]

[In percent]

	1948	1957	1st half, 1963	
			Actual	At 4-percent unemployment
Taxes revenues [2]	16.7	18.5	19.3	20.0
Expenditures [3]	13.6	18.0	20.0	18.7
Purchases of goods and services	7.4	11.2	11.5	10.8

[1] All data based on national income and product accounts.
[2] Includes social security payroll taxes.
[3] Includes payments by Federal trust funds.

Source: Computed from Department of Commerce data, except estimates for first-half 1963 at 4-percent unemployment by Council of Economic Advisers.

Mr. HELLER. However, since 1957, expansionary pressures have diminished markedly. Yet Federal tax revenues have continued to rise as a percentage of GNP, from 18.5 percent of GNP in 1957 to 19.3 percent in the first half of this year. And had the economy

been operating at a 4-percent level of unemployment (approximately the same as in 1957), tax revenues would have been a still higher percentage of GNP, an estimated 20 percent. During these same years, however, Government purchases rose only from 11.2 to 11.6 percent of GNP, and total expenditures from 18 to 20 percent. But again, had the economy been operating at 4-percent unemployment this year, the purchases actually made this year would have fallen as a percentage of GNP, and total expenditures would have risen only slightly, to 18.7 percent of GNP. There would have been a Federal surplus (on a national income basis) of about $8 billion.

There can be no serious quarrel with the proposition that, relative to the strength of public-plus-private demands, taxes have been too high since 1957. This relative disparity has been a primary source of our economic difficulties. And it is this disparity that the administration seeks to correct through tax reduction, through easing the tax brake.

The way in which an $11 billion tax reduction would translate itself into an increase of some $30 billion in total demand is increasingly well understood. After-tax consumer incomes would rise, at existing levels of production, by some $8.8 billion from individual tax reduction, and by an additional $1 billion from corporate tax reduction (through higher dividends). As consumer after-tax incomes rise, their spending on the purchase of consumer goods and services also rises. In fact, during each of the past dozen years, consumers in the aggregate have spent close to 93 percent of their available after-tax incomes on purchases of current output, and they would soon adjust their spending to restore that rate. To meet this added demand, some $9 billion of extra annual production of consumer goods and services would be generated. The production of these extra goods and services would be generated. The production of these extra goods and services—using labor now unwillingly idle and plants now insufficiently utilized—would generate new payrolls, profits, and farm and professional incomes. This extra income in turn would be respent on added goods and services, generating repeated further cycles of income and spending, for a total direct consumption impact of more than $18 billion a year.

At the same time, incentives to invest would be strengthened, both by reduction of business taxes and by the fuller use of existing plant and equipment. Extra business investment, together with higher residential construction and increased State and local government spending—financed by higher State and local tax yields from an expanding tax base—could add another $5 to $7 billion of annual demand and production. This production, too, would raise incomes, reinforcing consumer spending by another $5 to $7 billion. An expansion in production of approximately $30 billion per year (at this year's level of gross national product and income) is thus a reasonable expectation based on economic experience.

A deliberate choice to use the tax-reduction, private-demand route to fuller prosperity carries two obvious corollaries: First, we must not offset the expansion of private demands by an equivalent reduction of public demands—this would give us no net change in the total of private-plus-public buying and would undercut the strength of both our defense and civilian programs. Yet, second, we must restrain carefully the growth of public expenditure to avoid an excessive expansion of private-plus-public demand, to maintain efficient control

III. THE IMPORTANCE OF EARLY ACTION

over the use of public funds, and to assure the early restoration of balance in our public financial accounts.

Apart from the basic case for the tax cut in overcoming persistent slack and creating jobs, the question of timing is also important. The more rapidly production and incomes are already rising when taxes are cut, the more expansionary impetus the cut will provide—particularly to investment. Right now, expansion is occurring at a good pace, business confidence is firm, and the stimulus of the tax cut will reinforce a strong existing momentum, thereby having its maximum impact in closing the gap of unused manpower and capacity. If we wait, some of the momentum may be lost, and the tax cut will have less of a springboard from which to raise our economy to the higher levels at which it can and should operate.

We are unlikely to find a better time, and we could well find a worse one. Few serious observers expect that the current expansion can accelerate without a tax cut. Rather, the debated question is chiefly how much longer the expansion can be expected to continue before reaching a plateau or terminating in a downturn.

One who looks only at the unhappy record of the past would say a downturn is already overdue. The average duration of peacetime expansions since 1920 is 28 months, of post-World War II expansions (omitting the one that spanned the Korean conflict), 32 months. We are already in the 33d month of this one. If it lasts until next April, it will be the longest in our peacetime history, save only the 1933-37 climb from the subdepths of the great depression, an expansion which failed to reduce the unemployment rate below about 14 percent.

However, we reject any mechanical extrapolation of the past. Recessions are never inevitable, and wise policy can both moderate their severity when they occur, and even—by timely action—forestall them.

No one can with certainty forecast that a 1964 recession will occur if taxes are not cut now. But this much seems plain: The chances that the present economic expansion could continue through 1964 without an early tax cut are poor—so poor, that the opportunity to take out antirecession insurance as a byproduct of an attack on long-run problems becomes a powerful argument for timely enactment of H.R. 8363.

Most business forecasters tell us that, without the stimulus of tax reduction, auto sales and residential construction next year are unlikely to exceed current levels. Moreover, we know that Federal purchases will rise less in 1964 than in 1963. And last week, the McGraw-Hill survey reported that business plans to spend only 4 percent more in 1964 for plant and equipment than they spent in 1963. Since the fourth-quarter-1963 level is expected to exceed the 1963 average by more than 4 percent the survey apears to forecast no further rise next year in this strategic type of expenditures. This would be disappointing news were it not for the fact that other indicators—and past experience—suggest a more optimistic investment outlook for 1964, especially if taxes are cut.

The source of our expansion in overall demand during 1963 have been precisely the expenditures just reviewed—automobile purchases, residential construction, Government purchases, and plant and equipment investment. The outlook for the next 6 months is not for the total of these expenditures to decline or even to fail to grow, but rather

for the rate of increase to taper off sharply. In spite of a 2.6-percent rise in constant-dollar GNP in the first three quarters of 1963, the October unemployment rate stands at the same level as it did last December, 5½ percent (after seasonal adjustment). A slowing down of our rate of expansion would surely cause a rise in the unemployment rate.

Moreover, experience has shown time and time again that a slowdown in expansion sets to work forces that may produce contraction. As the rate of expansion tapers off, so does the need by businesses to expand their stocks of inventories and fixed capital. Thus a falling rate of expansion of demand during the first half of next year could lead to contraction in the second half.

Timely passage of the tax bill therefore becomes all the more urgent. Prompt action may enable us to forestall a recession. The Nation's stake in averting recessions can be illustrated by a simple calculation based on the recessions of 1957–58 and 1960–61. A downturn equaling the average force of these two recessions would involve a 2 percent, or $12 billion, drop in GNP (annual rate), and would bring with it—

A drop of over 9 percent in industrial production;

A rise of 2 million, or 50 percent, in unemployment; and

A sag in corporate profits (after tax) of over $5 billion, or 20 percent.

And since we are concerned with the transitional loss in Federal revenues as a result of a tax cut, it is sobering to reflect on the loss of Federal revenues which a recession would bring. After the 1957 recession, for example, it was 2 years (8 calendar quarters), before Federal revenues returned to their prerecession level. During this time, there was a cumulative reduction of cash revenues, below the prerecession level, of $6½ billion. Had recession been avoided, revenues of course would have risen, not fallen. Since Federal cash payments continued to rise (in part to fight the recession), there was a cumulative shift to deficit of $17.2 billion in the 2 years of the 1957–58 recession. In fiscal year 1959 alone, the cash deficit was $13.1 billion. A comparable recession today would produce an even larger revenue loss and an even larger Federal deficit.

Clearly, if the tax cut serves to avert a costly recession, it will have yielded a big immediate dividend, quite apart from its long-run benefits. But it is worth emphasizing again that the basic case for the tax cut rests on 6 years of perennially slack performance. Even if expansion were to continue for another year or two at its present pace, unemployment would still be far too high, and tens of billions of dollars of our potential output would still be running to waste. This was, and is, the basic case for the tax cut.

IV. THE BALANCE BETWEEN INVESTMENT AND CONSUMPTION

Choice of the tax-reduction route to expansion requires a choice as to whose taxes to reduce, whether high-income or low-income taxpayers; whether individual or corporate taxpayers; whether those older or younger, with larger or smaller families, receiving income from labor or from property; and so on. Although many broader considerations are also involved, there is at least one major economic question which underlies these choices. It concerns the desired balance between added consumption and added investment.

A number of considerations bear on the question whether the tax reduction should be primarily structured to raise consumer purchasing power or should concentrate instead on improving incentives to investment:

1. For a country concerned with stepping up its rate of growth and improving its competitive position abroad through cost-cutting investment, the U.S. record of private investment since 1957 is both revealing and disturbing. Fixed business investment in relation to GNP has fallen from the 10–11 percent levels of the 1949–57 period to an average of 9 percent of GNP in recent years. I might point out that while those percentages may look small, each percentage point represents roughly $6 billion of business investment. As we move from 9 percent to 11 percent of GNP we are talking about a difference of as much as $12 billion in investment. And in the 6-year period 1956–62, while GNP (in constant prices) was rising by nearly one-fifth, business fixed investment (also in constant prices) barely struggled back to its level at the beginning of the period. Much of the basis for the slowdown in growth and the speedup in the outflow of investment funds abroad is found in these figures. Until we make investment here in the United States more attractive than investment abroad, and raise the rate of domestic investment relative to domestic saving, we will not permanently solve our problem of excessive capital outflow. To deal with these problems requires that we raise our rate of investment closer to its earlier postwar levels. This, in turn, implies a somewhat larger percentage growth in investment than in consumer expenditures as we move back toward high employment.

2. Of course, even if the initial stimulus of a tax cut were concentrated entirely on consumption, investment would also be indirectly stimulated. As output of consumption goods and services expanded, producers would feel a growing pinch on capacity, which would lead them to raise their investment rate to relieve the pinch. But the investment response would be delayed, and it might well produce some price advances—reflecting both the pressure of demand on supply, and on effort by businesses to finance the investment through higher pretax profit margins. Moreover, it would be unlikely to give investment the extra push needed to step up our growth rate and our productivity advance.

3. Giving the entire initial stimulus to investment would, if the stimulus were effective, also indirectly increase consumption. As investment increased, the higher employment and consumer incomes earned in building new plants and producing new machinery would largely be used to expand consumer buying. But in the absence of simultaneously expanding consumer markets, investment might fail to respond to the stimulus provided. At the very best, the expansion in consumption would be delayed, and the effectiveness of the investment stimulus seriously weakened, because capacity would have to expand ahead of the ultimate market for its product.

4. We seek an assured, a balanced, and a sustainable expansion. To get it we need a tax reduction that gives a balanced stimulus to both consumption and investment, to consumption, to expand the ultimate markets for growing output; and to investment, both to provide the extra capacity to produce more consumer and capital goods in the years ahead, and to do so with the rapidly rising pro-

ductive efficiency that will support price stability and improve American competitiveness.

5. The balanced tax reduction in H.R. 8363 will raise the investment share of GNP back toward the levels of the earlier postwar period. In the midfifties, when the investment share was nearly 11 percent, the relative weight of consumer and business taxes was no different than it has been in the past 6 years. H.R. 8363, combined with the 1962 tax measures, will provide a balanced reduction of both individual and corporate liabilities—each by about 20 percent.

Consumer markets will receive the direct stimulus of an $8.8 billion individual tax reduction. A new reduction of $2.3 billion for corporations, combined with the $2.3 billion of business tax benefits under last year's tax changes will not only add to consumer dividend incomes and corporate cash flow, but, more significantly, will sharply increase the aftertax profitability of new investment. For example, the increase for a new investment in an asset of 10-year life would be an estimated 35 percent. In addition, while many large corporations may find their internal cash flow no obstacle to expanding investment, this is not true in all industries, nor is it typically true of smaller corporations, which get special tax advantages under H.R. 8363, nor of millions of unincorporated businesses whose owners will directly benefit from individual tax rate reductions.

The roughly $25 billion expansion of consumer markets which the tax cut is expected to generate, in its full effect, will validate the roughly $5 billion of added investment by business in expanded productive capacity. The stronger investment stimulants will result in more, better, and lower cost products for consumers. And the interlocking effects of stronger consumer markets and higher investment will create not only more, but more productive, jobs.

V. TAX CUTS AND THE PRICE LEVEL

An appraisal of the economic case for tax reduction must take account of its possible impact on price levels. Many critics of tax reduction fear that part of its expansionary force, possibly a large part, will be expressed in inflation. They often refer, in this connection, to the past record of deficits and price movements.

The facts of U.S. postwar experience contradict the assumed connection between deficits and inflation. The record peacetime deficit of fiscal 1959 produced no inflation at the time or subsequently, nor have the deficits of fiscal years 1961, 1962, or 1963, while the surpluses of 1947, 1948, 1951, and 1957 coincided with the periods when most of our postwar inflation occurred. In the 11 fiscal years 1947 through 1957, when we ran a cumulative net cash surplus of $20 billion, to which I referred earlier, consumer price increases averaged 3.8 percent per year and wholesale prices, 4.4 percent. But since fiscal 1957, while we have run a cumulative net cash deficit of $26 billion, the increase in consumer prices has slowed to 1.4 percent a year, and wholesale prices have remained essentially unchanged.

In other words, it is not the budgetary surpluses or deficits as such that determine whether we have inflation, but the level of total private and public demands relative to our productive capacity. Cutting taxes or increasing expenditures at the wrong time, when total demand is pressing against full-employment capacity, would risk inflation. But that is not our situation today. There is ample margin

for an increase in output, rather than prices, in response to an acceleration in demand. Our total output would have to be some $30 billion higher than now to reduce unemployment even to 4 percent and raise rates of capacity utilization to satisfactory levels.

The argument has been sometimes advanced that, before unemployment could be reduced to 4 percent, the economy would encounter bottlenecks in the form of shortages of skilled labor, which would lead to inflationary rises in wages and prices. The Council analyzed this question in considerable detail in a statement presented on October 21 to the Subcommittee on Employment and Manpower of the Senate Committee on Labor and Public Welfare. Although we found clear evidence of distressing and persistent pockets of structural unemployment we found little or no evidence to support the view that the economy would encounter serious bottlenecks on the way to a 4-percent rate of unemployment.

In the past 5 years our basic prices, especially our wholesale prices, have been remarkably stable, and wage increases have become steadily more moderate—in fact, our record of relative stability of prices and wage costs is unmatched by any other major industrial nation except Canada. We do not believe that a faster expansion stimulated by tax reduction need spoil that record.

In recent weeks and months, a number of price increases have attracted attention and concern. But the wholesale price index so far shows little or no reflection of these increases, which suggests (*a*) that there have also been some less publicized price reductions and (*b*) that the bulk of prices has not moved. Nevertheless, we must expect that there will be some further scattered price increases in the months ahead. Many of the increases we have already seen and will continue to see are in prices of raw materials, often of agricultural origin, and frequently traded on international markets. The trend of such prices has been stable or downward for a number of years, and some recovery will not be unexpected. But the abundance of world raw material supplies suggests that serious inflationary pressures are not likely to originate in these markets.

We have more reason for concern with price increases posted by domestic manufacturers in industries where prices are guided by the judgment of producers rather than responding exclusively to free-market interaction of supply and demand. With tax cuts in effect, or even in prospect, some producers may be tempted to take advantage of expanding markets to boost their prices and to enlarge the margin over their costs. In the light of record and rising profits and the still higher sales and profits from the tax cut, the American public would, in our opinion, have little sympathy for such pricing policies.

We also have good reason to hope that inflation will not originate in excessive increases in wage rate or fringe benefit costs. Leaders of responsible labor organizations increasingly recognize the tendency for wage rate increases that exceed the growth of productivity to become self-defeating if they are generalized, that gains realized in one turn of the wage-price spiral are lost in the next. An added buffer against inflationary wage settlements will be found in the faster increases of productivity stimulated by lower taxes—not to mention the billions of dollars of increase in take-home pay from the tax cut itself.

For these reasons we do not fear an imminent resumption of the price-wage or wage-price spiral. A combination of moderate increases in wage rates and other labor costs, healthy increases in productivity, and a rising volume of sales makes general increases in the level of industrial prices unnecessary. Indeed, some price reductions would seem appropriate as the expansion proceeds. We have had several direct indications from major industrial executives in the past few weeks, in a series of meetings we have had with business leaders, that they expect the tax cut to bring about volume increases and unit-cost reductions that will make it easier to hold current prices or even to reduce them.

CONCLUSION

The enactment of H.R. 8363 would consolidate and enlarge the notable economic gains already achieved in the past 3 years—gains which have loosened but not yet broken the grip of underproduction, excessive unemployment, and slow growth.

Though no single measure can solve all of our complex economic problems, H.R. 8363 promises significant advances on each of the following fronts:

It will not only lower our unemployment rate but help to keep it down;

It will accelerate the long-term growth of our productive capacity;

It will help to lower costs and correct our balance-of-payments deficit; and

It will provide the economic base for overcoming our chronic budget deficits.

At the same time that it yields these sustained long-term benefits, it will provide important short-term insurance against recession.

No domestic economic measure since the war has been more carefully considered, either within the executive branch or within the Congress. And none has been more important. We urgently recommend its early enactment.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Heller.

Mr. Heller, when were you appointed to the position you now hold?

Mr. HELLER. In January 1961.

The CHAIRMAN. At any time have you been in favor of balancing the budget?

Mr. HELLER. I am in favor of balancing the budget, Mr. Chairman, or even running a surplus, in a fully employed economy.

The CHAIRMAN. Did you agree with the President then when he said on January 30, 1961:

> It is my current intention to advocate a program of expenditure which, including revenues and stimulation of the economy, will not of and by themselves unbalance the budget.

Mr. HELLER. Do I favor that statement, is that your question, sir?

The CHAIRMAN. It was in his message of January 30, 1961. Did you favor that?

Mr. HELLER. At the time, yes.

The CHAIRMAN. You wanted a balanced budget at that time?

Mr. HELLER. Given the conditions that were stated in the President's statement, I was in accord with that position.

The CHAIRMAN. Then the President, a little later on, when he brought up the budget, said:

* * * At a modest surplus of $500 million, under the present economic circumstances a modest surplus of the magnitude projected, is the best national policy considering all of our needs and objectives.

But in fact, in a few months that turned into a deficit of $6 or $8 billion, is that not correct?

Mr. HELLER. That is correct.

The CHAIRMAN. When did you think the budget should be balanced and should not be balanced?

Mr. HELLER. Well, sir, I think the budget should be balanced or even run a surplus in an economy that is operating at high levels of production, at reasonably full employment, say in the neighborhood of 4-percent unemployment, and at times—in other words, when we are making full and growing use of our productive capacity. I take very much the same position on this as Representative Mills stated in defending the tax bill in the House of Representatives.

The CHAIRMAN. Well, what part of balancing the budget should come from a reduction of expenditures?

Mr. HELLER. Apart from the always necessary restraint in expenditures that is represented by efficiency and economy in Government, I do not think that under present circumstances we should achieve balance by an actual reduction in expenditures.

It seems to me that what is necessary is an expansion in the base of the economy so that we will have increasing revenues which, combined with restraint in the growth of Government expenditures, will yield a balanced budget in a balanced economy.

The CHAIRMAN. You do not advocate at this time any reduction of expenditures as a part of balancing the budget? As you know, it is out of balance. The Secretary testified that the deficits will aggregate $30 billion in 6 years—that is the past 3 years and the 3 years to come—and even then he did not definitely predict a balanced budget.

In other words, what I am trying to get at, Mr. Heller, is this: What is your plan—and the plan of the administration, if they desire to balance the budget at all; for reducing expenditures to balance the budget?

Mr. HELLER. Mr. Chairman, I think that the point made by Secretary Dillon is that in the series of years en route to a balanced budget we would accumulate as much as $30 billion of deficits.

I have a strong conviction, however, that if, on the one hand, we stimulate the economy by increasing private demand and, on the other hand, we cancel that out by reducing public demand, the total effect would be self-defeating because we would be canceling out with one action what we were undertaking with the other.

That conviction by no means suggests we should undertake spending for spending's sake. I am entirely opposed to that. We should only undertake the programs that can be defended and efficiently and economically carried out. Nevertheless, this does not call for an overall reduction in Government expenditures to offset the cut in taxes.

The CHAIRMAN. In other words, reducing expenditures is not a part of your program to balance the budget?

Mr. HELLER. Reducing expenditures as a proportion of the gross national product—in other words, reducing them relative to the size of the economy—is part of this program.

The CHAIRMAN. I am not talking about that, Mr. Heller. I am talking now about actually reducing present expenditures which are approaching $100 billion.

Mr. HELLER. Actually reducing total expenditures below their present level is not part of the program; no, sir.

The CHAIRMAN. Then do you agree with Mr. Surrey, the Assistant Secretary of the Treasury, that the effectiveness of tax rate reductions will be lost from the short-run point of view, if they are accompanied by matching reductions in expenditures, "even assuming such expenditure reductions were possible, which they are not?"

Mr. HELLER. I agree with that with one exception. I agree with it with respect to the impact on the total level of demand in the economy. On the other hand, if we paired tax reduction and expenditure reduction, we would come out with some increase in incentives from lowering taxes. I think that would be——

The CHAIRMAN. The reason I am asking this line of questions——

Mr. HELLER. Excuse me.

The CHAIRMAN (continuing). Mr. Heller, is that it appears evident to me that the program of the administration is to reduce taxes and increase spending, and the two together will make it impossible to have a balanced budget, in my opinion.

Do you agree with the preamble in the House bill which says:

> To further the objective of obtaining balanced budgets in the near future, Congress by this action—

that is, by this bill—

> recognizes the importance of taking all reasonable means to restrain Government spending and urges the President to declare his accord with this objective.

Mr. HELLER. Yes, I agree with that, Mr. Chairman.

The CHAIRMAN. But you say you do not favor reducing any expenditures?

Mr. HELLER. No. I think that restraint in this case is met by holding down the actual increase in expenditures that would otherwise take place. In other words, I think that, given the pressures of a growing population, rising standards of living, and consequently growing demands on Government, there is almost a natural built-in increase in Government expenditures. I think that has been the history over the years.

The CHAIRMAN. Do you think the expenditure budget, for next fiscal year will be greater than it is this year?

Mr. HELLER. Do I think that the expenditure total will be higher?

The CHAIRMAN. Yes.

Mr. HELLER. I would expect it would be; yes, sir.

The CHAIRMAN. How much higher?

Mr. HELLER. That, sir, I have no way of knowing at this stage of the game.

The CHAIRMAN. Then, do you think you are in conflict with the preamble which the House stated was inserted with the approval of the administration, that—

> all reasonable means to restrain Government spending and urges the President to declare his accord with this objective.

Now, you say you are not in favor of reducing Government spending. That is about what I expected, and I want to thank you for

your frankness. You have been very frank about it. I have anticipated it.

You are the first Government witness who has come out and frankly said you do not want to reduce the present level of expenditures, but you want to increase them.

Mr. HELLER. But, at the same time, Mr. Chairman, in fairness, it should be recorded that, in view of the tax cut, I am thoroughly in favor of restraining the advance in Government expenditures below what it otherwise would have been.

The CHAIRMAN. Well, are you in favor of restraining them to the extent of eliminating waste, extravagance, and unnecessary expenditures.

Mr. HELLER. Yes, I am, sir.

The CHAIRMAN. You said a few moments ago you were not in favor of reducing the expenditures.

Mr. HELLER. Because I think boiling out the waste and extravagance, at the same time that we are meeting the legitimate needs of the American people on both the defense and civilian fronts, would not result in reducing the total.

The CHAIRMAN. You said a few moments ago you expected the budget next year to be higher than this year.

Mr. HELLER. I do expect the budget of next year to be higher than this year.

The CHAIRMAN. We have made that a matter of record.

Last year you were one of the strong advocates for a so-called quickie tax cut. Would you agree that economic conditions which have occurred thus far this year now indicate that such a quickie tax cut was not necessary and would have been unwise?

Mr. HELLER. Well, Mr. Chairman, we have had this problem of excessive unemployment and unused capacity for almost 6 years. Quite apart from the question of whether I favored a quickie tax cut or not last year, if we had been able to reduce taxes we would have had a faster growth in our output, in jobs, and in profits in the meanwhile.

The CHAIRMAN. In other words, you believe that Congress would have been wise in adopting a quickie tax cut such as you advocated last year?

Mr. HELLER. Let me put it this way: If it would have been possible to have put through a balanced and well-considered tax cut under those circumstances, yes. But I think that is a question that has to go well beyond economics—into the question of whether it would have been possible for Congress, in its own judgment, to undertake action on that kind of a schedule.

The CHAIRMAN. If you had the choice between the present tax bill and the one you advocated a year ago, which one would you take?

Mr. HELLER. I did not advocate any particular tax reduction a year ago.

The CHAIRMAN. You did not advocate a quickie tax cut last year?

Mr. HELLER. I did not advocate a quickie tax cut in any official capacity last year; that is to say, there was no——

The CHAIRMAN. You were certainly quoted last year as favoring a quickie tax cut.

Mr. HELLER. What I am saying is this: If we had had action last year to reduce taxes, the economy would have been further along than it is today.

The CHAIRMAN. You did favor it then at that time?

Mr. HELLER. I did favor tax action, yes, to reduce the excessive fiscal drag on the economy.

The CHAIRMAN. What do you mean by a quickie tax cut?

Mr. HELLER. Well, a quickie tax cut would be a temporary reduction in taxes that would terminate within a year or so, and when I say I did not advocate temporary reduction——

The CHAIRMAN. Looking back upon what has occurred with the rising prosperity of the country, the increased profits of the business corporations, which bring about a greater employment—while it is true we may have more unemployed than we like—our total of employment as of today has reached the highest level in the history of the Nation.

Mr. HELLER. That is true.

The CHAIRMAN. I think it is around 69 million people, is that correct?

Mr. HELLER. Yes; 69 million on a seasonally adjusted basis and closer to 70 million actually.

The CHAIRMAN. Seventy million.

Mr. HELLER. Yes.

The CHAIRMAN. So when you look at this unemployment you have got to look at how many are employed as well as how many are unemployed, and the question of the number of unemployed is very difficult to determine. The question arises as to the number of wage earners in a family. Wives are working much more than they used to, and there are things of that kind that must be considered.

I am not in any way defending unemployment. I wish we could have full employment.

Mr. HELLER. Well, Mr. Chairman——

The CHAIRMAN. But what I want to get clear is this: In your statement you refer to the significant unmet needs for the expansion of the Federal programs in such fields as education, urban renewal, mass transportation, housing, public works, and health. In other words, you want to increase the appropriations and spending in these particular categories, is that right?

Mr. HELLER. Mr. Chairman, I do not believe you are reading from our statement of this morning.

Senator GORE. That was last year.

The CHAIRMAN. Is that what you said last year?

Mr. HELLER. Just so that the record would be straight, this is not the statement——

The CHAIRMAN. That was in the economic report. You make a good many speeches, and it is difficult to keep up with you. That was in the economic report submitted to Congress in January and I assume you approved it.

Mr. HELLER. What I think is this: there are significant unmet needs in the United States at the present time, unmet needs in fields that call for Federal action. In the course of time we will be much better able to meet those needs if we have the kind of expansion in the national product and national income and, as a result, in Federal rev-

enues, that will result from this tax reduction. Again, I am not necessarily talking in terms of expansion of the total budget. Last year, for example, the proposals of the administration included between $2 and $3 billion of increased or new programs which were offset by $2 or $3 billion of reductions or savings in the remainder of the budget.

I do not believe it is inconsistent with tax reduction to recognize the need for the expansion or strengthening of certain programs and the introduction of some new ones.

The CHAIRMAN. If you expanded those programs that would mean an increase in the budget, I would imagine.

Mr. HELLER. Well, it did not in the fiscal year 1964 budget proposed by the President. The total of civilian expenditures, other than space, defense, and interest on the debt was reduced slightly, in spite of the fact that significant advances were made in a number of programs.

The CHAIRMAN. In one of your statements did you advocate delegating to the President authority to cut taxes without an act of the Congress?

Mr. HELLER. It was subject to congressional veto, Mr. Chairman. At no time did we suggest that the President be given authority to cut taxes without congressional veto, and in presenting——

The CHAIRMAN. After the President cut taxes, the Congress could put them back; is that what you meant?

Mr. HELLER. The President's recommendation was that the proposed temporary tax reduction lie on the congressional table, so to speak, for 30 days before it would go into effect.

Senator WILLIAMS. Would the Senator yield?

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. As I understand it, the recommendation was that the President have the power to cut taxes, but that when it came time to raise them he wanted the Congress to have that responsibility.

Mr. HELLER. It was a one-way proposition——

Senator WILLIAMS. That is right.

Mr. HELLER (continuing). Intended as an antirecession weapon.

Senator WILLIAMS. That is right.

Mr. HELLER. Of course, the proposal was for authority for a temporary 6-month cut.

Senator WILLIAMS. That is right. He wanted political recognition of cutting taxes, but he wanted Congress to take the onus of raising them when it was necessary.

Mr. HELLER. Senator Williams, I think the hesitancy to suggest corresponding authority to increase tax rates was related more to respect for the congressional prerogative in tax questions.

Senator WILLIAMS. Why has Congress got the prerogative to raise them more so than it has to reduce them?

Mr. HELLER. It was the feeling, expressed by some Members of Congress, that a temporary suspension of the rates represented less of an interference with congressional prerogatives.

Senator WILLIAMS. But you would agree that the political factor was the most important factor in that equation.

Mr. HELLER. No, sir; I would not.

Senator WILLIAMS. Excuse me, Mr. Chairman.

Senator GORE. Mr. Chairman, would you yield?

The CHAIRMAN. Senator Gore?

Senator GORE. The complexity of the tax law, with the pressures involved from many sources and from all directions, indicate that a 30-day period during which a general tax cut proposed by the President would lay before the Congress, would be utterly meaningless, that is, if Congress wished to give it any kind of thorough consideration.

Mr. HELLER. Senator Gore, may I just comment on that?

While this proposal does not now lie before the Congress—the proposal was not repeated in the 1963 program—the dimensions of the cut and the form of the cut, would have been prelegislated by the Congress. This would not be a cut whose form the President would determine. It would have been determined by the Congress for triggering by particular actions.

The CHAIRMAN. I do not understand that. I wish you would explain that again.

Mr. HELLER. Mr. Chairman, the law——

The CHAIRMAN. What would the President do and what would the Congress do?

Mr. HELLER. The proposal was that the Congress would put into effect—put on the shelf, so to speak—a tax suspension provision which would specify how the individual income tax would be temporarily cut and under what conditions. Then the President would have authority to invoke the tax cut that would be precooked, so to speak, by the Congress—and subject to later disapproval by the Congress when invoked by the President. The administration indicated that it was the principle rather than the specific plan that was important, and that the measure would undoubtedly be improved upon by the Congress. One suggestion made was that the invoking of the authority by the President should be with the aid of an advisory board, perhaps with membership from the Senate Finance Committee and House Ways and Means Committee.

If the committee has no objection, we should like to insert the following excerpt form the President's letter to the President of the Senate and the Speaker of the House of Representatives, dated May 8, 1962, transmitting a bill which would give to the President, subject to congressional disapproval, standby discretionary authority to reduce personal income tax rates when economic circumstances require such action:

The form of the income tax reduction would be provided for in advance by Congress; it would not be determined by the President. By the term of the draft legislation the fixed statutory rates may be reduced by not more than 5 percentage points and the period of tax reduction would be limited to 6 months, unless extended by a new plan within the procedures prescribed in the bill. In no event can the period of uninterrupted tax reduction exceed 1 year without specific affirmative congressional action. The draft bill authorizes the President to terminate the period of tax reduction on a date earlier than that specified if he finds that a reduction in tax rates is no longer needed.

The draft proposal thus offers a practical plan for cooperative governmental action. Enactment of the proposed legislation would provide the basic legislative determination to use a temporary reduction in the individual income tax rates when economic circumstances require such action, while arming the President with a practical means of implementing the congressional will. The responsibility to act promptly would be the President's, but Congress would have the opportunity to disapprove the proposed reduction.

Senator GORE. Mr. Chairman, lest this be misunderstood as some offhand recommendation, I would like to read the first sentence of the President's message to the Congress of May 8, 1962, on this subject:

I transmit herewith, for the consideration of the Congress, a draft and a technical explanation of a bill which would give to the President, subject to congressional disapproval, standby discretionary authority to reduce personal income tax rates when economic circumstances require such action.

Later on this message, which is in the form of a letter to the President of the Senate and Speaker of the House, refers to this proposal as one that would provide for a reduction of, and I am reading now, "individual tax rates across the board." That is how the pending bill is described—as an across-the-board tax cut.

So if Congress had given to the President the power here requested, and such had been held a constitutional exercise of the legislative function, then we might have this present tax cut proposal dumped in our laps to go into effect unless Congress considered it and disapproved it within 30 days—minus the corporate element; the message does not refer to corporation taxes.

The CHAIRMAN. Just one more question along that line. Did that idea originate with you?

Mr. HELLER. That is an idea, Senator, that has been proposed for many years by many different authorities in the tax field. It does not extend to tax structure and base but simply to a reduction in rate.

The CHAIRMAN. I am asking you because I assume you make recommendations to the President about economic matters and taxes.

Did you advocate this particular plan of reducing taxes by the President?

Mr. HELLER. Mr. Chairman, that plan was advocated and recommended by the Council of Economic Advisers, by the Secretary of the Treasury, and by other members of the administration.

The CHAIRMAN. And by you, too?

Mr. HELLER. By me, too; yes, sir.

The CHAIRMAN. Is it not true that that proposal was coupled with a proposal for huge public works expenditures without appropriations by transfer of money appropriated for other purposes?

Mr. HELLER. It was coupled with a standby authority to accelerate public works.

The CHAIRMAN. In other words, would not those two actions have taken away from Congress the control of the purse which we had always understood was guaranteed by the Constitution?

Mr. HELLER. Mr. Chairman, we felt that safeguards would have been enacted by the Congress, and the specified conditions under which those expenditures could be made would have been firmly fixed by the Congress. We were very conscious of the prerogatives of the Congress in making these recommendations.

Senator DIRKSEN. Mr. Chairman, to make sure this record is straight, there was in connection with that tax proposal another proposal to take unobligated balances out of any fund, and they made no exclusion even of defense funds, for the purpose of using them for a public works program; isn't that correct?

Mr. HELLER. Yes, I believe—I do not recall the details on the funding on this.

Senator DIRKSEN. Well, it is, I can tell you.

Mr. HELLER. It was worked out very carefully by the Budget Director to provide a program for fast action and then, of course, replenishment of those funds. But it would all have been under fundamental congressional authorization. It would not have involved arbitrary action by the President.

Senator DIRKSEN. Well, it would have been a blanket authorization by Congress to permit the President to divert the funds from the purposes for which they were originally appropriated.

If you take money out of the defense balance that is unobligated and devote it to public works, that is a diversion of money and contrary to the intentions of Congress when the money was appropriated.

Mr. HELLER. Yes. It could only have been done if Congress could——

Senator DIRKSEN. It does not make any difference for 3 months or whatever it was.

Mr. HELLER. If the Congress had approved this and restored the funds later, that is quite right.

The CHAIRMAN. Is it not true that the unexpended balances last July totaled approximately $87 billion?

Mr. HELLER. Senator, I do not know the exact figures, but they certainly are up in that order of magnitude. They typically are.

The CHAIRMAN. Is it not true that the President is asking for new obligational authority this year of $108 billion, which makes a total of nearly $200 billion?

Mr. HELLER. These are, of course, running obligations. Some of the obligational authority applies to the current year, some to a future year. I do not think the total outstanding would ever aggregate into $200 billion of obligational authority for that amount at any one given time.

But your basic statistics are essentially correct as of July 1.

The CHAIRMAN. Isn't it true that the unexpended balances have been increasing?

Mr. HELLER. In recent years the obligational authority has exceeded the actual expenditures, and there has been a buildup of obligational authority. However, a number of recommendations were made in the initial budget to cut back that obligational authority, and Congress has, in addition, cut it back considerably. I believe the obligational authority that seems to be on the way to being approved this year may be somewhat below last year.

The CHAIRMAN. They may be slightly lower, but that does not reduce the $87 billion in unexpended balances of last July 1.

Mr. HELLER. These are the——

The CHAIRMAN. And generally these can be expended by the President without any further action by the Congress, and these are in addition to the new appropriations now being made.

Mr. HELLER. Senator, if I understand this correctly, this is an authorization by the Congress to obligate funds and undertake contracts on the longer term projects that span more than 1 year. In other words, if you are building a supercarrier or arranging for a trip to the moon, a lot of these eventual expenditures have to be committed long before they are actually spent. Then until Congress actually provides the funds in the annual appropriation process for those longer term projects there is no money at the disposal of the administration. It is an authority to spend, but the actual expenditure——

The CHAIRMAN. The $87 billion has already been appropriated and is available for expenditures.

Mr. HELLER. That is an appropriation for part——

The CHAIRMAN. It is true part of it has been obligated, but the full amount was available for expenditure. My recollection is that about half of it is not obligated.

Mr. HELLER. It is an appropriation or obligational authority to the administration, that is correct.

The CHAIRMAN. This $87 billion, a colossal sum of money and it is in addition to the current appropriations, which are running at approximately $100 billion or more.

Mr. HELLER. If I understand this process, may I say it is similar, for example, to General Motors appropriating $1 billion for a capital expansion program, and then actually spending, let us say, a third of it in the first year, and another third in the second and another third in the third. It is part of the process of providing for long-term expenditures, particularly capital expenditures.

The CHAIRMAN. But a part of it is not obligated. A part of the foreign aid is not obligated. That is one of the reasons why some of us are fighting very vigorously to eliminate or cut some of the foreign aid appropriations. We have already appropriated funds in these balances which are not obligated.

Mr. HELLER. I am sure that it does take time to obligate funds, and I am quite sure that you are correct.

The CHAIRMAN. If you look at the budget you will see they are not obligated.

Mr. HELLER. Yes.

The CHAIRMAN. They do not claim they are in certain instances.

Just one other line of questioning because I know other Senators have other questions. You have spoken of the tremendous impetus that would be given business by these tax reductions; that is to say, that you go on the assumption that every taxpayer who gets a reduction in taxes will use that reduction to buy something to stimulate the economy.

Have you estimated how many taxpayers would put the money in the bank, who would pay a debt off, who buy stock on the stock exchange or do other things which might not stimulate business?

In the class with incomes of under $3,000, the average tax reduction would be $49 per taxpayer; from $3,000 to $5,000, $67 per taxpayer; between $5,000 to $10,000, it is $90 per taxpayer; between $10,000 to $20,00, it is $165 average; between $20,000 to $50,000, it is $560; between $50,000 and over it is $2,194; and for all taxpayers, the average would be $110. When I speak of a taxpayer I speak of a joint return as being a taxpayer.

These figures have not been denied. I questioned Secretary Dillon on them, and he accepted the accuracy of these figures.

It is just very difficult for me to understand how this tremendous boom is going to be brought about by a tax reduction averaging $110.

I think one-third of the tax returns are for single people, and two-thirds are on joint returns.

Mr. HELLER. Mr. Chairman, according to Treasury figures submitted to your committee (hearings on H.R. 8363, pt. 1, p. 240) the average annual tax reduction will be $174 per taxpaying unit.

There are approximately 51 million taxpaying units, individual and joint. While the average reduction may seem relatively modest—although I think $174 is a substantial amount to a lot of people—when you multiply that by roughly 51 million taxpaying units, you have a total stimulus to private demand of the $8.8 billion in the bill, H.R. 8363.

With respect to the spending of that, surely some people will spend less and save more, and other people will spend more and save less. But economic experience ever since 1950 has been that people have spent, on the average—and we have to deal with averages when we are dealing with 50 million taxpayers—between 92 and 94 cents out of every dollar of aftertax income, and that in spite of the fact that per capita income, adjusted for price changes, have risen by about 20 percent over this period. We base a good bit of our analysis of the impact of the tax cut on this remarkably steady relationship—year in, year out, even quarter in, quarter out—between what they have left by way of take-home pay or aftertax income, and the amount they spend out of that, and it has averaged right around 93 percent.

The CHAIRMAN. You are estimating what percentage of this is going into direct purchase of consumer goods and so forth? I am asking what percent of the people, if they owed a debt, they would pay the debt off, or if they wanted to lay aside some money for a rainy day they would put it in the bank.

Mr. HELLER. We have calculated what consumers have been doing with their funds over what is now roughly a 13-year period, and have found that they save between $6 and $8 out of every $100, and they spend on consumer goods—including, of course, their installment buying and so forth—about $92 to $94 out of every $100 of additional income after taxes. Those in the upper income brackets spend somewhat smaller proportions; those in the lower income brackets spend somewhat higher proportions. The figures that are available on the distribution of the spending by income brackets are much less extensive than those on overall spending which I have just cited, but the available figures tend to bear out the proposition that 90 percent or more of the consumer tax cut will be spent.

The CHAIRMAN. In case of the withholding they will get a few cents maybe. The people in the $3,000 bracket would get little more than 15 cents a day, and the withholding would come off weekly, it would not come in any one payment, and I just want to emphasize that the figures that I read are correct. The difference between us is in the basis for calculation.

Mr. HELLER. I am simply taking the total number of tax returns, Mr. Chairman, both individual——

The CHAIRMAN. But you gave a figure——

Mr. HELLER. Both single and married.

The CHAIRMAN (continuing). Of $170.

Mr. HELLER. There are around 51 million taxable returns.

The CHAIRMAN. If you put it on tax returns, as I did, it comes out to $110. But some of those are joint returns, they are for two people.

Mr. HELLER. So that counting each joint return as two taxpayers reduces your average to $110.

The CHAIRMAN. That is right.

Thank you very much. I want to thank you again for your frankness. You are a representative of the administration who admits there is no plan ahead to reduce expenditures.

Senator Smathers?

Senator DIRKSEN. Mr. Chairman, may I ask a question at that point?

The CHAIRMAN. Yes, Senator Dirksen.

Senator DIRKSEN. Dr. Heller, what do you make and what is your interpretation—these statements have been made by the President on down—that there is going to be expenditure restraint and expenditure control and expenditure discipline? Exactly what are all these in terms of figures?

Mr. HELLER. Senator Dirksen, we do not yet have the figures for fiscal year 1965, since that budget is not yet formulated. I think it is fair to say that there are some illustrations of what the President had in mind in the budget for fiscal year 1964 and, indeed, in the budgets for fiscal 1962 and 1963 in the following senses:

For fiscal 1964 the total of civilian expenditures, as I noted before, leaving out defense, space, and interest, is below the expenditure levels for 1963.

Second, since the budget was presented, the President has cut back by several hundred millions of dollars the requests for expenditures in fiscal 1964. That was certainly expenditure restraint.

Third, the rise in civilian spending in the Federal budget in the first 3 years after this administration is less than the rise in such spending in the last 3 years of the preceding administration.

And, fourth, the statements of the President and other members of the administration, refer to the economy efforts that are being made throughout the administration, the most dramatic being the $3 to $4 billion savings that Secretary McNamara is not only striving for but already well on the way toward achieving in the Defense Establishment.

And, finally, it is an exercise of expenditure restraint to hold down the expansion of expenditures that otherwise would take place under the natural pressures of population, of increases in postal services, veterans' benefits, and so on.

As you know, we have a number of open-ended programs that simply say, "This is how much it shall cost per person or per act," and the cost rises as we multiply by the expanding number of persons or acts.

I think that under those circumstances it is no admission of guilt and no admission of anything imprudent or irresponsible to say that there will be some expenditure increases.

Senator DIRKSEN. When Secretary Dillon was before this committee, he used at least a tentative figure, and I should say it is speculative, but he was talking about the 1965 budget in terms not of $99 billion but of $102 billion, and it could conceivably, of course, be more.

Mr. HELLER. I think he was using that—excuse me.

Senator DIRKSEN. That does not sound like expenditure restraint to me.

Mr. HELLER. He was probably using that illustratively. However, I take it that there was then some implication in his statement that

expenditures were likely to rise in fiscal year 1965 over fiscal year 1964.

The CHAIRMAN. Senator Smathers?

Senator SMATHERS. Dr. Heller, the last post at which you taught, did you teach constitutional law or a course in economics?

Mr. HELLER. Senator Smathers, I taught economics.

Senator SMATHERS. I presume that you are familiar enough with constitutional law to know that when it comes to the appropriation of money and the cost of Government that the Government can spend no more money than that which the Congress itself appropriates.

Mr. HELLER. That is true. I will confess to having taken a course in constitutional law in the Wisconsin Law School some years ago, and I believe that that accords with what I learned there.

Senator SMATHERS. Well, I would merely say that while I am very much in favor of a tax reduction bill, a statement that somebody helped the President prepare about what we ought to do in this, violates, so far as I am concerned, my concept of the Constitution which provides for three separate branches of Government, sovereign in their own sphere of activity.

But in any event, do you understand that the Congress, after all, is the one that appropriates funds and finally with respect to the final amount of moneys which will be spent or not spent. This power lies solely in the hands of the Congress?

Mr. HELLER. There can be no question about that.

Senator SMATHERS. I am not quite clear from the line of questions asked as to whether or not you really and truly favor a balanced budget?

Mr. HELLER. I favor a balanced budget in a high employment, high production, prosperous economy, and I indicated that in this respect I follow essentially the position taken by Congressman Mills in reference to the impact of the tax bill.

Senator SMATHERS. Are you at the same time against wasteful expenditures on the part of the Government even though the Congress might appropriate the money?

Mr. HELLER. I clearly am against wasteful, uneconomic, and inefficient expenditures; yes, sir.

Senator SMATHERS. Suppose we had a balanced budget, and there were programs recommended which would unbalance the budget, would you favor those programs or not, if unemployment was less than 4 percent of the work force?

Mr. HELLER. I would oppose the generating of additional pressures on the economy that would run the risk of inflation under those circumstances.

Senator SMATHERS. I gather from what you are saying that it is in an effort to bring about a balanced budget is the reason you are willing at this time to undergo a continued deficit or maybe even a temporarily larger deficit.

Mr. HELLER. Yes. The basic consideration is that we have unused resources which the force of the tax cut could put to work. The deficit, of course, does not put them to work. It is the force of tax reduction that puts more money in private hands.

Senator SMATHERS. What sort of precedence, if any, do you have that would indicate that a tax reduction of this character would, in

fact, stimulate the economy to the point that there would be greater business activity and greater return of revenues to the Treasury and eventually a balanced budget?

Mr. HELLER. Senator, We have made a study of past tax reductions. In this connection in the United States, of course, we had the experiences of the twenties when successive tax reductions resulted in or were followed by expansions in the economy and rising revenues.

We have the experience of 1954 tax reduction of $7.4 billion in the face of a recession deficit. While cash receipts went down by $3.8 billion from fiscal year 1954 to 1955, they went up $9.3 billion from 1955 to 1956 as the tax reductions became fully effective and provided their stimulus along with other factors in the economy.

Senator SMATHERS. May I ask you a question right on that point because I know my good friend from Delaware is going to ask another question? The fact is that in 1954 Government expenditures were reduced. But looking beyond that point, can you establish from the tax cut which was instituted in 1954, as a fact that there was increased revenue in the years following the reduction in taxes of 1954?

Mr. HELLER. That is a fact.

Senator SMATHERS. How much did those revenues increase?

Mr. HELLER. Well, I have just before me at the moment the one figure of from fiscal 1955 to fiscal 1956 the cash receipts went up $9.3 billion. I could get more detailed figures.

(The table follows:)

Federal Government receipts

[Billions of dollars]

Fiscal year	Administrative budget (net)	Cash budget	National income account budget
	Levels		
1955	60.2	67.8	67.0
1956	67.6	77.1	76.3
1957	70.6	82.1	80.9
	Changes		
1955–56	+7.7	+9.3	+9.3
1956–57	+2.7	+5.0	+4.6
2-year total	+10.4	+14.3	+13.9

We also have a series of figures and facts from other countries that have reduced taxes, and it is fair to say that in every case within, a year, sometimes two, the revenues grew to levels above their pretax cut levels.

Senator SMATHERS. Could you give us an illustration? For example, I understand in Great Britain they have recently——

Senator GORE. Before you leave our own experience, would the Senator yield for a moment?

Senator SMATHERS. Yes.

Senator GORE. I would like to call attention to Dr. Heller's statement in which he seems to be in argument with the statement he has just made. I quote:

In retrospect the reasons—

I will point out he did not list tax reduction as one of them—

for our excellent postwar performance in production and employment are clear enough: during a decade and a half of depression and war, vast backlogs of demand had been built up by consumers, farmers, businesses, and State and local governments—for more and better durable goods, for houses, for farm machinery, for plant and equipment, and for roads and schools.

I will not read further, but I just point out to the Senator from Florida——

Mr. HELLER. But, Senator, if you did read further you would note that I was referring to the immediate postwar period. We continue in the same paragraph to say:

The Korean conflict imposed new requirements before these backlogs had been fully worked off. And after Korea, high consumer and investment demands were supported for several years by the tax reduction of 1954 * * *.

Senator GORE. I would like to read what Secretary Humphrey said about that period.

Senator SMATHERS. Are you quoting him for yourself or for Dr. Heller?

Senator GORE. They are both going down the same alley.

Senator SMATHERS. I would imagine Dr. Heller would not agree that he is going down the same road Secretary Humphrey was going down.

Senator GORE. On the contrary, I thought he had been quoting the former Secretary Andrew Mellon, and George Humphrey with great glee and approval.

Senator SMATHERS. I have not heard it this morning, had you, Dr. Heller?

Mr. HELLER. No, I had not.

Senator SMATHERS. Had you mentioned Secretary Humphrey this morning?

Mr. HELLER. No, I had not, and I have not quoted Andrew Mellon.

Senator GORE. All right, I will pursue this on my own time.

Senator SMATHERS. Now, with respect to Great Britain, to get back to this point as to whether or not there is any validity in the fact that a tax reduction does stimulate the economy, and looking for actual precedence outside textbooks in order to support that theory you mentioned the tax cut of 1954. Now, what other tax cuts can you name anywhere that have resulted in a stimulated economy and which would give us, as reasonable people, the right to conclude that we might be able to balance the budget by adopting this program?

Mr. HELLER. Well, Senator, you mentioned the British example. That happens to be very closely parallel to the bill before this committee at the present time, because last spring the United Kingdom put into effect a cut that, translated into terms of our gross national product, was about $11.7 billion—a combination of individual tax cuts and business tax cuts. Since that time, they have had a rise of 7 percent in industrial production. That was by August. We do not have the later official figures.

They had a rise of 5 percent in retail sales, and their unemployment rate was cut by two-fifths. And we heard some confidential figures last week, not yet released, which indicated that those gains have continued since August.

Senator SMATHERS. I was privileged to read the other night an article by Mrs. Sylvia Porter with respect to a tax cut that is taking place in Austria. Are you familiar with that?

Mr. HELLER. We are.

Senator SMATHERS. What has been the result of the tax cut there?

Mr. HELLER. In 1958 they had a tax cut which within 2 years resulted in an expansion of the economy that had increased revenues by 16 percent over the tax revenues prior to the tax cut.

It was a cut that, together with increased expenditures, brought a deficit that was equal to 14 percent of their revenues. The deficit here contemplated would be equal to about 12 percent of our revenues.

Senator SMATHERS. So then is it your conclusion that a sizable tax cut has stimulated the economy of Austria?

Mr. HELLER. Yes, indeed.

Senator SMATHERS. And is continuing to do so?

Mr. HELLER. It is; and, by the way, I have recently talked with both the Austrian Finance Minister and the Governor of the Central Bank. On the basis of their very favorable experience, they strongly urged or at least approved of tax reduction as a means of expanding the economy and balancing the budget.

They had that large deficit, but within 3 years the expansion of the economy had generated enough revenues to balance their budget.

Senator SMATHERS. Now, Mr. Heller, are you familiar with the Business Advisory Council headed up by Mr. Henry Ford and Mr. Stuart Saunders?

Mr. HELLER. The Business Tax Committee or the Business Advisory Council?

Senator SMATHERS. Business Tax Committee, whichever one it is that they head up.

Mr. HELLER. Yes.

Senator GORE. The lobbying group.

Senator SMATHERS. Sort of like the TVA lobbyists. [Laughter.] Anyway, they head up this particular group. Are you familiar with their position on this tax bill?

Mr. HELLER. Yes; I am.

Senator SMATHERS. Do you consider them to be rather conservative men and sound in their economic leanings and views?

Mr. HELLER. Yes; I consider them to be conservative and sound.

Senator SMATHERS. Do you know whether or not they favor this tax reduction bill?

Mr. HELLER. They do.

Senator SMATHERS. Do you know whether or not they favor it immediately?

Mr. HELLER. They do.

Senator SMATHERS. Are you familiar with the U.S. Chamber of Commerce?

Mr. HELLER. Yes.

Senator SMATHERS Do you know whether or not it is considered a conservative group or a great liberal group that is trying to destroy the economic stability of the country?

Mr. HELLER. I think the answer is clearly on the conservative side.

Senator SMATHERS. Do you know whether or not they favor this tax reduction bill?

Mr. HELLER. I understand that Mr. Barlow testified before this committee on behalf of the chamber of commerce favoring it.

Senator SMATHERS. As I remember that testimony, and maybe you have read about it, did he favor it immediately or did he favor it next year or did he not favor it at all?

Mr. HELLER. Immediately.

Senator SMATHERS. Immediately.

Are you familiar also with the labor organizations, the American Federation of Labor and the CIO group?

Mr. HELLER. Yes, sir.

Senator SMATHERS. Do you know how they stand on this particular tax reduction bill?

Mr. HELLER. They favor it.

Senator SMATHERS. They favor it.

Senator BENNETT. Will the Senator yield?

Senator SMATHERS. I will be happy to yield.

Senator BENNETT. Is it not true that the AFL-CIO favor tax reduction at the lower end and a complete rewriting of the bill for the corporation in the upper end? That is the testimony they gave us here, so they do not favor this tax bill. They favor a tax cut, provided it is concentrated among their members.

Mr. HELLER. Senator, on balance, I think their position is that—given the choice between this bill or inaction—they favor this bill. I am sure that every organization and individual would suggest methods of changing it and improving it. I am sure the chamber of commerce would, and I am sure the AFL-CIO would.

But the question is, on balance, when all is said and done, whether they are for or against it, and I think they made it very clear that they are for it.

Senator SMATHERS. Now, Dr. Heller, just a couple of other questions.

First, are you at all familiar with what would be the size of the deficit we will have this year?

Mr. HELLER. This current fiscal year we are in now?

Senator SMATHERS. Right.

Mr. HELLER. As I recall the testimony of the Secretary of the Treasury and the Budget Director, it is in the neighborhood of an estimated $9 billion, about $3 billion below the level originally projected.

Senator SMATHERS. If we cut the entire foreign aid program, and if we cut half of the space program would we not still have a deficit of some $3 billion or thereabouts?

Mr. HELLER. Even leaving out the negative economic impact, yes; we would.

Senator SMATHERS. Is it possible for you to conceive of the Congress of the United States cutting the Veterans' Administration or the highway program or the farm program to the extent there is any conceivable way that we could balance the budget this year by just the mere reduction of expenditures?

Mr. HELLER. Not in terms of the past experience and commitments; no.

Senator SMATHERS. Just from your observation of Congress in action over the last 20 years, you would not conclude that would be a likely result.

Mr. HELLER. I do not.

Senator SMATHERS. So the result is we are going to have a deficit this year no matter what the Congress does. Looking at it as a reasonable and prudent man you can conclude we are going to have a deficit this year and next year certainly?

Mr. HELLER. I think that is true, sir.

Senator SMATHERS. Then it comes to the conclusion, as I gather it, that recognizing the Congress being what it is—and I am proud of it and what it does, but it is not very penurious about certain programs, and won't be—it is your judgment that in the light of the fact that Congress will not greatly reduce the amount of Government expenditures, the only way you are ever going to achieve a balanced budget is to stimulate the economy to the extent that you bring in sufficient revenue to keep up with expenditures; isn't that correct?

Mr. HELLER. I think that is right, and I think we have tried to stress the process by which a tax cut would achieve the objective you have just stated.

Senator SMATHERS. It is your judgment that the only way we are going to achieve a balanced budget in the foreseeable future, insofar as you are concerned, is to bring about a tax reduction which would stimulate the private segment of the economy?

Mr. HELLER. Exactly.

Senator SMATHERS. I do not have any further questions.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Dr. Heller, your answer to that question reminds me of a report that was received from one of the young men over home the other day who said that he is so far behind in his installments and other debts which are piling up that the only possible way that he can ever foresee of paying off his debts is to get an increase in salary. Isn't that what the Government is operating on, with no effort to live within its income at all, but figuring that it can only live within its income by increasing revenues?

Mr. HELLER. Senator Williams, we are dealing here with the operation of the whole economy. If we want to make a homely comparison with the private economy, the best analogy, I suppose, is with the businessman who cuts his prices and realizes a higher return from the resulting increased volume of business.

Senator WILLIAMS. Did you ever try that with your own personal expenditures?

Mr. HELLER. I think that there are many cases in which the investment in education or in a house or similar capital expenditures is a sound and prudent investment which pays off over a period of years, and I think here the investment in expansion of the economy, in building more plant and equipment, in creating more jobs, is a sound one, which will pay off in higher output and higher profits and higher jobs and higher revenues.

The CHAIRMAN. Will the Senator yield?

Senator WILLIAMS. Yes.

The CHAIRMAN. At that point when Mr. Dillon testified, he said he thought there would be a $30 billion deficit in the 6 years, the in-

terest on that $30 billion would be $1 billion, at 3⅓ percent; in other words, we are adding $1 billion to the expenses of the Government by reason of borrowing $30 billion.

Mr. HELLER. Well, I would thoroughly agree that that has to go into the calculation, Senator. In any case, when you incur a debt——

The CHAIRMAN. That, of course, is added to the deficit.

Mr. HELLER. That is right.

When you incur a debt, you have to balance the costs of that debt against the benefits to be derived from it according to very careful calculation, like the one you just made. It is only when you find that the benefits exceed the costs that it is worth undertaking.

Senator WILLIAMS. Dr. Heller, you have compared your recommendation for a tax cut in this instance with the results of the 1954 tax reduction which stimulated the economy.

Do you think the 1954 tax reduction as it was embraced was a wise step at that time?

Mr. HELLER. Yes, I do, sir.

Senator WILLIAMS. The 1954 tax reduction of about $7 or $8 billion was accompanied by a corresponding reduction in expenditures and, as you say, it was a tremendous success.

Now, this time you are recommending a tax reduction, but an increase in expenditures. Is that not different from the step taken in 1954?

Mr. HELLER. I think the circumstances were very different, and that we would have been very much worse off, Senator, in 1954, if we had not offset some of the reduction in expenditures with reduction in taxes. At that time——

Senator WILLIAMS. I agree with reducing taxes when it is offset by a reduction in expenditures, and that was the case in 1954. But that is not what you are recommending here. You are recommending a reduction in taxes but an increase in expenditures; is that not true?

Mr. HELLER. Yes, sir.

At the present time we have a very different basic situation because of the fact that in 1954 we still had quite a bit of this underlying private demand pressure which, combined with the tax cut, was enough to offset the decline in the Federal expenditures.

At the present time we have had 6 years of continuing high unemployment, and 6 years of continuing excess capacity, and 6 years of underutilization of our economy, and under those circumstances, of course, the economics of the case are quite different. They call for a larger stimulus to the economy to get it back to full employment and to get it back to a balanced budget.

Senator WILLIAMS. Now, to go back to the tax cut in 1948. At that time we had an $8½ billion surplus, and Congress cut taxes during that period and, at the same time reduced expenditures. About 3 years later our revenue was $6 billion higher than it was in 1948. That, too, was a success. But when that tax cut was made it was accompanied by a reduction in expenditures. Did you approve of the tax cut in 1948?

Mr. HELLER. Yes; under the circumstances. In retrospect, it was a good tax cut for the period before Korea.

Then, of course, when Korea intervened, the whole tax situation had to be reversed, and the Congress at that time enacted $15 billion of tax increases in 2 years.

At the time of the 1948 cut, we were confronted with a vast overhang of liquidity from the postwar period. Private demand was slowing down somewhat just at the time that the tax cut was approved, but it was a good deal stronger than in the current economy. Therefore, it was consistent with full employment to have a reduction in public expenditures and an increase in private expenditures through a tax cut.

Senator WILLIAMS. I am glad to hear you say that.

In the period 1946–53 you were serving in the capacity as a consultant to the Treasury Department, were you not?

Mr. HELLER. Yes, I was a good part of that time.

Senator WILLIAMS. And the Treasury Department at that time opposed the tax cut. Now as we understand here that you disagreed with the position of the administration at that time, but that in reality you were in favor of the tax cut which the 80th Congress enacted?

Mr. HELLER. What I said, Senator, was that in retrospect I think this tax cut did not harm the economy.

Senator WILLIAMS. At that time did you support or oppose the tax cut?

Mr. HELLER. At that time, I was not serving as a consultant on the general question of over-all tax cuts in 1947–48. At the time of that tax cut controversy, I was out of the country.

Senator WILLIAMS. You have not answered my question. Were you in favor of that tax cut or opposed to it at that time as an individual?

Mr. HELLER. Well, my memory does not really serve me.

Senator WILLIAMS. I won't press the point.

But also in 1947 and 1948 you served as an adviser to the U.S. Monetary Fund in Germany, did you not?

Mr. HELLER. In the U.S. Military Government, yes.

Senator WILLIAMS. In the U.S. Military Government.

Were you a part of the team at that time that recommended that the West German Government should launch a huge spending and deficit financing program to stabilize their economy?

Mr. HELLER. No, indeed, exactly to the contrary. I was part of the team that recommended the very tight anti-inflationary currency reform—and tax reform—that was put into effect in 1948.

Senator WILLIAMS. Was that successful?

Mr. HELLER. That was successful.

Senator WILLIAMS. Do you not think it would apply here in this country if we advocated the same recommendations of a tight monetary policy and a balanced budget, or have you lost confidence in that position, too?

Mr. HELLER. If we were in the same position of immense excess demand and very restricted supply I would recommend the same thing for this country, Senator.

Senator WILLIAMS. In all of the history of this country, in the 180-some years of our history, has there ever been a more prosperous year than the year 1963 as related to full employment, corporate earnings and dividend payments, and the average income by wage earners? Has there even been a year in the history of this country when it has been higher?

Mr. HELLER. As far as full employment is concerned, if you measure that in terms of the number——

Senator WILLIAMS. I am speaking of taking it as a whole.

Don't single out just one. Has there ever been a more prosperous year in the history of our country than 1963?

Mr. HELLER. If you measure it in absolute terms, no. If you measure it in terms of the proportion of our resources employed, the answer is, yes, there has been many more, prosperous years in the postwar period.

Senator WILLIAMS. If in a period of highest income in the history of our country we cannot live within our budget what kind of circumstances do you think we must have in which we can live within our income as a nation?

Mr. HELLER. We must have circumstances in which we provide adequate employment opportunities for people who are able and willing to work, and in which we can provide enough profits for corporations and other businesses. Today it is true profits are at an all-time high. They have been running after taxes something about $27 billion. But if our economy were fully employed, and if industrial capacity were not running at 85 to 87 percent, but 92, 93 percent, as I think we all wish, profits would be around $30 billion after taxes.

So I am saying that my aspirations for the American economy are to make full use of this enormous productive potential that it has. We are not doing that, and in that sense we are certainly not as prosperous as we should be.

Senator WILLIAMS. In answer to a question from the chairman you said you were in agreement with the President's statement and recommendation to the Congress in early 1961 that he was going to submit a balanced budget, and expected a surplus of $500 million. At that time the average percentage of the total labor force that was unemployed in America was 6.7 percent, slightly higher than it is today.

Now, if at a time when the average unemployment rate was 6.7 percent you agreed with the President when he said we should balance the budget, what has happened in the 3 years that changed your opinion?

Mr. HELLER. Senator, I am glad you give me an opportunity to clarify what I said because apparently I did not make myself understood.

I referred to the various provisos that were in the statement. Subject to defense needs, subject to the problems of unemployment and recession, and subject to the other provisos that were in that statement, I did favor it. But, as it turned out, unemployment was too high, defense expenditures had to increase, and so on. Under exactly those circumstances—clearly enunciated in the way in which the President made the pledge—I, of course, favored the measures needed to overcome the effects of recession and to strengthen our defenses, and these involved a deficit.

Senator WILLIAMS. Excuse me. You said in one of your statements, that this 1964 budget carries a reduction in expenditures in practically all categories except space, interest on the national debt, and our defense.

Mr. HELLER. In the aggregate.

Senator WILLIAMS. In the aggregate.

Now, will you tell me where those reductions are, because I have heard that claim expressed many times, but I have watched these

appropriation bills come through the Congress, and in every single instance they are higher than they were last year.

For instance, the budget is asking for $895 million in the Department of Commerce, which is an increase of $150 million over the 1963 budget.

HEW is asking for an increase of $694 million over the 1963 budget; Justice is asking for $20 million over the 1963 budget; Labor is asking for $194 million over the 1963 budget; General Services is asking for $62 million over the 1963 budget; the Treasury Department is asking for $420 million over the 1963 budget; the Department of Interior asked for $111 million over the 1963 budget. Altogether an additional 36,492 new employees are being asked for throughout the Government.

I hear a lot of talk about this reduction. Tell me where it is.

Mr. HELLER. Senator, I do not have the details in front of me, but there were, of course, reductions in the net costs of the Post Office, and there were reductions in net costs in some of the housing and Export-Import Bank programs, as I recall. If I may, I would like to have the privilege of correcting this for the record.

In his statement before the Joint Economic Committee last January (hearings, January 1963 Economic Report of the President pt. 1, p. 72), Budget Director Gordon presented the following table summarizing anticipated increases and decreases:

Changes in 1964 administrative budget expenditures for programs other than defense, space, and interest

Description	*Billions*
1963 program expenditures (other than defense, space, and interest) as in table 1	$29.7
Expenditure increases in 1964:	
Pay reform already enacted	.3
Program commitments already made (urban renewal grants, public assistance grants, etc.)	1.5
Proposed increases in present programs (public health, manpower training, scientific research, etc.)	1.0
Legislative proposals for new programs (education, youth employment opportunities, etc.)	.3
Total	+3.1
Expenditure decreases in 1964:	
Effect of new postal rates	—.5
Farm price supports	—.9
Other built-in decreases (U.N. loan, veterans readjustment benefits, etc.)	—.8
Substitution of private for public credit	—1.0
Other decreases	—.3
Total	—3.4
1964 program expenditures, as in table 1	29.4

There were reductions in the net expenditures of a number of programs, that offset the increases in other programs to arrive at a slight reduction in overall civilian expenditures, but I cannot tick them all off for you.

Senator WILLIAMS. I cannot tick them either because I have searched through that budget and I have not been able to find them.

I did find one item where they claimed a $928 million decrease in Agriculture, but that is not true. That is only a bookkeeping item of juggling the figures because I have before me here the committee report on the appropriation for Agriculture, and instead of a $928 million reduction it calls for a $39,138,000 increase. As you take these appropriations, every single category is increased. If you can find any reductions I wish you would send them down, along with a recommendation that the Congress roll back that particular appropriation below last year to that extent, and support it with an administration support.

Now, it is my understanding that you were the author of the term "Puritan ethics," is that correct? [Laughter.] Puritan ethics.

Mr. HELLER. I might say unfortunately, yes. [Laughter.]

Senator WILLIAMS. Well now, this has become an important term.

Mr. HELLER. May I say in that connection I do not want to be presumptuous enough to claim to be the author of the term, but it happened that I did utilize it in testifying on tax reduction.

Senator WILLIAMS. Now, this has become an important term in the current fiscal policy debate, and I thought it might be well to have some clarification of this point.

Is it your opinion that the term "Puritan ethics" refers to those who advocate a balanced budget?

Mr. HELLER. Well, sir, I think that is very probably part of the Puritan ethic. I think the essence of it is a call for prudence and fiscal responsibility, both in private and public finance. It is a belief, and I think a thoroughly sound one, that obligations should not be undertaken unless one is in a position to honor them. I think that is the essence of the Puritan ethic.

Senator WILLIAMS. Well, you stated that you hoped that if this tax bill were enacted you could look forward to the day when we would have a balanced budget in a condition such as you described, is that correct?

Mr. HELLER. Yes, sir.

Senator WILLIAMS. Therefore, you hope the day will come when you, too, can be one of these Puritans, is that correct? [Laughter.]

Mr. HELLER. I have heard that someone has said that he would rather be a Puritan than a Heller, and I hope I can be both a Puritan and a Heller.

Senator WILLIAMS. You wish to be a Heller right now, but you hope to be a Puritan before it is over, is that correct?

Mr. HELLER. I think I am being a Puritan. I think this is a responsible program. And in the months since I made that, as I say, possibly unfortunate reference, there is evidence in the widespread support, for the tax cut, from various organizations and individuals that Senator Smathers was citing, that as the American people have come to understand the basic philosophy and the basic economics of the President's tax proposal, they have felt that it measures up to their very stern Puritan ethic.

Senator WILLIAMS. Since you have mentioned that, you are in complete agreement, as I understand it, with the chamber of commerce position on this tax cut?

Mr. HELLER. I am in complete agreement that it should be passed, and passed quickly.

I am not in complete agreement on all of the ins and outs of their position, any more than I am of the AFL-CIO position.

Senator WILLIAMS. Forget that for the moment. One of the recommendations of the chamber of commerce was that a determined effort be made to restrain spending, and hold it down. Are you in agreement with that phase of the chamber of commerce recommendation, or do you leave them when they go to talking about restraining expenditures?

Mr. HELLER. No; I think we have said in our own statement that we are in favor of restraining the advance in expenditures, which is the same as saying we would hold them down.

Senator WILLIAMS. So we won't get confused about this, is each one putting his own definition on what is restraining——

Mr. HELLER. That is the problem.

Senator WILLIAMS. Do you support the position of the chamber of commerce as they said it should be restrained?

Mr. HELLER. I do not know exactly what they have called for. My guess is, without having seen the details, that I probably do not, that I would differ with the implementation of that particular intention.

Senator WILLIAMS. Then the point is you were in agreement with the chamber of commerce only when they agreed with you, but to the extent they recommended a curtailment of expenditures you leave them?

Mr. HELLER. Well, I would not put it quite that way.

Senator WILLIAMS. How would you put it?

Mr. HELLER. I would say that I am in favor of the general principles of cutting taxes and of prudence in Government expenditures. In that respect I do go along with their position. The exact implementation or translation of that into practice is a matter on which I am sure we would have differences.

Senator BENNETT. Will the Senator yield?

On April 18—and this is what happens to a man who writes—on April 18 you wrote a paper on the employment and aggregate demand, and on page 29 of that paper you said:

> The administrative budget proposed for the fiscal year 1964 calls for a $4.5 billion increase in expenditures—

Then, to skip over a part of a sentence—

> * * * the kind of expenditure increases projected for this year and likely to be forthcoming in subsequent years would prevent any significant increases in the fiscal drag on the economy.

Do I take that to mean that you mean we should have an annual recurring increases of around $4.5 billion a year, and if we do not have them there will be a significant fiscal drag on the economy?

Mr. HELLER. Senator, on the first part of your question I was simply taking the average increases in the budget over a number of years and projecting them in the future. This was not an expression of desire but an expression of what the Congress seemed to be doing year in and year out in expanding expenditures. Given this increase in expenditures that we have had over a lengthy period of years, we would not get a drag on the expenditure side. They would continue to expand.

Senator BENNETT. This then is not restraint. This is the acceptance of a status quo, and an agreement that there is going to be a

continual increase in the area of $4.5 or $5 billion a year; and that, as you say, this or the inference of this sentence, "The kind of expenditure increases projected for this year and likely to be forthcoming in subsequent years would prevent any significant increase in the fiscal drag on the economy," and I read that to mean if you do not have expenditure increases in this general magnitude, you will have a significant increase in the fiscal drag on the economy. To me this is not restraint. This is anything but restraint.

Mr. HELLER. Part of this is, as I say, a question of whether I was simply projecting from the past or making recommendations. I was not, as you note there, indicating either assent or dissent from this. I was simply saying that in terms of what had happened in the past this kind of increase seemed to be, in effect, approved by Congress.

Senator WILLIAMS. How far back would you go when you say in the past? I do not find any continuous $4.5 billion increase. Between 1953 and the following years I have the following figures: in 1953 the expenditures were $74.1 billion; 1954, 67.5; 1955, $64.3; 1956, $66.2; 1957, $68.9; 1958, $71.3; 1959, $80.3; and in 1960, $76.5 billion.

In other words, at the end of that 8-year period, they are just $2.4 billion higher than it was in the beginning. You had the ups and downs. This is a 1953 to 1960 period.

When you move over into the 1961 it jumped from $76.5 in 1960 to $81.5 billion in 1961; to $87.7 billion in 1962; to $92.6 billion in 1963; and to $98.8 billion projected expenditures for 1964.

Now, you only get that $4½ billion average by taking these terrific increases in the last few years and averaging them. You can prove anything by figures, but the figures do not always prove the facts.

Mr. HELLER. Well, Senator, I think you would agree that the earlier figures that you were citing did include the very substantial reduction at the end of the Korean conflict.

Senator WILLIAMS. I started with 1953, and if you go back to the years of the Korean impact, 1952, 1951, and 1950, you will find that the expenditures were $36.4 billion in 1950, $47.4 billion in 1951, and $61.2 billion in 1952.

You will find that there was increase in these with the Korean impact. But even going back and including the Korean war, you cannot get any such increases unless you take this additional $20 billion which has been added in the last 3 years.

Mr. HELLER. In the 3 years preceding that, net budget expenditures rose from $71.4 billion in fiscal 1958 to $80.3 billion in 1959, and then dropped to $76.5 billion in 1960; then rose to $81.5 billion, $87.7 billion, and $92.6 billion. If you take the overall period from 1958 when it was $71.4 billion, to $92.6 billion in the fiscal year 1963, this $20 billion-plus in 5 years does come out to about this figure.

Senator WILLIAMS. I say you can prove anything by taking the years that you wish, but if you can go back over the years, even to 1949 and come up, you do not find any such rate of expenditure.

Now between 1949 and 1952, yes, there were sizable increases in expenditures. Those were war years.

Mr. HELLER. Well, of course, percentage increases on the smaller base in earlier years would be the same, with somewhat smaller absolute figures. After we wound down from the fiscal year 1954 level, Sen-

ator, it went up from $64 billion to $66 billion, $69 billion, $71 billion, and then $80 billion, so that there was a pretty steady rise until the fiscal year 1960.

Senator WILLIAMS. And then a drop in the succeeding year.

Mr. HELLER. Then it dropped in fiscal 1960 to $76.5 billion.

Senator WILLIAMS. That is right.

Senator BENNETT. Are we to assume then that you assume that an annual increase in the area of $4.5 billion is restraint?

Mr. HELLER. No; I do not think that one can say, without looking at the programs and the needs what is restraint in any given year. I think you have to look at the whole picture as of a given time—in terms of the fiscal picture, the economic picture, and the Government budget—and determine what is a restrained budget under those circumstances, Senator.

Senator BENNETT. I think to most people "restraint" means holding expenditure levels approximately equal to those of the figure or the year with which you are making a comparison.

Mr. HELLER. Well, that is, of course, where there are some differences. I do not think restraint leads to one absolute budgetary rule.

As I say, it depends on the overall economic situation. It depends on the judgment of the administration and the Congress on particular programs vis-a-vis the private needs of the American people. I do not think we can usefully equate restraint with a constant budget or a reduction.

Senator BENNETT. Well, it is very interesting.

I would like to, if the Senator will permit me, to go back over some of these same years.

Senator WILLIAMS. Surely.

Senator BENNETT. In 1955 expenditures were less than they were in 1954. In 1958 they were less than they were in 1957; in 1959 they were less than they were in 1958, and then we had a jump. Was this restraint? There actually were some years when expenditures were reduced. Wouldn't you call this more nearly restraint than in the years in which they increased?

Mr. HELLER. It is possible in those years they should have been reduced even further. I do not think one can make an offhand judgment without looking, as I say, at the total situation, the wisdom of the programs, and the extent to which they are carried out efficiently. I do not think we can make a single judgment as to what constitutes restraint.

Senator WILLIAMS. I will just ask a couple of questions and then I will quit.

Dr. Heller, do you share the public and congressional concern about budget deficits and public debt which you mentioned in one of your speeches, or do you still think the public and the Congress are in the throes of a misguided Puritan ethic?

Mr. HELLER. Sir, I never stated that the Congress and the public were in the throes of a misguided Puritan ethic. Those certainly are not my words.

As I said a moment ago, I do feel that there has been a considerable swing of responsible and informed opinion toward the position that this proposed tax cut, and the proposed expenditure restraint going with it, do represent something that meets the test of the Puritan ethic.

Senator WILLIAMS. You have just separated yourself from this latter pace on this restraint in spending, because you said while you are for restraint you do not want to be restrained to the point where it stops you from spending. You do not want it to be effective. You want increased expenditures; you have admitted that. You are for restraint in words only; isn't that true?

Mr. HELLER. No, sir; that is not true.

What I am saying is that, with a population increase of 3 million a year in this country, and with an advance in the demands and aspirations of people——

Senator WILLIAMS. I see. We can unload part of that debt by averages on these new babies that are coming in each year; is that correct?

Mr. HELLER. No, not that either. I am simply saying that restraint is represented by making sure that we are making prudent decisions; that we are making an efficient division of our expenditure between private and public use; that indeed the tax cut represents a use of the private market mechanism for expansion, and that in this period we certainly shall have to look at all Government expenditures with a very cold eye and restrain ourselves in the expansion of Government programs.

Senator WILLIAMS. In a period when you are operating at a deficit and you have no foreseeable chance of changing that situation whereby you will have a surplus to enact a tax cut such as is being recommended, do you not agree that the only way which this tax cut can be financed is to increase the borrowing of the Federal Government, that is, we have got to borrow the money to make this tax cut to the American people, is that not true?

Mr. HELLER. You have to borrow some additional money as a result of the tax cut, but not an amount equal to the tax cut.

Senator WILLIAMS. To the extent that it reduces our revenue we have to borrow that amount of money, is that not true?

Mr. HELLER. Yes, sir.

Senator WILLIAMS. So when you speak of giving each individual family $170 per return, as you referred to it, or $110 per taxpayer as the chairman referred to it, that money will be borrowed and charged up to the grandchildren of that same individual who is getting that tax cut this year; is that not correct?

Mr. HELLER. Well, it becomes an obligation of the 190 million people of the United States, that is true.

Senator WILLIAMS. Is it not true what I just said?

Mr. HELLER. Yes, I think so. But may I say that I truly believe—and I think again the experiences that were cited earlier give ample basis for expecting—that the expansion of the debt that will occur from the tax cut in these intervening years will be more than offset by incurring less debt in the future and by eventual surpluses in the budget from the expansion of the economy.

Senator WILLIAMS. If we keep expanding this theory of borrowing the money to finance tax cuts and paying for the luxuries of today, do you not think we are in danger of reversing that old principle where a man in public life would stand on a platform and say, "All that I am or ever hope to be I owe to my mother." And in the future we are going to have to stand up and say, "All we are enjoying or hope to enjoy we owe to our children."

Mr. HELLER. I hope the trend that has occurred in the postwar period whereby the debt has been continually decreasing as a proportion of our national income will make that unhappy prospect not come true. After the war, our public debt was about 110 percent of a year's output in this country. Now, it is about 55 percent, and still falling.

In the sense of a real burden on the present generation and a prospective burden on future generations of transferring these funds from the taxpayers to the debt holders, the actual burden of the debt has been falling, not rising.

Senator WILLIAMS. Well, recognizing that this is about as close as you and I are ever going to get together in our philosophy, I will quit by saying that when we are both in the same line of thought, I will look forward to that time when we both can be Puritans, but other than that, we dissent.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. I have been hearing some remarkable pronouncements. In the first place, I heard the distinguished ranking minority member say that this is one of the greatest prosperity years in history, and I want to say I share that belief, and I hope all people coming here will continue to follow that theory down the line because I think it is a great tribute to this administration's successful running of the affairs of Government and the business of this country.

Senator WILLIAMS. I join you in congratulating them. I only wish more of it had been financed on current income rather than borrowing the money and charging it up to our children, because I think it is a great danger when either you or I as individuals or the Government itself tries to increase our living standards when we cannot afford it.

Senator HARTKE. I might say, in response to that, in that field I think that probably if anyone is going to be concerned about children, anyone on this committee, that I probably am in a position to be more concerned than anybody else. I do not know anyone who has more than seven children. I do have seven. The oldest is 18 and the youngest is 2.

Dr. Heller, as you know, I am not a late convert to this tax reduction theory. The fact of the matter is, if anything, my concern was voiced to you before there was any official pronouncement in this field; isn't that true?

Mr. HELLER. That is correct.

Senator HARTKE. I noticed in your statements here, and I think that in your effort to be overly fair, and I want to commend you for a very fine statement, you draw some comparisons. But just for the record, during the Eisenhower years, what was the total deficit that was added to the Federal debt?

Mr. HELLER. Well, sir, I should have that at my fingertips, but I do not. May we calculate that in the next few minutes and give it to you? [The addition was $22 billion.]

Senator HARTKE. That would be fine if we could get that. I think it might be important.

Mr. HELLER. I do recall a figure that is relevant to this, and that is that during the Eisenhower administration there was an increase of—and permit me to correct this figure for the record—roughly $186 billion in expenditures over those of the preceding administration. [The correct figure is $182 billion.]

Senator HARTKE. How much was that again?

Mr. HELLER. Roughly $186 billion. [$182 billion.]

Senator HARTKE. Over the preceding administration?

Mr. HELLER. That is right. In other words, the 8 Eisenhower years over the 8 preceding years.

Senator HARTKE. One of the real problems that I find coming to me repeatedly is this one you heard voiced here today, and that is why don't you cut expenses of the Government in times of exceeding prosperity.

Let me ask you, are businesses cutting their investments and expenditures, private businesses, during this period of prosperity?

Mr. HELLER. No, they are expanding them; and at a rate comparable, greater or less, than the Federal Government is expanding its indebtedness?

Mr. HELLER. If you take the rate of expansion of plant and equipment expenditures, for example, I think that it is of the same order of magnitude, perhaps a little bit greater, than the rise in Federal expenditures this year.

Senator HARTKE. In regard to the present situation, I suppose that some people can argue, and my good friend from Tennessee frequently discusses this with me, that you should not cut taxes for business people because they are doing all right now.

The truth of it is that, as I understand it, there is an expected 5-percent net after taxes for business corporations anticipated for this year which, as I understand also, is one of the greatest periods of profits, net profits, for corporations that they have experienced since the income taxes really went into the higher brackets, and it was before the war of 1941–45; is that true?

Mr. HELLER. Yes, that is true, sir.

Senator HARTKE. In the gross national product, as you have indicated, without question we are going to hit the $600 billion mark.

I recall that in 1961, in the early months, the question was whether or not we would even be able to hold the line at the $500 billion mark or whether we were going to go backward; wasn't that the concern during the recession?

Mr. HELLER. There was that concern. We have undoubtedly exceeded the expectations of many in this $100 billion rise since early 1961 to the first quarter of 1964.

Senator HARTKE. If it continues at the present rate, the gross national product and its increase is going to be in the neighborhood, in the 4-year period under this administration, of about 20 percent or a growth rate of about 5 percent a year.

Mr. HELLER. Given a continuation of the present rate that is correct in real terms.

Senator HARTKE. In real terms?

Mr. HELLER. That is, taking out all price rise, that $100 billion will represent an expansion of about 15 percent in 3 years. So your 4-year figure is correct, 20 percent, given a continuation of the rate of increase since early 1961.

Senator HARTKE. The present best estimates about the Soviet economy are that last year they were at about a 4-percent growth rate, and this year, anticipating about a 3-percent growth rate, and if so you want to compare ours with the Soviets, if you want to do that, we are doing pretty well, too.

Mr. HELLER. In our combination of expansion from recession and trend growth, we certainly are.

Senator HARTKE. So basically, as far as the country is concerned, we are not in great economic strife at the moment except for a group of people who are suffering from unemployment directly or those people who are underemployed; isn't that true?

Mr. HELLER. Yes; and the greatest beneficiaries from this tax program would be those in the category of the 4 million unemployed, those who are the invisible unemployed who have dropped out of the labor market because of the discouragement of finding jobs, and the tremendous flow of new entrants of 1.2 million each year.

Senator RIBICOFF. Will the Senator yield?

Senator HARTKE. I will be happy to yield.

Senator RIBICOFF. That is an interesting statement. In the last 2 days we had two economists, Mr. Keyserling, representing the liberal point of view and an adviser under President Truman, and Mr. Freeman, who was an adviser under Mr. Eisenhower. Both of them agreed that this bill would do hardly anything for unemployment.

I am curious to know where you get the conclusion that this bill will do something for the unemployed?

Mr. HELLER. Senator Ribicoff, we have studied the relationships of past tax cuts to economic expansion, and, more fundamentally, the relationships of expenditures by individuals and investments by corporations in response to increases in income, profit, and utilization rates. We have studied the increase in gross national product in relationship to the creation of jobs, and all of these studies lead to the conclusion that the tax reduction will create between 2 and 3 million new jobs.

Senator RIBICOFF. But don't you have a different situation in the country at the present time with different kinds of economic problems? We have 725,000 youths between 16 and 19 years of age unemployed, representing 21 percent of all the unemployed people in America. What will this bill do for these youths, 725,000 youngsters, 21 percent of the unemployed, what will this bill do to give jobs to those youngsters?

Mr. HELLER. By creating these additional jobs, by creating a climate in which teenagers will be absorbed into productive employment, it will certainly do a great deal for this group. It will by no means do all. That is, you have to conduct and enlarge the programs that we have already underway of training and retraining. We need more vocational training to be sure we do not have square pegs for the round holes that being created or will be created by the tax cut.

The record of the past shows that whenever overall unemployment drops, teenage unemployment drops more than in proportion. Between 1961 and 1962, for example, total unemployment dropped by 1.1 percentage points, but the unemployment rate of teenagers dropped by 1.9 percentage points. Teenagers are at the end of the queue, so to speak, so that when the labor market strengthens, they benefit most.

Senator RIBICOFF. But these youngsters we are talking about are without any basic training, without any skills to take these jobs. With automation, with greater skills required, you do have structural unemployment in this country. There is nothing this tax bill is going to do, to pick up the slack in that structural unemployment.

What surprises me, frankly, is the failure of the administration and others to use all of the arguments that can be used for their case.

The Senator from Virginia, the chairman, and the senior Senator from Delaware make good arguments for their philosophy.

There is another argument to be made, and yet you keep throwing your case into their forecourt instead of trying to make your own.

Mr. HELLER. Senator, that is a judgment which I am not entirely prepared to accept.

I believe that we have to have a combination of programs—not only the tax cut, but programs to overcome the structural problem by improving training and retraining, and by improving basic education.

Senator RIBICOFF. But that is going to cost money. If you are going to absorb 725,000 youngsters and see that they got a proper curriculum, and see that they have a proper training program, no matter how you slice it, that is going to cost a lot of money.

Mr. HELLER. Well, of course—these programs are already costing money.

Senator RIBICOFF. And they are going to cost more to do the job.

Now, therefore, if you are going to absorb these 725,000 youngsters they are going to have to be trained; that is going to cost a lot of money. So you really cannot make the argument that you are going to spend less money in future years if you are going to absorb these 725,000. They are not going to be absorbed by the tax cut.

Mr. HELLER. I think you are underscoring one of the reasons why I have not said we are going to spend less money in future years. We do have these needs that are pressing on us, and they will inevitably cause some increases in the Federal budget.

Senator RIBICOFF. I want to commend you for your statement to the chairman because I think the administration is painting itself into a pretty tough corner in the arguments that it has been making here in view of its future projects and its future way of conducting the affairs of Government with an expanding population and with the greater needs that this country is going to have.

I would not be hesitant, if I were you, to use all of the arguments that you have to carry forth your theory because that does represent a point of view. I think one of the great problems is that in the so-called dialog, in the argument that is being made in the country, the country does not understand this point of view because nobody in this administration basically is making those arguments.

Mr. HELLER. Senator, as you know—particularly with your interest in the health, education, and welfare field—the President has proposed very substantial programs to expand education, general, vocational, and scientific.

Senator RIBICOFF. Exactly. But when the chairman reads to you a statement at the beginning of the bill concerning the fact that you are not going to make expenditures, I think the chairman has placed you in almost an untenable position to have to live by that statement which is inconsistent with other policies that will require additional expenditures.

I know the chairman's philosophy, and I think that is why the chairman appreciated your frankness as I do. If the administration is going to advocate these programs, they are going to have to spend more money and not come and imply that these expenditures won't be made.

I mean there is a basic philosophy as represented by Senator Byrd, and he expresses it very well. Now if there is another philosophy, I think that the country and everybody else would respect the arguments that could be made to express that other point of view. I think Senator Byrd would be the first to admire a man who advocated another point of view and made all the arguments in favor of the side he believed in. I think you would agree, Senator.

The CHAIRMAN. You have stated my views better than I can.

Mr. HELLER. Senator Ribicoff, I do not think any member of the administration has appeared before Congress and suggested that the administration was going to spend less in the aggregate this fiscal year, or is going to propose smaller in the aggregate expenditures in the next budget.

The request for a new obligational authority might be less, but there will be no request for lower expenditures. But it should be noted that merely because certain existing programs are absorbing a given amount of money it is not necessary that they should for all time continue to absorb that same amount of money. Opportunities exist to reduce or terminate some existing programs to make room, as indeed this year's budget did, for new programs. A relatively small rise in the total budget is not inconsistent with new and expanded programs in many areas.

May I bring this back for just a moment to the teenagers? If we have this tax cut we would find that Government programs to train and educate these youngsters above their present level will be joined by private programs.

We have long had private inservice training, and apprenticeships, and on-the-job training programs, and why do we not have more of them today? Because it is not necessary or profitable for private employers to provide them. It will become profitable when the level of output and the need for additional workers makes it worthwhile. This is a source of true economy in government. By making the private economy work full tilt it can take some of the expenditures off the shoulders of government.

Senator RIBICOFF. But, Senator Williams and Senator Hartke, each with different points of view than mine, indicate you have one of the most prosperous years going in the Nation's history right now, with profits being very high, and yet where is there any absorption today of these unemployed youngsters through an apprenticeship program?

Mr. HELLER. But, sir, the jobs are not there. If the jobs are there, it will become profitable for private business, as it has in the past, to take on a good chunk of this training, side by side with Federal training and retraining programs.

Senator RIBICOFF. Yes. But productivity keeps rising much faster, does it not, than the number of people who are needed for that productivity? There is not a direct ratio or direct proportion.

Mr. HELLER. Well, our challenge is to provide enough stimulus to the economy to expand demand faster than our productivity advances. The failure of demand to expand sufficiently has been our problem. Demand has been expanding in the past year, for example, just enough to offset the rise in productivity and the growth of the labor force, but not fast enough to absorb the unemployed.

Senator RIBICOFF. This tax bill does not do it. This tax bill still makes a large portion of money available for investment with big in-

dustry and big business and big banking still having large sources of investment that they cannot utilize at the present time.

Mr. HELLER. It provides a stimulus to increased investment for modernization, cost cutting, to serve our balance-of-payments objectives and growth objectives side by side with the expansion of total demand.

No policy can operate on just a single track. We have one track which represents the expansion of demand through tax cuts. We have a second track that represents the expansion of efficiency and productivity, which means more output for a given input or, in other words, the cutting of costs to provide growth, to support price stability, to improve our balance of payments. And then you have to build bridges between these two tracks through training and retraining programs, through a better educational program, through relocation and area development programs and the like, to take care of the human fallout from the productivity advance.

Senator RIBICOFF. But basically this is going to cost money. And it——

Mr. HELLER. Well, it is costing money now.

Senator RIBICOFF. And it will cost more.

Mr. HELLER. Meeting needs of this kind is the cause of a good bit of the increase in our civilian budget expenditures in the last 3 years, and has also required using some of the savings from reductions in other programs, as we were discussing a moment ago.

Senator RIBICOFF. Thank you for yielding. I should not have taken so much of your time.

Senator HARTKE. That is fine, Mr. Heller. I think the distinguished Senator from Connecticut and the Senator from Virginia are doing a fine job of giving what I think is a wonderful idea a rough time.

I just want to disagree with them in their philosophy. I love both of them, and I think they are both wonderful gentlemen. I have been a guest at the home of my distinguished chairman, and I hope that that invitation is never turned down, because it is a wonderful place to eat fried chicken and Virginia ham.

I have all been up in Connecticut and eaten some Italian food in some of those Italian neighborhoods up in Connecticut.

But let me say I do not think the administration has to do much apologizing on this thing. This is the most prosperous time probably in the history of the United States, and it has been great, but what the administration is saying is that it can be greater. That is what you are saying?

Mr. HELLER. That is right.

Senator HARTKE. And I do not think there is any apology needed for that.

I think, Mr. Heller, you put your finger on something very important, and that is the fact that there does come a time when on-the-job training becomes not alone economical but very vital for the future of any production machine, does it not?

Mr. HELLER. Yes, it does.

Senator HARTKE. And it will not whenever that machine is working at about 50 or 60 percent of its capacity, and that is the problem today, is it not?

Mr. HELLER. They are running on the average somewhat higher than that, but that is perfectly right. Until you get it closer to full capacity it is not interesting, so to speak, in terms of profitability.

Senator RIBICOFF. Will the Senator yield?

Senator HARTKE. Just one moment.

The truth of it is that some of these programs will go down in cost. The welfare program will go down when you put people to work; the unemployment costs will go down. Some of these aid programs, some of the so-called welfare state programs can be, for all practical purposes, not terminated, but severely curtailed in their application and need if we have full employment, which is the stated policy of the Government in the Full Employment Act of 1946.

Mr. HELLER. It will create more employment.

Senator RIBICOFF. As the plant gets more productive and the manufacturer wants to get as much production out of the people who work there as he can, he will find himself using more overtime with the skilled employees, and not using the unskilled employees because those employees who, even though their wages will be higher, will be producing more than the unskilled.

Mr. HELLER. This is a point we have looked into, Senator, with a number of corporation presidents and other executives, and we are encouraged to find that a lot of them tell us they have already stretched their present work force to about the limit of overtime work. We are told, not in all cases, but in a great many cases, that they would expect to expand their employment along with any further expansion of production.

The average manufacturing workweek has already, as you know, expanded by about 1½ hours since early 1961 and already reflects a great deal of overtime. So we are reasonably confident that a lot of the impact of additional output will be translated into new jobs.

Senator RIBICOFF. I bring you back to your argument with Senator Byrd. Senator Byrd's argument that he made at the beginning is that basically when you talk about employment you have to take into account overtime, the wives, and several people working in the same family, so you have different factors to go into.

I am for a tax cut, you see, and in this I disagree with Senator Byrd. But I do think that Senator Byrd is getting the best of the argument with you because of the failure of the administration to make the arguments it could make for its position here.

Senator HARTKE. If the Senator will yield back again I will say this: It is very difficult in times of the most prosperous period in the history of the United States for the voices of those people out of work to be heard. It is very difficult for the voice of poverty to penetrate into the hearts and the souls and the minds and the thinking of a man who is drawing an overtime paycheck.

Senator RIBICOFF. That is right; and that is why it is the duty of people who advocate this program to galvanize this voice by making the arguments they can make instead of running away from them.

Senator HARTKE. I might say I cannot see any stronger argument for it than pointing out the dangers of a recession as Mr. Heller has done here. I think, if anything, the administration has itself failed in one aspect only, and that is it has failed to really prophesy the proportions that can come from this tax cut. I think your recoupment

estimates are too low. I think the age which is coming in America is something beyond almost the fondest dream that any member of the administration has pointed to today.

I think this is a great age for children, and I am not one who is voicing concern for it, but I think this tax cut should be put through effective retroactively January 1, and I think that is the only way you are going to get a balanced budget and cut down on your unemployment and your welfare checks.

The truth of it is that the welfare rolls in the District of Columbia increased last month, if the reports are right. There must be some reason for that.

Senator RIBICOFF. The reason you have is because these are the people who cannot find jobs. You have got some 4 million of these people on welfare, and it is going to take a lot of training to get them off welfare.

You have some 40 million people in this country who are considered poor, and the general prosperity passes them by.

If you are going to do something for those 40 million people in this country there is going to have to be a lot more done than tax cuts. What will these tax cuts do for the unemployed miners in West Virginia and Kentucky? There is a lot more that has to be done for them, but it won't be done with the arguments and the philosophy that are being presented to this committee.

Mr. HELLER. Senator, may I——

Senator HARTKE. Go ahead.

Mr. HELLER. With your permission, may I just note again on that very point that when overall unemployment drops, the unemployment of the particularly disadvantaged groups drops about twice as fast. When the overall unemployment rate drops by 1 percentage point, unemployment of nonwhites drops by 2. The overall unemployment rate dropped by 1 percentage point from 1961 to 1962. The unemployment rate for miners dropped by 2 percentage points.

When unemployment gets to 4 percent, overall rates of unemployment for the groups you are referring to are, of course, still far too high, and we cannot be satisfied with 6, 8, and 9 percent rates for particular groups even if the overall rate is at a reasonable level.

Senator RIBICOFF. You still keep playing into Senator Byrd's hands. As he pointed out right at the beginning, and I have respect for my chairman, a very astute man. He pointed out you have 70 million people working. In other words, your employment base is rising and yet you come in here because you are worried about a static rate of unemployment. Employment rises but unemployment remains static.

Now, the burden of the case is upon you to show that this bill will do something for the unemployment rate. There are great problems in this country that some people recognize, and I think you are one of those who recognizes them, but yet the voice is not here in America to explain what has to be done for these people. You are not going to absorb 21 percent of the unemployed, 725,000 youngsters between 16 and 19 years of age, unless we understand what we have to do to absorb these 725,000 youngsters, and this tax cut by itself won't do it. I think it is a great mistake to think so because, in the short run, there

will be a boost to the economy, but in the long run these problems still remain with us.

So there are other problems that have to be solved if we are going to solve the problem of unemployment. Now, there are reasons for a tax cut, and there are justifications for a tax cut, but I think it is a great mistake to indicate that the tax cut will solve all the problems that beset our society.

Mr. HELLER. I have just one comment, Senator Ribicoff. It is the comment that the administration, in general, and we, in particular, on the economic side, have constantly stressed the necessity of balanced, complementary programs—programs to fit the square pegs for round holes, along with creation of more holes. Today it is even more urgent to make sure that, when we have the square pags rounded off, the holes are there—the job slots are there—for them to fit into. For this, you need interlocking programs, on the side both of training and of aggregate demand.

Senator RIBICOFF. I agree with you, Mr. Heller, and I respect you.

However, the way this record is being built up there is nothing in this record that indicates that. The record as it is being built up goes quite contrary to that. This is the type of record that is being built up in these hearings.

Mr. HELLER. As I indicated in my prepared statement, we have developed these points at great length in a 57-page statement we submitted to Senator Clark's subcommittee on the interrelationship bebetween the tax cut and the structural programs.

Senator RIBICOFF. That is right. But that is one committee for one purpose. There has to be a consistency in the testimony that comes into this committee. It is not enough to have you present one philosophy before the Labor and Public Welfare Committee, and then have others emphasize a different philosophy before the Finance Committee. I think there has to be a consistent philosophy that is presented to the Senator, whether he is a member of the Finance Committee or the Labor Committee, because Senators do read, and Senators do have some degree of intelligence, and Senators do have understanding, and Senators are trying to do a job, and Senators are trying to understand a complicated question. This is one of the reasons I supported the chairman in not cutting off these hearings because there is a big job to be done in this country, whether you are for the bill or against the bill, to understand what is in the bill, what it will do for America and what it won't do for America, and that is why I stood behind the chairman when he insisted that these hearings be conducted so America could understand, and the Senate could understand what is actually involved, even though we may disagree with the results and conclusions we seek to accomplish.

Mr. HELLER. Senator, if you will examine that testimony and this, I think it will show you that they express similar concerns—both as to the tax cut and as to expenditure programs.

The CHAIRMAN. The Chair was considering making a statement of his own, but I do not want to get into either square hole or a round hole, and after what Senator Ribicoff said, which I greatly appreciate, I think the best thing I can do for the moment is to keep quiet. So we will meet at 2:30 this afternoon.

(Whereupon, at 1 p.m., the committee was in recess, to reconvene at 2:30 p.m., the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.
Senator Gore?

STATEMENT OF WALTER W. HELLER; ACCOMPANIED BY GARDNER ACKLEY AND JOHN P. LEWIS—Resumed

Senator GORE. Doctor Heller, since you advocate a tax cut for individuals when disposable personal income is high, and since you want a tax cut for corporations when there is high liquidity throughout the corporate structure, I can only conclude that your advocacy of this bill is based on Keynesian concepts and involves an effort to spur overall demand. Is that conclusion justified?

Mr. HELLER. Senator, without putting a label on it, I should say the main purpose is to spur overall demand, but also to spur investment incentives in the process.

Senator GORE. In other words, you are dealing with macroeconomics, endeavoring to take what I have described as a shotgun blast at the target, instead of a specific shot at the areas of distress and difficulty.

In other words, you are in essence using the macroeconomic approach in your advocacy of this bill.

Mr. HELLER. Our approach is an attempt to lift the economy through a massive stimulus, primarily on an aggregate demand basis, but so structured as to take account of microeconomic problems and coupled with programs that would hit at some of these microeconomic problems.

Senator GORE. Well, I am trying to paraphrase and state as accurately as I can the position you have taken, as I understand it.

I am not trying to trap you in any way by putting words in your mouth. If you prefer some other phraseology, please feel free to state it. In general, have I stated your overall thesis correctly?

Mr. HELLER. I think that is right; and I am not suggesting, Senator, that you are trying to do anything but state our position. I think it is important to constantly emphasize the balance between the macromeasures and the micromeasures. This particular part of the program is, as you say, the attempt to increase the overall level of demand.

Senator GORE. Please understand that no one appears to be as concerned as I am about the macroeconomic approach, but I am talking now about the tax bill itself, not the whole Government program, and your approach to it is macroeconomic.

Mr. HELLER. The approach is through macroeconomics. We think it will make a substantial contribution toward solving some of the microeconomic problems, too.

Senator GORE. I understand that, but in theory you and Andrew Mellon say pretty much the same thing. It is really not a new burst of economic brilliance or theory.

Mr. HELLER. We do not claim novelty; no, sir.

Senator GORE. Well, in your economic report from 1963, in referring to the failure of fiscal policy to cure the great depression and the

recovery which ensued after World War II began, you state, and I quote here:

Any expenditures, private or public, on the same scale would have expanded demand and put men back to work.

Now, this may be true.

Mr. HELLER. What was the page reference, Senator?

Senator GORE. That was from your 1963 economic report, where you discuss the failure of fiscal policy to cure the great depression.

Mr. HELLER. That is the top of page 72; thank you. I have it.

Senator GORE. Thank you. Do you have it now?

Mr. HELLER. Yes; I do.

Senator GORE. Yes, it appears at the top of page 72.

Now, this may be true and macroeconomics may be applicable to such a desperate situation as the one we faced in the great depression. But do you not recognize that the situation today is entirely different? Today we are in a period of relative prosperity. In fact, we heard it described this morning as unprecedented prosperity. Yet you still propose this macroeconomic approach to the problem. Now, unless I yield to the tempation to give you a free lecture, I pause for you to make such comments as you desire.

Mr. HELLER. Senator, if you look to the wellsprings of greatness in this country, what you find is a very restless dissatisfaction with anything but the best. I think that is what you are finding today and it is reflected in this program. It is true, as Senator Hartke said, that there has been a very impressive advance in the past 3 years. A $100 billion increase in GNP in 3 peacetime years will be unprecedented. But we are not keeping up with the expanding capacity of our economy. We are not employing the unemployed, we are not cutting down poverty at the rate that we did when we were growing faster, from 1947 to 1957. We are not, in other words, living up to the enormous potential and the enormous future of this economy. And that is why we propose, on top of a very substantial expansion, a very impressive expansion, to put forth a stimulus that will carry us all the way to the top. We are part way up the hill, but we are not at the top.

Senator GORE. And yet you are proposing a macroeconomic or shotgun, overall approach to the problem, thus attempting artificially to boost demand by a process which will undoubtedly be wasteful and create as many—perhaps more—problems as it will solve.

We have some problems, yes. You have described some of them. But you have not explained to anyone's satisfaction yet, as far as I know, unless it be your own, how the tax proposal is going to solve the specific problems that now exist.

You have acknowledged that our problem is not lack of prosperity. We are at an alltime high. You said to Senator Hartke this morning that thus far in the administration, in real terms, we have a rate of growth of about 5 percent a year. But you are still advocating the same approach which you say would have worked in the bottom of the depression.

Mr. HELLER. If I may comment on that, it is true that we have had a very substantial expansion that will average about 5 percent a year. That, of course, is not the same thing as long-term growth in our capacity, because a good bit of our expansion was the makeup of the recession of 1960–61, which had put us in an economic trough, and

while it is an impressive performance, we still do not have enough prosperity to provide the jobs and the rate of capacity utilization that will keep our economy humming at full tilt.

I do not think that we are going to solve the problems like those of poverty, like those of unemployment, like those of even structural unemployment, until we provide stronger job opportunities. May I give an example of that, sir? In the 10 years from 1947 to 1957, when we grew at a trend rate of about 4 percent per year, we reduced the poverty quotient in this country from 33 percent of the population to 23 percent, taking a 1961 family income of $3,000 as the poverty line. But from 1957 to 1961, when we were growing at an average rate of just 3.1 percent, we only reduced that by another 2 percentage points in 4 years.

What we are saying is that by full use of our potential, by full employment, by full utilization, we will make a dent in some of these tough problems that beset the economy in some of its less attractive regions and corners.

Senator GORE. You know, Doctor, I find it perfectly amazing that you, with such alacrity, will assume that the tax bill is going to solve all these problems. You must have gotten that from that Presidential speech in which it was said the tax bill was going to solve even the dropout problem.

Do you really think that this is a cure-all?

Mr. HELLER. No; it is not going to solve all our problems. We have said that in our statement.

Senator GORE. Why do you state all these unsolved problems as justification for this massive tax reduction, when our problems are specific?

Mr. HELLER. Passage of the bill will create the setting within which we will have a real good, fighting chance of solving these problems. I do not think we have the right setting for it if we have a slack economy with 5½ percent plus unemployment.

Senator GORE. That is a different situation. You say now that this tax cut is going to create the setting. That is a very interesting statement. What kind of setting, and then what are we going to do after the setting is created?

Mr. HELLER. It will be a setting in which there are sufficient job opportunities so that people can be gainfully employed if they are looking for work, and can be employed full time if they are only employed part time. That, in itself, will provide a number of exits from poverty, for example. At the same time, however, other programs—the education programs, the training programs, the programs of job retraining and so forth—will have to be carried forward in order to make it possible to use those exits from poverty. In other words, it is a necessary condition. We are not saying it is a sufficient condition to solve all our problems.

Senator GORE. Well, I want to ask you some specifics. Before doing so, however, let me call to your attention the fact that there was a big tax cut in 1954, which amounted to approximately the same percentage of the then gross national product as the one now proposed.

Mr. HELLER. That is right.

Senator GORE. And then last year we had the investment credit, which you showed by your statement this morning has not been very

effective in stimulating plant investment. We had the depreciation changes. We have had all of these tax stimuli and a big increase in gross national product, and yet I want to give you from the record the statistics on some specific employment: In 1953, before the 1954 tax cut, there were 4,853,000 full-time jobs in agriculture. This year, with much greater production, there are 2,587,000. Then in mining, in 1953, 866,000 people were employed, but today only 617,000. Yet there is more production. I am not blaming you for these figures; I am just trying to find out how this tax cut is going to increase employment in mines, in factories, and in agriculture.

Let me give you the figures for manufacturing. I take it you realize that in 10 years we have not gained a single job in manufacturing.

Mr. HELLER. That is correct.

Senator GORE. Not a single job. Yet we have had a $5 billion tax cut for the investment element of our economy. Let me give you the exact figures: In 1953, there were 17,549,000 people employed in manufacturing. In 1963, 10 years later, after all the effects of the 1954 tax cut and the investment credit and depreciation changes of last year, there are only something over 16 million employed in manufacturing.

Let me give you construction: In 1953, 2,623,000. With all of the multiplier effect that has intervened and the technological improvement and automation, with our vast highway program underway and other construction at a great deal greater volume than it was 10 years ago, there are only 2,300,000 people employed in construction.

Now, let me say again, I do not cite these figures with any joy. It illustrates the enormous economic, sociological, and political problems that we have. And yet you are proposing the same old remedy under which there has been less employment in manufacturing, less employment in transportation, less employment in agriculture, less employment in mining.

Mr. HELLER. First of all, in looking at the statistics for 1962, we are looking at a year when there was an average of 5.6-percent unemployment. If we were operating at full employment, there would, of course, be more jobs in all of these categories.

Senator GORE. Well, I used the preliminary figures for March 1963 to get a decade spread there.

Mr. HELLER. Well, of course, this year our unemployment has been average 5.6 percent, also—5.7, actually.

Senator GORE. But we had the big tax cut in 1954, which was advocated in the Ways and Means Committee on the identical basis as you advocate this tax cut. And we were told last year that the investment credit was by all odds the most efficient way to stimulate investment, that, in fact, it was far more efficient and effective than a direct reduction in tax rates.

Yet with all of these things, we have less employment, less jobs in these major categories than we had 10 years ago. So I ask you, Just how is this further tax cut going to do the job which the other tax cuts have failed to do?

Mr. HELLER. With reference to the employment statistics, of course, as we all know, there have been increases in many of the other areas—wholesale and retail trade; finance; insurance and real estate; service and miscellaneous; and indeed in government, particularly State and

local—the school systems and so forth have required a lot of additional employment.

Those are the areas that account for the amount of increase in employment we have had.

Senator GORE. I agree. It is in the service field and government.

Mr. HELLER. It is in the service and——

Senator GORE. Perhaps the largest single increase has been in teachers.

Mr. HELLER. I think that is probably right; yes.

Senator GORE. And this is in the public sector.

Mr. HELLER. It is very largely in the public sector, yes; in the State and local sector.

Senator GORE. Oh, yes; I want to be as completely fair as is possible, because I think you are advocating a fallacious policy. Instead of solving the problems of our society, your policy will permanently impair the ability and capacity of the Government to assist in doing so. The conflict is so sharp that I want to lean over backward, to be perpectly fair, and give you every opportunity to present your case fully.

Mr. HELLER. I greatly appreciate that, particularly since this is a very fundamental issue about how this country is to make full use of its human and material resources. As I say, in contrast with the shrinkage in some areas, there of course have been increases in others over these years.

I should say also, Senator, that the decreases in the areas that you cited are, of course, the product of increased productivity. That is, we are producing more per man-hour than we did then, as you pointed out. And that increased productivity is part and parcel of what we have to have in order to expand our total capacity as an economy and in order to maintain our competitiveness, cut our costs, hold prices stable, and so on. I think we are agreed up to that point, that we would not want to stop the advance in productivity in order to solve our unemployment problem—that would be a self-defeating way to do it.

Then the problem becomes how to make full use of this set of resources that we have. I think part of our problem——

Senator GORE. Senator Ribicoff made some statements this morning along this line and you have just stated a fact upon which we can agree, if I may interject here before we go to the next point. That is, productivity—production per man-hour—has vastly increased. So many people deprecate the United States now, and its economy, that I would just like to cite once again the comparison of some indexes of the productivity in this country and that in some other countries: Agricultural production in the United States is 2.5 times as great per worker as agricultural production in France and Germany. Railroads here use 3.7 employees per mile; Germany, 16.2; United Kingdom, 29.2; Russia, 29.6.

In steel, the margin is narrower because we furnished much of the money to modernize their plants. But even so, the U.S. steelworker produces 220 tons; the German worker, 174; the Japanese, 99.

The coal miner in our country produces 14 tons per day and in Europe, 2 tons a day.

Now, what I am trying to get at, Doctor—and I do not want to deter you from a full answer, nor do I want to stop technological improvement. But what I am trying to get at is how a tax cut, which you say will bring about further modernization of plant, and, of course,

although you do not use the term, you must acknowledge that if it is effective at all in that regard it must bring about more automation——

Mr. HELLER. True.

Senator GORE. Of course, it is true. And you are being very candid in saying that. But how does this give jobs in manufacturing, how does this give jobs in transportation, in agriculture? We need more schoolteachers, yes. We have more children to educate and a need for greatly improved education.

But I do not see how your tax bill fits into those two things.

Mr. HELLER. This is a question that is entirely legitimate—one that we have to answer in the course of defense of the tax reduction and one that I believe we can answer. I think, Senator, the reason that we had essentially full employment through 1957—not as low unemployment as we would like to have it, but essentially a good record, averaging 4 percent in the 1947–57 period, including a couple of recessions in the process—was that we had a high level of total demand in the economy. We had enough demand by consumers, by business and by governments to engage our resources fully.

Senator GORE. You described that very well this morning. I do not know whether you used the term "pent up" but you referred to the demand that had been unanswered as a result of the stringencies of the Korean war.

Mr. HELLER. Yes; and then the effect of the 1954 tax cut was to help maintain demand in the period beyond 1954.

Senator GORE. There is an interesting point there. The demand, within 2 years after the 1954 tax cut, was not sufficient to utilize the plant capacity generated through that period. But I do not want to divert you from your point. I do not want to divert you from your principal answer.

Mr. HELLER. Since about the third quarter of 1957, we have had a persistently inadequate level of total demand to use all of our manpower and all of ou available industrial capacity. And at no time over this period have we come closer than about 5 percent unemployment to the full employment target. For 72 consecutive months, we have had 5 percent or higher unemployment.

Now, if $11 billion of additional consuming and investing power is put into the hands of consumers and into the hands of business, this will massively increase their capacity to buy the products—both the consumer products and the capital products—of American industry. This in turn will translate itself—by all standing relationships, by all past experience—into an increase in our gross national product in the neighborhood of at least $30 billion. About $25 billion of that increase would be consumption and about $5 billion would be investment.

In that process, I am persuaded, Senator, that the expansion of the economy will not only provide enough revenues in the course of time to bring our Federal budget into balance at high levels of employment and activity, but that it will provide a much broader and fuller revenue base for the State and local governments, the very ones that have to employ the teachers and others to satisfy the expanding demand for State and local services.

As you know, the Treasury computations at the behest of the Joint Economic Committee suggest that when the tax cut is fully in effect, without any changes in State and local tax rates, this will bring about $3 billion of revenue to the State and local units.

Senator GORE. Yes; I know. On the basis of that computation, the Democratic National Committee spokesman advised people in the State of Tennessee that this tax cut was going to give over $400 to each family in Tennessee, but the average per family tax liability in the State is about $500.

Mr. HELLER. The Treasury made a very careful State-by-State appraisal of the systems and what would happen in this kind of expansion.

Given the overall stimulus of the tax reduction, of the consumption spending, to match the increase in investment, the increase in capacity—and in this respect, I think the tax cut is well balanced—not only will it lead to the greater satisfaction of private needs and desires, but will also make it easier to meet the needs in the public sector out of a larger total "pie."

Senator GORE. Let me ask you a simple question. Could we stimulate the economy by buying 1 million new automobiles next year and transporting them to the trough of the Atlantic Ocean and dumping them overboard?

Mr. HELLER. Yes, we could; but it would be a most wasteful and silly way to do it.

Senator GORE. But it would provide economic stimulation, would it not?

Mr. HELLER. It would provide economic stimulation, yes; in the worst possible way, I should think.

Senator GORE. Well, we are not discussing purposes at the moment. I agree it would be foolish to do that. But so far as economic stimulation is concerned, that is about the way some of our foreign aid program operates. Please understand, I support foreign aid and I am not saying that to be critical, but strictly from the standpoint of economic principle, the stimulation of the economy of the country, the buying of a million automobiles and dumping them in the ocean would be stimulation somewhat similar to buying the same number of automobiles and sending them to Japan.

Mr. HELLER. Sending them to Japan free of charge, you say?

Senator GORE. Yes.

Mr. HELLER. I should say that there is a rather substantial difference as far as the world is concerned. If you dump them in the ocean or if you use them from the productive purpose of building the economic base in Japan. But that is a separate question. I am just trying to look at the economics of it, not the question of the aid program as such.

Senator GORE. Nor am I. Nor am I trying to interpret its effect upon the world economy nor upon Japan. But as far as making jobs here in the United States and using steel and manufacturing automobiles, the economic stimulus in the United States would be about the same.

Mr. HELLER. I think that is probably right, Senator, but I would rather carry your example one step further and say that the purpose of the tax cut is to see to it, in terms of automobile production, that we produce hundreds of thousands or a million additional automobiles which can then be bought by the people in the United States. I think that is the fundamental difference here between those two.

Senator GORE. So you are proposing here now to give tax cuts so people can buy automobiles?

Mr. HELLER. No; I very carefully tried to put it in the context of your example. I am not making a choice as to how people use their money, sir.

Senator GORE. But this is essentially what you are proposing.

Senator HARTKE. Will the Senator yield?

Senator GORE. Certainly.

Senator HARTKE. Is there anything wrong with people who do get a tax cut buying automobiles?

Mr. HELLER. No; not at all. They may use it for better housing, better schooling, travel, more adequate State and local services—I do not think it is for us to decide. That is part of the philosophy of the tax cut, that we put the money in the private hands and let the private units spend the money as they see fit.

Senator GORE. That comes down, it seems to me, to a basic question. Is the need in our society for more schools and better education or for more automobile factories and freewheeling?

Mr. HELLER. I think we have a complex of needs. I think we have the need for continually expanding our productive capacity in this economy and our productivity, and any of us who have children are also very keenly aware of the need for more schooling, better schooling, better higher education. I do not think there is any conflict between these two.

In fact, an economy that can produce more because it is efficient and productive and has a lot of investment in the private sector can make better provision for the public sector than an economy which is poor in the private sector.

Senator GORE. Of course, we have the largest automobile production in history this year. General Motors has the largest profits, the largest dividend, the largest cash flows. You would not say that General Motors is one of our acute national problems, would you?

Mr. HELLER. I would not. It is a great moneymaking company, very efficient.

Senator GORE. Would you say that what is good for General Motors is good for the United States?

Mr. HELLER. I would say that what is good for the United States may also be good for General Motors. I do not see anything wrong, Senator, with a tax cut that expands the total economy and in the process expands the investment and profits of General Motors. A full employment economy would expand their profits and I think it would expand their employment.

Senator GORE. Are you sure of that?

Mr. HELLER. Well, as we have to——

Senator GORE. Do you know the history of employment in the automobile industry in the last 10 years?

Mr. HLLER. Yes. It has declined. This is true. At the same time——

Senator GORE. And they have had one tax cut after another.

Mr. HELLER. But look at what has happened in Detroit, Senator, for the past 2 years.

Senator GORE. I have been looking at it. I have been looking at it for the past 10 years.

Mr. HELLER. They had what they thought was an intractable problem. I visited Detroit about 2 years ago, and they could not see how

their problem could be boiled down to size. Now, demand for automobiles has risen and that 11-percent rate of unemployment in that area has dropped to 5.4. I think it is a sterling example of the increased demand leading to an increase in employment. We have talked to executives in the automobile industry, among others, and they say that while perhaps there could be some increase in automobile manufacture, without a proportionate increase in employment, still and all, higher demand would require business to increase their employment substantially.

Senator GORE. Well, I have referred to the liquidity of not only General Motors but corporations in general, the unprecedented level of profits and dividends, no shortage of investment capital. Now, I will ask you if one of our national problems is a shortage of automotive production capacity.

Mr. HELLER. No; I do not think that we have a shortage of that capacity in terms of present levels of demand. No; I do not.

Senator GORE. So this is not one of our problems, then?

Mr. HELLER. This is not one of our problems. I think the problem of liquidity of corporations may be a little bit more serious than you indicate, that is, in the sense that while the overall cash flow of corporations is very good indeed and even exceeds a bit their total plant and equipment investment, the distribution is such that not all industries share equally in these funds. In particular, small business—for which this bill before you proposes to provide virtually a 27-percent cut—the small corporations and individual proprietorships are very hard up, typically, for investment funds and have to rely on internal funds. They do not generate adequate funds. The individual tax cuts and the special tax cuts for small business are a very important part of this bill in terms of building up the economy.

Senator GORE. Now, Dr. Heller, without any planned strategy on my part to bring you to this point, you have arrived at it in your own way—it seems to me you have just disproved your macroeconomic thesis. You say that General Motors and the large corporations are in this advantageous position, that this may not be true of the small business element of our economy. But you propose this macroeconomic, overall, scattergun method which will principally, or at least highly, benefit those who do not constitute a problem, either in productive capacity, profitability, or availability of investment capital.

Therefore, I come back and say you have disproved your thesis. What we need is specific programs to solve the areas of distress. We need microeconomics, not macroeconomics, if I may use the terms of economists.

Mr. HELLER. You are using them very well.

I feel this: That in the structuring of the tax deduction and tax revision, one certainly can build in—and I believe the administration and the House, in its efforts, have built in—microeconomic considerations, because otherwise, we could not explain the fact that the tax on the large corporations is a 4- and 8-percent cut, and that the tax cut for the smaller corporations is 27 percent. I think this is aimed precisely at the kind of problem that you mentioned—that the larger corporations are better fixed with funds. At the same time, a program of this kind has many facets and one of the basic facets is to increase further our productivity, our cost-cutting programs, our competitive ability in world markets.

Adding on the investment credits and depreciation allowances, which I think have compiled a pretty good record for their first year, I think we have a good macroeconomic program with good microeconomic structuring. And I believe that is a sound approach to the tax cut.

Senator GORE. Your principal weapon in this tax bill which we are discussing is to open the faucet wide, with a general flooding of tax relief to those who do not need it, by terms of your own description, to areas of our society where there is not a problem. This is indicated by some statistics here that I think you will find interesting.

Ten years ago, the percentage of corporate profits distributed in dividends—that is, after-tax corporate profits—was 50 percent. That had been over a period of years the general pattern. I see in 1952, it was 52 percent. It ranged from 45 up to 58; then back down to 48 in the early postwar period. But in 1963, it has jumped to 66.7 percent.

Now, this is, of course, partly the result of the tax reduction that has been given. This shows that the tax cuts have gone not into more jobs in manufacturing, necessarily, in improved plant, but in greater dividends. Yet you propose more of the same thing. Now, how does that solve the problem of education?

Mr. HELLER. Again, one has to look at the balanced nature of the program. We have emphasized that the $8.8 billion of tax cuts on the consumer side are an essential part of a program which would make full use of the capacity that has been and is being built. That $8.8 billion, plus the $1 billion of additional dividends, roughly, would course through the economy, would be spent and respent, would eventually end up in a multiplied effect, together with the corporate reductions, of about $30 billion of additional output.

As I said before, $25 of that $30 billion would be on the consumption side. This is an attempt, on the one hand, to stimulate incentives, productivity, efficiency, cut costs, and on the other, to provide the additional markets to take these goods and services and make full use of the additional production, and the additional capacity. So I think that in that respect, it is a balanced approach. It does recognize that part of our problem in recent years has been under utilization of this capacity.

That is one reason why, for example, although the investment credit and depreciation liberalization did touch off a billion dollars of additional investment this year, they by no means have yet seen their full impact. There is always some delay, but as we raise consumption and as industry works these new methods into its accounting and into its planning, we will see a much increased stimulus in the course of time by the interaction of consumption and investment. By that interaction, we will see a much increased stimulus to expansion, modernization, and growth.

Senator GORE. I hope you do not mind if I suggest an apparent contradiction. You refer to underutilization of our productive capacity as being one of our principal problems, and yet, on the other hand, advocate a tax cut on the basis of increasing productive capacity.

Mr. HELLER. I do not really think that is a contradiction, sir. After all, in a free economy we are always aiming at a combination of full employment, faster growth, price stability, balance-of-payments equilibrium, and fair distribution of the fruits of the economy.

Senator GORE. You mean fruits of the economy or the tax bill?

Mr. HELLER. No; the fruits of the economy. And in order to advance on all these fronts at once, we cannot just pick out one segment and say, "Look, let us have all of this poured into consumption."

In the early postwar period, we were investing 10 to 11 percent of our GNP in productive plant and equipment. But mainly, we have only been investing 9 percent. I think if we are going to stay competitive in the world, we have to move simultaneously on the front of expansion of consumer demand, and expansion of cost-cutting investment.

Senator GORE. Well, I am aware that by now my colleagues, some of those in regular attendance at this hearing, must be weary of hearing my views. But as you said this morning, no more important issue has been before the Congress in many years. When one feels as deeply as I do that what is proposed will not only miss the mark of our national needs but permanently hamper the country in providing solutions for those needs, I try in every way I can to reach my colleagues on the committee and the American people and just—maybe you might take a message to Garcia yourself. Let me give you an illustration of what I mean by specific problems.

The President has appointed some sort of a committee for Appalachia. I have forgotten what he calls it, but he has an Advisory Committee appointed to propose solutions for the depressed economic conditions in the Appalachian region, reaching from Pennsylvania to northern Georgia and Alabama, through West Virginia, which seemed to impress the President a great deal in 1960. Are you aware of the recommendations that this Commission is making?

Mr. HELLER. Not in detail, but in the general direction, yes.

Senator GORE. They do not involve a tax cut, do they?

Mr. HELLER. I think if you spoke to the people who are involved in this, they would feel that the expansion of job opportunities coming from the tax cut would make these problems a lot more soluble, a lot more amenable to solutions under the specific programs that would be aimed at Appalachia as such—whether it is the problem of revenues for education, or agricultural adjustment, or teenage unemployment in this area, or even the unemployment of these miners, and so on. With a higher level of job opportunities throughout the country, it would help create the setting and produce the wherewithal to provide a solution to the Appalachian region.

Senator GORE. Well, I am going to cite you an example of what has occurred in a part of Appalachia with the expenditure of relatively small amounts of money. I refer to the area redevelopment program and the accelerated public works program. I think that the total number of approved projects in my State is about 100, and I am advised that partly as a result of these, bringing in new water supplies and sewage disposal plants to communities, indigenous industries have expanded and some new ones built up, moved in, and I am advised by the employment security officials that we have the lowest rate of unemployment in Tennessee that we have had for several years—below 4 percent. I do not claim full credit for this total development to accelerated public works and the area redevelopment programs, but they are a vital part of it.

The total cost is about $20 million. What I am trying to illustrate, Doctor, is that what we have in this country is an economy of vast and

unparalleled prosperity in the main, a situation unlike the great depression to which you referred in your economic report. We do have areas of distress. We have structural unemployment, which Senator Ribicoff referred to this morning. It seems to me that we could do the job far more efficiently, far more economically, by having specific programs of action to solve those specific problems of distress rather than to have this macroeconomic scattergun giving an $11 billion tax cut and borrowing the money with which to do it, adding to the danger of inflation, adding to the cost of carrying the public debt, with no assurance that it is going to produce any particular number of new job opportunities. And, moreover, giving the largest benefits to those who need them least.

So what I would propose is a reconsideration of programs of governmental action which will be far more economical and far more effective, producing community facilities and highways of lasting benefit. With the tax cut, you do not know that you will have anything to show for your money except a very large deficit.

Mr. HELLER. I think, Senator, that if you have 2 to 3 million additional jobs and people employed to show for it, that is a very great deal.

Senator GORE. You think so, but you have not been able to show us how you are going to do it.

Senator HARTKE. Will the Senator yield at this point?

Senator GORE. Let him respond, first, please.

Mr. HELLER. All I have said is that the entire weight of the evidence of experience in tax reduction, here and abroad, the entire weight of the evidence of the way in which the American consumer and the American investor and the American businessman uses their money supports the case that we have made for the tax cut. In other words, the $11 billion of tax cut will translate itself into the increased demand, increased production, increased jobs, and increased profits that we have projected. I do not know what other way except by an appeal to repeated experience—and by the fact that we can, through this tax cut, provide for insurance against recurrence of recessions that have bedeviled this economy time and again—I do not know how else to persuade you and the other members of the committee who may not favor the tax cut that this is an effective way to achieve some of the great goals that the American people have set for themselves.

Senator GORE. Well, now, Doctor, you have just said that the entire experience with tax reduction indicates that this is an effective way. I cite you your own statement in which you referred to the McGraw-Hill survey. I will read to you from your own statement concerning the depreciation changes and investment credit of last year, which amounted, I believe, to approximately a $2.5 billion tax cut:

> And last week, the McGraw-Hill survey reported that business plans to spend only 4 percent more in 1964 for plant and equipment than they spend in 1963. Since the fourth quarter 1963 level is expected to exceed the 1963 average by more than 4 percent, the survey appears to forecast no further rise next year in this strategic type of expenditures.

It seems to me that you contradict yourself.

Mr. HELLER. We go on to say, of course, that this would be disappointing if it were not for the fact that other indicators and past

experience suggest a more optimistic investment outlook for 1964, especially if taxes are cut.

The point I made earlier—that you have to couple the increased capacity and the increased consuming power which would be generated by this tax cut—is a very solid one. I think you would find—and this was indicated in the McGraw-Hill survey—that once the tax cut was put into effect business would have an increase in sales and they would increase their investment programs.

Senator GORE. I would like to come back to this, but first I would like to yield to Senator Hartke.

Senator HARTKE. I would like to go back a few minutes ago before we went off, is it not true that when there is a reduction in demand and a corresponding reduction in production, the net result has been an increase in unemployment?

Mr. HELLER. There has been an increase in unemployment, that is absolutely right.

Senator HARTKE. Which really is a slowdown in the whole overall mechanics of the economic machinery and we call it a recession. All it is really is a reduction in the demand and reduction in production; therefore a reduction in jobs. And the reduction in demand and the reduction in production is the actual direct cause of reduction in jobs. If that is true, the converse equally ought to be true.

Mr. HELLER. I thank the Senator for that interjection. That is a very important way of visualizing the effects of a strengthening of demand through a tax cut—the converse of the effects of a weakening in demand in a recession.

One of the things, Senator Gore, which might be worth mentioning here, is that the expenditure programs you mentioned—such as accelerated public works and area redevelopment, are among the programs that have been introduced by this administration, since early 1961.

Senator GORE. Please understand, I applaud the administration for that. It is the pledge upon which the President was elected. But now, that position is being abandoned.

Mr. HELLER. Then you take that whole list: area redevelopment, accelerated public works, manpower redevelopment and training, and retraining, the housing act, the social security amendments, public welfare amendments, the equal pay acts, and so on, and combine this with the major stimulus of the tax reduction, you have a combination which is powerfully equipped to get the economy moving again.

Senator GORE. You are now doing what Senator Byrd accused you of doing this morning. I seemed to sense that you were trying to assure him that you were not doing what you are just now saying you are going to do.

Mr. HELLER. I am simply citing the programs that are already built into the budgets that have been proposed. I am citing acts that have been passed by Congress and that have been financed by Congress.

Senator GORE. I understand. But sitting in the chair where you are sitting now, both Secretary Dillon and the Director of the Budget Bureau said that the administration was not supporting a continuation of the accelerated public works program, and I am advised by House leaders on the other side of the Capitol that the deals and the promises that were made to get the tax bill through over there

have created a political climate such that they do not even plan to call up the area redevelopment bill. In fact, one Member said you could not get an appropriation through to bury Grandma.

Now, I agree with the statement which Senator Hartke made, if I understood it correctly, that the element in our economy that needs stimulation is consumer demand. No one has yet cited any shortage of productive capacity in industry, in mining, in agriculture. And that our problem was underutilization of productive capacity. So I agree that the element of our economy that needs stimulation is consumer demand and the acute need lies with these 5 to 8 million who are wholly or partially unemployed, the 25 percent of our population that is living either in abject poverty or on the verge of it. But you refer to take-home pay. Your tax bill would give a thousand dollars increase in take-home pay to a single taxpayer with $300,000 a year in ordinary income.

I do not know just how that is going to increase consuming power.

Mr. HELLER. I would make two points: One is that on the basis of past surveys of investment, about 70 percent is primarily for modernization rather than expansion—it is hard to make these precise allocations but surveys of businessmen's own allocations showed that they were investing about 70 percent for modernization. In other words, we are not simply trying to stimulate investment for expansion of capacity. We are trying to modernize, become more efficient and get these lower costs and hold our prices so that we can be competitive. I think that is a very central point here.

Senator GORE. Doctor—had you finished?

Mr. HELLER. I had a second one, but I have momentarily forgotten it.

Senator GORE. I do not think it will be lost. You will get around to it.

I think, frankly, we have heard a lot of nonsense about how this bill is going to increase revenues, how it is going to cut taxes for the people of Tennessee. In fact, if what has been said to my people were true, I might have to change my position. They would not be paying any taxes to speak of. We will just have this wonderful Utopia in Tennessee where people are just not required to pay taxes, although Government services are going to be increased.

It is true, I think, that with the same rate structure, a higher level of activity produces more revenue, both in actual dollar amounts and as a percentage of total production. But, Doctor, can you honestly claim that a lower rate structure will, over a period of years, say over a period of a cycle, produce a higher percentage of total national production in the form of Government revenues?

Mr. HELLER. One has to compare this with the alternatives. If the alternative, first of all, is no action, the answer is "Yes." We have evidence, as already indicated, from our past experience and that of other countries. There is evidence, also, in the standard economic relationships in our economy, that we would have a sufficient expansion in our economy so that higher revenues would be realized in the course of time even if we took no action.

Senator GORE. I did not say a higher amount of revenue. You are going to have a higher amount of revenue over a given period of years, due to the natural growth of our economy, whether taxes are cut or whether they are not cut.

Mr. HELLER. Well, then, the central question of meeting——

Senator GORE. Let me state what the central question is. The question I asked you is this: Will a lower rate structure, applied to the economy over the period of a cycle, produce a higher or a lower percentage of production or gross national product in the form of Government revenues?

Mr. HELLER. I am sorry. If that is your question, the answer is obviously that it will produce a lower percentage. I was addressing myself to the total, which I firmly believe will be higher—the lower percentage will give us a larger absolute amount.

Senator GORE. You and I agree that the total is going to be higher. This country has been growing for a number of years and it is going to continue. And there has been a lot of nonsense on the part of the Treasury of claiming that all of this growth, that is going to occur whether we have a Secretary of the Treasury by the name of Dillon or Dinwiddie, is going to occur. Yet they claim all of this is going to be as a result of the tax cut. That simply is not true, and what you have said is the truth, that when we apply a lower tax rate structure to the economy over the cycle, you are going to have a lower percentage of the gross national product in the form of Government revenue. Yet you have listed in your economic report all of the unmet needs of our society. I am trying to get you to tell me how this bill is going to meet those unmet needs.

Mr. HELLER. Senator, I think that at the risk of some repetition, it will do it in two major ways.

Senator GORE. I am going to run that same risk, Doctor.

Mr. HELLER. First, a lot of the unmet needs are the product of inadequate job opportunities and if you create 2 to 3 million additional job opportunities, you will meet some of the needs and reduce some of the costs of Government and make some of the funds available for other programs.

Second, I have a deep conviction that while we will take a smaller percentage of the gross national product if we cut taxes, the gross national product will grow faster as a result of this tax cut, as a result of both the consumption stimulus and the incentives. In other words, we will not only have a growing "pie," which we would in the course of time, anyway—you are quite right—but the pie will grow faster than it otherwise would have. It will fill out and enlarge the pie tin—that is, the full capacity of the economy—and Federal, State, and local governments will, as a result of the tax cut, have more revenues to finance the programs that you want and that I want in the course of time.

Senator GORE. And in proportion to need, the Federal Government will have a correspondingly less amount of revenue.

Mr. HELLER. I am saying that full employment and faster growth will (a) reduce the need for these programs, and (b) yield more revenues than you would have had without the tax cut, thereby enabling you to make better provision for the unfilled needs that remain. That is a very deep conviction and as I say, it is based on what has happened in other countries and what has happened here.

Senator GORE. You can say with the deepest conviction, and so can I, that a full employment economy would bring many blessings. But what exasperates me is how you constantly wrap around yourself the

assumption that the passage of this tax bill is going to bring about such a Utopia. You have not shown us in any respect how that is going to come about.

Mr. HELLER. Well, we have not described it, nor meant to, as Utopia. We have tried to suggest that—

Senator GORE. I accept your objection to the word. Let me substitute "full employment." You have used that term.

Mr. HELLER. Yes, we have.

Senator GORE. Do you think this tax bill is going to bring about full employment?

Mr. HELLER. I think that this tax bill will bring us within not only striking distance but very close to the interim target of 4-percent unemployment if it is put into effect promptly and at the levels that it now provides. I would say within a year and a half or so after the tax cut is fully in effect that this is not an unreasonable expectation on the basis of experience and analysis.

Senator GORE. Well, Doctor, I do not know what you mean when you say on the basis of experience and analysis. I know of no experience and no kind of analysis on which such a conclusion can possibly be based.

Mr. HELLER. Well, I do not know whether it would be worth your time and the committee's time to go through the process in greater detail than we already have. The fact that we would put roughly $10 billion more into the hands of consumers, who have shown us by 13 years of unvarying basic behavior that they would spend 93 percent of it means that there would be roughly $9 billion of additional demand for goods and services in the first round, and that as the beneficiaries of the tax cuts spend this, and as their grocer, as their appliance dealer or hairdresser, and so forth, respend it, and as it goes into this endless chain, it will again create an additional roughly $9 billion of demand.

This will give us—

Senator GORE. How many new jobs?

Mr. HELLER. The $18 billion would provide in the neighborhood of 1.2 to 1.5 million jobs. Let's give it a range, as we do with the rest, 1.2 to 1.5. Then, as that spending interacts with investment spending since, after all, when people consume more by that magnitude, business will have to stock more inventories and invest more in productive machinery and equipment and plant. As that process works itself out, and particularly with the additional investment stimulus that is provided, I think it is fair to say that we can expect another $5 to $7 billion of purchases. This, itself, of course, would touch off a further chain of consumer spending which would finally bring us to a total of another $10 to $14 billion of demand in the gross national product in addition to the original $18 billion. One cannot, of course, get down to the last dollar or last million dollars in such a computation. But in an underemployed economy with unemployed available resources this is the kind of process which one can confidently expect to occur—the kind of process which is going on in the United Kingdom today in response to their similar tax cut.

That $30 billion, we have estimated, will give us—that $30 billion of additional demand—

Senator GORE. Over a year and a half?

Mr. HELLER. Yes; and that, of course, will reach its peak somewhere in mid-1966—about a year and a half after the bill is fully in effect. This would be a year-in, year-out expansion, because you have permanently cut taxes. You have not just put in a "quickie" tax cut.

May I amplify this morning's record just to the extent, Senator, of saying that when I said I did not favor a "quickie" tax cut, last year, what I was really saying was that I did favor a tax cut but not a "quickie" tax cut. I wanted it to be a permanent tax cut because of this under utilization of our resources that had persisted so long.

But given that $30 billion of extra demand—not counting any of the demand generated by the normal growth of the economy that is now taking place—would give us, as I say, between 2 and 3 million additional jobs. This would say, in effect, that somewhere between $12,000 and $18,000 of additional GNP creates one additional job. That is the process by which we feel that this tax cut will achieve its major objectives of toning up the American economy, bringing us close to this interim goal of 4-percent unemployment.

Senator GORE. Well, I think you have just made a statement, a forecast which experience will not justify, but I want to be sure that I understand. You have predicted that if enacted, this tax cut over this year and a half would generate $30 billion of increased gross national product.

Mr. HELLER. In the next 2½ years—a year and a half after the tax cut is fully in effect.

Senator GORE. Once again, you are the first administration witness who has given us any real definite index of what you mean by short run and long run. And you say, then, that this forecasted $30 billion in the next 2½ years will generate, in your opinion, based upon experience, about 2 million new jobs.

Mr. HELLER. Somewhere between 2 and 3 million, over and above whatever other expansion would normally have taken place in the economy.

Senator GORE. Well, now, from the—I want to call your attention to the fact that the gross national product increased from the third quarter of 1962 to the third quarter of 1963 by $31.7 billion, but the employment was not increased 2 to 3 million, but there were in fact 888,000 jobs, many of which were in the public sector, such as schoolteachers.

Mr. HELLER. This is not inconsistent with the projection we have just made, for at least two reasons: One, in the past year, you are counting only those net additional jobs that were created over and above the jobs that were created to absorb the people who were displaced by increases in productivity, by automation, if you will.

In other words, when you have a 2.5-percent increase in productivity per year, you are, in effect, displacing 2.5 percent of your labor force each year by increased efficiency, by more output per unit of work. That is one factor. The second factor is that typically, in a period of cyclical expansion, you get a higher amount of GNP per additional job than you do in a longrun trend sense. What we are doing is striking an average, taking account of increased productivity, an average of the GNP that it takes to add a job to an economy that is increasing its pace of expansion over a period of several years.

Senator HARTKE. Will the Senator yield at that point?

Senator GORE. Of course, if you accelerate—yes; I will yield.

Senator HARTKE. Along that same line, I would like first to compliment my distinguished colleague from Tennessee for one thing, that he does not oppose the tax cut and then propose nothing as a substitute. He, as I understand in my conversations with him and from his questions, he thinks there is a better way of solving this problem of unemployment, and that is, basically acceleration of public works and programs of that sort.

I think at least those who come here and argue against a tax cut, which the administration contends will reduce unemployment, ought at least to be honest with this committee and with the public as to what they propose to do in regard to unemployment, or otherwise whether they actually, in fact, are satisfied with this unemployment as it is. I will say to my distinguished friend from Tennessee that he does not leave me in that predicament as far as those things are concerned.

Senator GORE. I want to thank my friend. Though I may be the only man who says it, I say it with the deepest of conviction, that I am unquestionably correct and right in saying that the pressing and unmet needs of our country are in the public sector of our society. Our need is not for bigger profits for General Motors. It is not for more productive capacity for automobiles, refrigerators and washing machines. We need better education. We need not more hotels but more hospitals. Yet we have this scattergun approach here, giving tax reduction, most of it, to tthose who need it least and in areas where it will create perhaps more problems than it solves. What I suggest is a reexamination of the whole problem and programs of action aimed economically and efficiently and directly at the problems of our society.

I thank my distinguished friend.

Senator HARTKE. I would say to my distinguished friend that I would find a great deal of sympathy and consideration in even putting greater emphasis on consumer purchasing power in the increased exemptions bill which I introduced in 1961, when I thought we should have about a $10 billion tax cut.

But is this not true, Doctor Heller, that one of the difficult things to present to the public is that while things are going so well—in other words, as we have said this morning, they are better than they have ever been—it is pretty hard to convince the people that they should try to make things better? In other words, things are better than they have ever been, so why complain? Why not leave well enough alone?

Mr. HELLER. Well, I think that the reason in good part is that we are internally isolationists, if you will. In other words, we are isolated in good part from the problems of poverty, from the pockets of unemployment, from the dilapidated housing, from the ghettoes in the big cities. Even the building of our big superhighways, where we now go over these areas instead of through them—just a simple matter of that kind tends to make us a good deal less cognizant to these problems as a nation, I think a good deal less sensitive to their proportionate importance in the Nation.

So, I would thoroughly agree. But the impact of the tax cut—the stimulative impact and the creation of jobs—will not recognize those boundaries. The stimulative impact will go right through those

boundaries into the ghettoes and into the poorer areas and into the depressed areas of the country. It will not do the whole job. But I do think that this overall stimulus to the economy, lifting the economy—for example, in stimulating investment and building of plants in Tennessee and West Virginia—I think its beneficial effects will be felt throughout the country and it will be felt in terms of the tone of job opportunities.

Senator GORE (presiding). But the principal benefits and effects go to those who simply do not need them. I just do not understand you, Doctor. I do not understand a Democratic administration proposing such a thing.

Mr. HELLER. I regard this as a bold exercise in responsible fiscal policy—that is, in undertaking a stimulus to the economy.

Senator GORE. It is a bold repudiation of the record of the Democratic Party and the last two Democratic administrations and every Democratic platform for the last 30 years.

Mr. HELLER. I think it is the country's policy weapon of choice to get the country moving again. And I do not see that that is a repudiation of Democratic principles.

Senator GORE. I want to read you what a very distinguished reporter and writer, Mr. Bernard D. Nossiter, says in an article in the magazine the Progressive—I will just read you two sentences. He refers to this bill as 300 pages of legalistic jargon:

> Nearly every page adds feathers to the nest of the most affluent in this partly affluent society.

I will skip a little.

> The bill promises to provide the most massive redistribution of income in the United States since World War II.

But it proposes the redistribution in the wrong way, in the wrong direction. It proposes to redistribute the income more disproportionately to those who are already the vast beneficiaries of our society and take from those who have not.

Mr. HELLER. This, I think, is open to very serious dispute. I do not think that the proportionate distribution of tax burdens in the individual income tax, when all is said and done, is going to be substantially altered. Some 59 percent of the tax reduction will be going to the people with under $10,000 yearly income who have now paid 50 percent of the tax. The remaining amount will go to those over $10,000.

Senator GORE. Now, Doctor, we do not look at those percentages the way the Treasury does. You know perfectly well that the people in the lower income brackets on a dollar basis get very little relief from this bill.

Mr. HELLER. That is true, because they pay little tax.

Senator GORE. And of course when you multiply a few dollars by the mass of people you get huge amounts. But this is a very unfair tax bill with disproportionate relief to those people who do not need it.

Mr. HELLER. I was simply referring to your quoting from Nossiter about the alleged worsening. The people who now pay 50 percent of the total individual income tax will get 59 percent of the benefits. So putting this, per se, in terms of distribution—not saying this is necessarily right—it will not change it. But I think the present

important point for the economy as a whole is that the greatest periods of improvement in the lower income groups, and, indeed, of redistribution to the benefit of the lower income groups, Senator, have been when we had full employment. I think the biggest redistribution here is the creating of jobs and incomes for the 2 to 3 million unemployed who do not now have jobs.

Senator GORE. Well, I think you propose to do the wrong thing in the wrong way in this bill and propose to do it permanently.

Now, just let me get into the record one thing here with respect to your recommendation last year. I would like to read from the annual report of the Council of Economic Advisers of January 12, 1962:

> Policy to reverse recession or speed recovery often calls for a temporary boost in private purchasing power. Permanent reduction in tax rates could give the economy as strong or stronger a stimulus but at the possible sacrifice of tax revenues which would be most desirable after the economy returned to full employment.

So whether you call it "quickie" or not, you were proposing in January 1962 a temporary reduction in tax rates, whereas now you are proposing a permanent reduction in tax rates.

Mr. HELLER. We were talking there about a hypothetical situation if there were a recession. Did I understand you correctly, that is from our 1962 report?

Senator GORE. You were referring there to the standby authority for the President to reduce taxes.

Mr. HELLER. That was not a recommendation in terms of, say, the 1962 expansion situation. We were suggesting that for antirecession purposes, Senator, there ought to be temporary tax reductions to overcome the temporary recessions. And that is quite apart from the long-term problem of persistent slack and unemployment, for which we need permanent tax reduction.

Senator GORE. Well, my colleague has asked me to yield, and I shall surely do so. I apologize to him for not doing so more quickly. Following that I have but one other question and then I shall desist.

Senator HARTKE. Let me say this: Is it not true that as far as the recession is concerned, when we move into public works in order to create jobs, a lot of that money also flows into the hands of those people who, frankly, are doing pretty well even under normal circumstances?

Mr. HELLER. You have made a point that one of my colleagues has called to my attention: the fact that, of course, in the first round, it may flow somewhat differently than under a tax cut. But on the second, third, fourth, fifth, and sixth rounds, there is no differentiation. The economy does not differentiate where the money originally came from—whether it came from private spending out of tax reduction or private spending out of a public expenditure program—it simply courses through the economy the same way. That is true even for General Motors.

Senator HARTKE. And quite honestly, when they go in public works to suppliers and to contractors who are in business at that time, their amount of business is materially increased, their profits, generally speaking, under normal circumstances, are materially increased—their holdings, their corporate investments, all these things. When the sewerlines are built, for example, they are built by general contractors who are in existence. The only one you really create the jobs for is

that contractor. You generally do not set up a new contractor. It is the same contractor doing business in the same old stall. The only thing about it is that because he has more money at his disposal, he goes over into the general supply of labor, and if there is unemployed labor there, he picks it up and puts it to work.

Senator GORE. Good.

Senator HARTKE. I will grant you that.

Senator GORE. That makes jobs, which the tax cut may or may not do.

Senator HARTKE. The same thing is true when you put the tax cut through, is it not, Doctor? That when those people get that money, they are generally going to spend about 90 to 93 percent of it, the general consuming public?

Mr. HELLER. That is correct.

Senator HARTKE. When they go down to the store to buy a tricycle or if they go and buy anything with it, somebody, whoever sells it to them, increases their sales. And as a net result, if they are not paying taxes, they may start, or if they are paying taxes, they pay more, because generally speaking, they should make a profit. They in turn go back to the producer and ask for greater production and, under normal circumstances, the producer in turn will have to do one of two things: either improve his capacity to produce with the same amount of labor or add to the labor in the plant. Generally speaking, when they have exhausted all of the available supply of labor which is thoroughly trained, if it is expedient for them to go on to job training, they will train the people themselves, thereby relieving the State or Federal Government of this free training program. This is the way it worked in the old days when you had the apprenticeship programs.

Especially it is true, is it not, Doctor, in the construction business, because one man can only lay so many bricks a day and if they want greater production they have to put on more bricklayers. This is where we have a heavy amount of unemployment today, in this field. The same is true of common labor hauling the bricks to the site, and also the carpenters.

But when you come to these things, generally speaking, most people today really are not concerned about unemployment unless they are the unemployed themselves; is that not right?

Mr. HELLER. That is a very serious problem here, and the necessity of dramatizing these problems is very great—the necessity of making the country more aware of the disadvantaged groups which are not getting their full share of this advancing prosperity in the economy.

Senator HARTKE. And it is difficult to take the necessary preventive measures to prevent a recession, while it is quite easy, generally speaking, to take corrective measures when you are in the middle of a recession, to take care of the problems of unemployment.

Mr. HELLER. If I understand you, what you mean is they are much more obvious once the recession takes place.

Senator HARTKE. That is right. We do not have to have any 3-month period of hearings if we have a recession in order to get a public works bill passed.

Mr. HELLER. You have to pour in a lot more resources to correct the problem once you are on the downslide than when you are still on the upgrade. But it is true, it is not dramatized in expansion.

Senator HARTKE. I would like to place in the record at this time the fact that in calendar year 1958, the amount of unemployment compensation due to recession almost doubled. Also, the trend report which was issued by the Bureau of Family Services of the Department of Health, Education, and Welfare, which shows that from November 1957 to April 1958, the period of the so-called recession at that time, the number of persons receiving general assistance rose by almost 70 percent; in the corresponding period of the recession, 1960-61, the rise was about 40 percent. For the corresponding year, when we were coming out of it, the corresponding rise was 9 and 17 percent, respectively. I would like to put this entire thing in the record.

Senator GORE. I will accept it.

(The document referred to follows:)

REPORT ISSUED BY BUREAU OF FAMILY SERVICES, DEPARTMENT OF HEW

"The rise in the average number of civilians unemployed in 1958 and in 1961 reflected the impact of the 1957-58 and 1960-61 recessions. The proportions of the civilian labor force that were unemployed in 1959 and 1961 were approximately the same.

"Among the assistance programs, aid to families with dependent children and general assistance are most affected by changes in employment conditions. The number of persons receiving these types of aid usually go up during the winter months, but when unemployment is relatively high or exceeds the seasonal increase, the rise is steeper. Thus from November 1957 to April 1958 the number of persons receiving general asistance rose by almost 70 percent; in the corresponding 1960-61 period the rise was about 40 percent. For AFDC, increases in the same period were about 9 and 7 percent, respectively. In contrast, over the same months of 1958 and 1959, the general assistance rolls went up only about 16 percent and the number in April 1960 was about 5 percent below that for the preceding November. In AFDC, the percentage rise was 4.6 in 1958-59 and 3.5 in 1959-60. During these periods both the total number of unemployed and the winter rise in unemployment were smaller than in the recession years."

Source: Trend Report, December 1962 issue.

Senator HARTKE. I want to thank my distinguished friend from Tennessee. I admire him and am generally on his side. I hate to see him led astray.

Senator GORE. I think you will be on the side of my personal exemption amendment.

I yield to Senator Carlson.

Senator CARLSON. Dr. Heller, you want to feel highly honored, because it is not usual that this committee keeps a witness all day.

Mr. HELLER. I do, indeed, Senator.

Senator CARLSON. You, of course, are an outstanding economist and you have been most generous in your public statements and writing of books and articles and magazines, and therefore, of course, it gives many of us an opportunity to have read some of your articles, heard some of your statements, and therefore, it gives us, I would say, many questions that we might want to ask.

Mr. HELLER. I can imagine that. I agree with one of my colleagues in the administration when he said that a man who goes into public service should never have written any articles or books before he entered service.

Senator CARLSON. I just wanted to follow along with one question Senator Gore had gotten into. I am not going to detain you at any great length, because I certainly do not appear here as an economist. I am not. I have been on this committee for some years; I was on the

House Ways and Means Committee for several years and I am as concerned about high taxes as anybody, in the administration or out. Second, if there is anyone who wants to help the unemployment situation, I certainly do. I have some grave questions about the proposed tax bill resulting in substantial increase in employment.

I believe you are a little more optimistic today than you were a few weeks ago about taking care of our unemployment in this country. I think a few weeks ago you said in something like 2½ years we would take care of 2½ or 3 million unemployed. I think today it is down to about a year and a half.

Mr. HELLER. No, sir; I think in the course of our colloquy, we did straighten that out. I said a year an a half after the tax bill goes into full effect, which is January 1, 1965, which corresponds to the figure I was using earlier—2½ years after the first step of the tax bill goes into effect, on January 1, 1964.

Senator CARLSON. I just happened to catch that a while back when you made the statement. As I say, there is no one who hopes that will work out more than I do.

The question I have is this: We had Roger Freeman before this committee, of Stanford University, Calif. He made this statement, and I am going to read it:

> In the same month, last September, 7.4 percent of all hours in manufacturing, the only industry for which this information is available, were overtime hours, paid for at premium rates. The industry could have employed at regular hours all of its workers and all of its unemployed and still had to get over 2 percent of its work done on overtime pay.

Labor Secretary Wirtz was quoted as saying:

> I think we have to start asking whether things are working out right, if 7 percent of our work is being done on an overtime basis when we have 5 to 6 percent unemployment.

What comment do you have to make on that?

Mr. HELLER. Well, Senator Carlson, if we were able to convert all of that overtime into additional employment without detriment to our productive costs and efficiency and to the human beings involved, that would have great attraction. But I do not think that is the way American industry and American labor works; that is to say, I think that one has to give the industry of this country the flexibility to use its manpower to best advantage, and a lot of that best advantage is simply to work certain people longer hours, rather than to put on additional people. I am sure there is some margin there. Nevertheless, I am sure that we would be interfering with the most efficient allocation of manpower and the most efficient productive methods if we were to arbitrarily say, no, you cannot work anybody overtime.

Senator CARLSON. With that I would be in agreement, but can we assume that if we reduce corporate taxes by $2 billion or more, there would be less unemployment, or would it be reasonable to assume that these companies would say, why should I worry about hiring additional people? We will just pay overtime. How will that help unemployment?

Mr. HELLER. I am sorry, I lost the thread.

Senator CARLSON. My thought was, is there any reason to believe, even with a tax reduction, that these corporations will not continue to use overtime employment and probably expand it instead of reduce it?

Mr. HELLER. I am sorry I did not get it the first time around. Senator, we have already had an increase in the average workweek of nearly an hour and a half over the past 2¾ years. Firms are already stretching out their existing work force a good deal in those cases where they can apply overtime. We have on this very point rather closely investigated with a number of industry leaders what they would do to produce the additional output. They say they would have to put on additional men in a very substantial number of cases. I think we can be reasonably confident that not too much of the stimulus of increased demand would go off into simply stretching the workweek. A great deal of it would go into additional employment. It is hard to pin that down for sure; it is a matter of judgment based on past experience, on interviews with business leaders, and on the fact that we already have the workweek, on the average, stretched pretty tight.

We think, therefore, that the chances of converting a great deal of this additional investment and additional demand into jobs are favorable.

Senator CARLSON. I believe I noticed within the last 2 or 3 days that Walter Reuther, of the AFL–CIO, was concerned about this and made some kind of a remark that he felt we would have to get to a 35-hour week soon, and I believe he stated, probably place some penalties on overtime work.

Senator BENNETT. Will the Senator yield?

Senator CARLSON. Yes.

Senator BENNETT. He wants to increase the yield from ½ times normal wages to double times the normal wages in order to penalize overtime.

Senator CARLSON. I was not going to get into that except in this way, that I am as concerned as anyone about getting people to work. But I do not see an industrialist, who is in one of the large industries, whether he has overtime or a 35-hour week, getting people in from some of these structural unemployment areas that we do have, and we have some that are regrettable. That is the thing that really concerns me.

Mr. HELLER. Of course, Senator, one of the points is that when there is excess labor all over, as there is when you have 5.5 percent full-time unemployment and another 1.3 percent of part-time unemployment equivalent to full time, and then some submerged unemployment—under those circumstances, the scarcity of labor or the availability of labor does not have much to do with where a man locates a plant, where he locates a new addition to his productive capacity.

If, on the other hand, you tighten up the labor market by creating new jobs, then the areas that have more or less chronic additional or surplus labor become much more attractive to a plant location. That have been true in past periods of full employment.

That is what I meant before when I said to Senator Gore that I thought that areas like eastern Tennessee, West Virginia, and eastern Kentucky, would have a considerably greater attraction for the location of plants, on the labor supply side, in a tight labor market than they do in a loose labor market, where employers can find available labor anywhere.

Senator CARLSON. I believe in the McGraw-Hill recent survey, they were able to show we are only using 85 percent of our productive capacity.

Mr. HELLER. I believe their latest figure has been revised to 87.

Senator CARLSON. Eighty-five was the last one I saw.

Assuming it is even 87 percent, is there any reason why these plants should expand with a tight reduction until we bring up this 87 percent to near capacity?

Mr. HELLER. That is a very good question, to which we have a partial answer from the surveys which have been made of businessmen's preferred operating rate. By and large their preferred operating rate averages about 92 percent of capacity. They figure that when they get up in that range, 90 or 92 percent, they are using most of their efficient capacity, and they have to have a certain amount of downtime. They tend to move into expansion of capacity once they get up to that general area.

That is one of the points I was trying to make earlier, that you are much better off if you can introduce this tax cut in a rising economy with about 85 to 87 percent of your capacity utilized than if you wait until it falls off to perhaps 80 to 83 percent of capacity. Because when you superimpose on the higher levels of operation the new stimulus of added consumer demand, there is a strong incentive to expand investment.

I stand corrected, by the way, Senator. Your figure of 85 percent, I am told by my colleagues, is correct.

Senator CARLSON. I did not expect you to be corrected, because I am very apt to be wrong. But it was just given to me recently.

On that same line of questioning and reasoning with you, you stated to Senator Gore that capital spending by industry would probably be somewhere around 4 percent or plus for next year. That is, prospective plans where something over 4 percent for next year. Now, this tax bill, assuming that we pass it next year, and frankly, I am one who thinks we are going to, that will not encourage or increase that very much, will it, for 1964?

Mr. HELLER. There are an increasing number of companies, at least from our conversations and discussions with business decisionmakers, that in effect have two sets of plans: One set of plans with no tax cut and a more expansionary set of plans with a tax cut. I think the McGraw-Hill survey in effect suggested that this was the case, that with the tax cut, a number of firms would adjust their plans upward. Now, there is some slippage, there is some timelag in this. But I really think the 4-percent figure is going to be revised upward—partly because on the uptrend, the September McGraw-Hill survey typically is revised upward; partly because some other surveys have already indicated a greater increase; and partly because the tax cut will result in a boosting of the plans for next year.

Senator CARLSON. Would you not say that the action taken by this committee in the Congress last year with regard to investment credit and accelerated depreciation were responsible not only for the 4 percent but possibly for some anticipated growth, regardless of the tax cut?

Mr. HELLER. They are responsible for part of the projected increase for next year and they were responsible, according to the earlier

McGraw-Hill survey, for about 40 percent of the expansion in plant equipment and investment this year.

Senator CARLSON. Now, let's get down to the people who are going to go to work, and I should not get into this, because the Senator from Tennessee went into it thoroughly. We had two industries, if you want to call it that, who have been operating at fairly good capacity. One is the automobile industry and the other is housing. Do you expect great increases in them?

Mr. HELLER. Private forecasters tell us that in the absence of a tax cut, we would be likely to have approximately the levels we have had in the past 2 or 3 years, about a 7 million car year and about 1.4 million housing starts. They say with the tax cut, one could count on an expansion of those figures.

Senator CARLSON. What about inventories if they are being built up at the present time? Do you expect a great increase in inventories?

Mr. HELLER. If we continue at the same pace we now are, without tax reduction, I would not expect any extensive buildup of inventories. If we have the eventual increase of $25 billion of consumption under the impetus of the tax bill, that would require a substantial increase in inventories in the process.

Senator CARLSON. It would if we can get people to go out and purchase these goods.

Mr. HELLER. I do not think that would be any problem, judging by their past performance as consumers when you increase their take-home pay.

Senator CARLSON. I am concerned about it and maybe I should not be, as to how much of this will get back into the channels of trade and actually get our economy moving. There is no problem with me, that I am certain it would.

We are going to reduce Government spending, I assume, or at least hold it. Maybe I should not use the word "reduce" but we are going to try to hold it, I assume, at the present rate with some increase as we go from year to year. That will not add any great number of employees.

Mr. HELLER. No; I would say that while the normal—however we define normal—increase in Government expenditures, will, of course, add some, it is not going to provide an additional source of expansion over and above what we have now. As a matter of fact, I think that a fair forecast is that Federal purchases, for example, will increase less next year than they are this year. Federal purchases will be less of a stimulus next year than they were this year because the increase will be smaller. State and local government spending, of course, expands by about $4 billion year in and year out and I assume it will again next year. So that will not be an additional source of stimulus, either. It will provide some additional jobs, but will not be an additional expansionary force.

Senator CARLSON. I use the term "normal" because I think this Nation is going to continue to grow in population and gross national product. It may not be the growth we like, but I think it is going to continue to grow.

Now, if we are going to give these consumers a substantial increase in spending money, do we have any concern about what might happen to some of these expenditures as far as our balance of payments is

concerned or imports? Is there any reason why these people are not going to buy Volkswagens or why they are not going to go to Europe or someplace?

Mr. HELLER. No, indeed. There is not any doubt that with a higher gross national product or higher income, there will be a higher rate of imports. We are persuaded of one thing—and our European colleagues have had similar experiences which have made us rather confident of our judgment—and that is, that what you lose in the swings, you more or less gain in the roundabouts. That is to say, we will gain competitive advantages through lower cost production made possible by modernization, more efficiency at full capacity utilization, and so forth—in other words, we will make gains on the export side that will offset the increased imports. But very considerably more important from the standpoint of the balance of payments is the impact on the flow of long-term investment funds. The enormous expansion in the outflow of these funds is the most significant problem that has emerged on our balance-of-payments front in the past couple of years. Primarily, it is because we have not had profitable enough levels of operation in the United States to compete for long-term investment funds in the international market. When we increase our rates of profit, both by increasing sales volume and by decreasing tax costs, we are persuaded that this will make the United States a more attractive place to invest and will keep more of those funds at home. That is a very fundamental purpose of the tax program as far as the balance of payments is concerned.

Senator CARLSON. Well, Dr. Heller, I am concerned about our future trade. You and I are not going to get into that discussion, I can assure you, but having been a member of this committee, where I helped to write the Trade Expansion Act of 1962, I am greatly concerned about its future.

If we are going to get into the Common Market, I can see how that can really hurt us in the balance of payments.

Mr. HELLER. We are concerned that our negotiations are skillfully and effectively undertaken. There is one side of the problem on which we are definitely gaining right now, and that is that a good part of Europe is under very strong inflationary pressure. France, Italy, the Netherlands are all facing very substantial inflationary pressures, and I think some of the other countries may experience them as well. If we manage to hold our costs or cut them while others are rising, our competitive position is going to improve very substantially. If the discussions around the negotiating table do what they are supposed to do, I think it will help.

Senator CARLSON. I hope so. I have just returned from a visit to Germany, where I visited with not only the German people, but people in France and Belgium and they are becoming very protectionist. I can see where we are going to have a real battle in working out a trade program that will permit us to maintain our present standard of living and the high wages we have had, of course. But as you say, there is an inflationary trend over there, which from our standpoint is very helpful.

I have three questions which Senator Dirksen left. I shall read them to you:

Early in your statement, you mentioned that since 1957, our advances in employment and production have not been sufficient to pro-

vide the jobs required to employ our growing labor force. Yet 1957 represents the same number of years after the 1954 tax reductions that 1967 represents after tax reductions proposed for 1964–65, and the 1954 tax reductions represent the same percentage of the then gross national product that the 1965 tax reductions represent of current estimates of gross national product. Now, the question: What assurance have we that the effects of the proposed tax program will not peter out as the effects of the 1954 tax program did?

Mr. HELLER. The 1954 situation was a considerably different one from the one today. As was pointed out, the 1954 cut essentially just offset the expenditure winddown after the Korean war. In other words, there was a matching of expenditure cuts and tax cuts. I think that is a rather different situation than the one that we face today.

Furthermore, looking at the problem as it developed, we had first the great postwar unfilled demands, then the Korean situation, then the 1954 tax cut, the housing boom and the investment boom, all of which helped to maintain a high level of total demand. Now, however, we have run into a change in the age structure of population, and demand has not grown as rapidly as it should have in the last 6 years. We may have a pickup later on when our present postwar baby crop becomes a set of full-fledged consumers. We have to be sure we supply jobs for them, because by and large, they become jobseekers before they become full-fledged home builders and equippers and a full-fledged source of family demand.

The prospect of the demographic development in the years to come will provide a very solid basis for the expansion of longer run demand, provided only that productive employment is made available for these people as they come on the labor market.

Senator CARLSON. There are some who are advocating at the present time a rather sizable reduction in the production of defense material. What happens then, in this period you are mentioning, with these new employees?

Mr. HELLER. If there is a sizable reduction in defense expenditures, then two major things can happen: One, we can make more adequate provision for some of these other needs that are facing us, either at the Federal or State and local level. And two, if an $11 billion tax cut is the appropriate level of tax cut for this economy, with the existing level of expenditures, there is no reason why it would not be entirely sound to match a sharp cut in defense expenditures—to the extent that it is not absorbed in other programs—with further tax reduction.

Senator CARLSON. The second question I have here. You mention in your statement that:

> The chances that the present economic expansion could continue through 1964 without an early tax cut are so poor that the byproduct of antirecession insurance becomes a powerful argument for timely enactment of H.R. 8363.

The Wall Street Journal of October 21 reported as follows from the Hot Spring, Va., meeting of the Business Council:

> Treasury Secretary Dillon and Walter W. Heller, Chairman of the President's Council of Economic Advisers, rang economic alarm bells last week with public statements strongly hinting that they did not see how the recovery could continue very far into next year unless new zip was given the economy by the tax cut.

In contrast came the Business Council economists' projection, as passed on by W. B. Murphy, president of the Campbell Soup Co., that even total absence of a tax cut wouldn't prevent business from rolling along, without a recession next year.

What is your comment on that?

Mr. HELLER. I attended that meeting in Hot Springs and met with the members of the Business Council who constitute a liaison group with the Council of Economic Advisers. Mr. Donald David is Chairman of this group, and members include Mr. Roger Blough, Mr. W. B. Murphy, Mr. Fred Kappel, and others. I gathered that the report was based on a misunderstanding of what their economists had said and of what many, if not most, of the members of the Business Council felt. That is to say, the business economists, and this group, seemed to feel that the expansion would tend to flatten out and possibly even turn down later in 1964 without a tax cut. The majority of the liaison group seemed to be of much the same feeling. The Wall Street Journal report was the result of a somewhat unclear press conference in which the impression gained did not represent the majority feeling.

Later on there was a meeting of business economists in Cleveland wherein a great majority of them flatly predicted recession, as I recall, if there were not a timely tax cut.

What we are saying is that we just do not see the sources of expansion beyond the middle of 1964 without the stimulus of a tax cut.

Senator CARLSON. In other words, it is one of those that might be a misquote, like Fred Funston says they misquoted him on the sale of wheat to Russia.

Mr. HELLER. These things, as you must know quite well, from your own experience, occasionally happen this way, even with the best of intentions.

Senator CARLSON. In your statement you state that the years 1947 through 1957 set an overall record of production and employment because of backlogs of demand built up during the war periods, but were not free from other economic problems, such as several periods of rising prices. Now, in H.R. 8363, accompanied as it will be by an excess of expenditures over receipts before a tax cut, I see the same type of forced draft economy as we had in the postwar period and expect the same results so far as rising prices and subsequent economic decline are concerned.

The question: Why should it work out differently now than it did then?

Mr. HELLER. Senator, the answer that one should give Senator Dirksen on this is in good part contained on pages 19 through 21 of our statement, and I do not want to repeat that. But the essence of it is that we have at the present time several things going for us, so to speak, to help avoid price inflation: One, a very substantial amount of unused capacity and unused manpower.

Two, a very great growth of the labor force; a much faster growth of the labor force than at that earlier time.

Three, the post-war inflation psychosis, if you will, is broken. We have not had any movement in the wholesale price index for 5 years, and I do not think that we are building inflation into our busines planning and expectations, nor into our consumer planning and expectations, as we did earlier.

And four, we do not think that this tax cut represents a forced draft. We do not think that it represents an overstimulus to the economy. We feel that it is pretty well adjusted to the size of existing capacity and the prospective growth of capacity of the economy, and we feel that the economy can absorb the stimulus without inflation.

Finally, as I said in my statement, I think that both by stimulating greater efficiency and by making possible some price cuts, this tax bill will help us avoid inflation.

As a matter of fact, I was very gratified to hear one of the business economists say, "We have long argued that the corporation income tax is passed on to the consumer. Now, when it goes down, let's see that it is passed back to the consumer." An exhortation like that does not constitute action, but it does constitute, I think, a very statesmanlike acceptance of business responsibility to the consumer.

Senator CARLSON. You mentioned that we have not had any great increase in wholesale prices, which is correct, but have there been some substantial increases in retail prices?

Mr. HELLER. Well, the cost of living has been moving up at a slow but monotonous pace and no one likes to see an increase of around 1.3 percent per year. That has been mostly in services and a good part of the increase has been matched by the increase in quality of goods. But nevertheless, it has been creeping up steadily.

Senator CARLSON. I believe some economists, and I am sorry I do not have the name or the reference, have stated that a 2-percent increase across the board in costs would wipe out all the benefits in this tax bill to consumers. Is that right?

Mr. HELLER. No, sir; it is not right. We do not want it, but if you had that increase in prices, it would not wipe out the benefits of the tax cut. I think we must remember that on one side of the equation is the seller and on the other side of the equation is the buyer. If you take 2 percent more from the buyer, you are giving 2 percent more to the seller. You may create some injustices and some economic disturbances in the course of these price increases, but that purchasing power does not vanish from the economy. When you add the purchasing power from the tax cut, it would still have its impact on the economy in spite of a price increase.

But let me make very plain that we do not anticipate that kind of inflation and we certainly would decry it.

Senator CARLSON. Of course, if the wholesaler did not increase his prices, he would not get any advantage.

Mr. HELLER. The wholesaler is going to have higher volume, sir, and I would hope, if anything, he could make a higher profit at a lower price on higher volume.

Senator CARLSON. Thank you very much, Doctor.

Senator GORE. Senator Bennett?

Senator BENNETT. Mr. Heller, my good friend, the Senator from Kansas, has anticipated the chief thing in which I was interested. I do not want to repeat everything he went through. But I have the same feeling he has, that this tax cut will not produce a permanent service of gains in the economy which can bring us to a balanced budget. When I look at the 1954, 1955, 1956 picture, it seems to me we see there a pattern that could probably be repeated here.

In the first place, you mention in your statement several times the figure of $30 billion, which seems to be a magic figure. This is the amount by which our economy is falling short. Then you say that this is the amount that will be generated by the tax cut with the multiplier effect.

Now, in 1955, the economy jumped over 1954 by $33 billion, which is an interesting comparison with the present situation. We passed the bill in 1954; it was not until 1956 that we came to a balanced budget. In 1954, we passed the bill and in 1955, unemployment dropped from 5.6 percent, which is just the same as the current estimate of unemployment, to 4.4 percent. It stayed down in that area for 3 years and then went right through the roof up to 6.8 percent.

In 1955, after 1954, we cut the cost of Government by $3 billion, and in 1956 and 1957 and 1958, it crept up again, $2 billion a year, approximately. So with a tax cut which bore about the same relationship to GNP that this recommended tax cut bears comparing 1954 to now, and with a cut in expenditures of $3 billion, we produced a jump in the gross national product of $30 billion. Actually, it was nearly 33. But in 1956, we only produced a surplus of $1.6 billion and in 1957, a surplus of $1 billion, a little smaller, but approximately the some size, $1.59 billion. We had a deficit in 1958 and then this tremendous deficit in fiscal year 1959.

Now, it seems to me that if you rely on a tax cut to provide the stimulus, you have to look back at this history and realize that there are some other things in this situation that we are leaving out of our calculations here.

We are talking in a vacuum, as though the tax cut and the Federal expenditures will produce all these effects.

Senator GORE. Off the record.

(Discussion off the record.)

Senator GORE. Back on the record.

Senator BENNETT. To go back, Mr. Heller, as I said, Senator Carlson, reading the questions handed to him by Senator Dirksen, began raising that question: What is there different in this situation that will give us hope that we are going to have a prolonged and sustained benefit from this tax cut when, in 1954, with a $33 billion jump in GNP in the next year and a $3 billion cut in expenses after another year intervening, we came up with 2 years with limited surpluses, then went into a period of deficits?

Then I made the statement, I think we are talking in a little bit of a vacuum and there were some figures I wanted that I have been trying to reach for ever since I came back and now some willing friends are scribbling back there. But it seems to me that the missing factor here may be the substantial reduction in corporate profits as a percentage of gross national product.

And while they stayed fairly level, both before and after taxes, through the last few years, their proportionate importance in our economic picture has been declining. And as a result of this decline, are not the corporations, have not the corporations lost, actually, a greater opportunity for retained earnings for investment than they can possibly get back out of this tax cut? And should not we be

more concerned with improving the profit position of corporations for the purpose of stimulating investments than we are to give them a one-shot-in-the-arm jolt with a tax cut?

Mr. HELLER. Well, Senator, first of all, as against a "quickie" tax cut—that is, a temporary tax cut—this would be not a shot in the arm but a continual increase in the profitability of business.

Senator BENNETT. The 1954 tax cut was not a temporary tax cut. That was a continuing tax cut. The corporations were relieved of the whole undistributed profits tax burden in 1954. That was not a quickie. Yet all during that period from 1954, and I will have the figures in a minute, the profitability of corporations in comparative terms, as related to gross national product, dropped. I have a memory that the rate in 1950 was 8 percent of GNP and now it is down to 4.5 percent of GNP. Unfortunately, I have not been able to lay my hands on the figures. Maybe you have them there.

Mr. HELLER. Well, we do have some figures. Perhaps one general point should be made before we delve further into the profitability aspect of corporations. That is a point that has come up several times—why is it that we have to reduce taxes repeatedly? Part of the reason is found in the progressive nature of our tax system which, even at existing levels of taxation, tends to take a higher and higher proportion of our income.

Senator BENNETT. That is not true of corporate tax. Corporate tax is not progressive.

Mr. HELLER. Excuse me, I am thinking now of the overall impact of taxes on demand and of course, we have had this softening of total demand, which the tax cut is designed to offset.

As far as your point on the profitability of corporations is concerned, this of course is always a complex question. Total profit before taxes and inventory valuation adjustment as a proportion of national income was 11.3 percent in 1954; then 13.6 percent in 1955; then 12.7; 11.8; 10.2; 11.9; 10.7; and in 1961 and 1962 was running right around 10.3 percent and in the second quarter of this year around 10.7 percent of national income.

Senator BENNETT. You are talking about national income, not gross national product.

Mr. HELLER. But I am talking about some softening of those ratios since the period you mentioned. I might say that 1929, for example, was about 11 percent. Today's ratio is in the order of magnitude of returns in the late 1920's.

Senator BENNETT. As I say, these figures do not gibe with the ones that I have used and they bother me for that reason.

Mr. HELLER. Part of the problem, Senator, of course, is also the comparison over time of corporate profits by themselves. Obviously, when you have had accelerated depreciation in 1954, and when you have had a catching up, so to speak, of depreciation with higher prices of machinery, a good deal of what was previously going into something labeled "profits" has instead been going into cash flow.

(The following table was subsequently submitted for the record by Senator Bennett as pertinent to this discussion:)

Relationship of corporate profits and gross national product

[In billions of dollars]

Calendar years	Gross national product	Profits before taxes	Profits after taxes	Ratio to gross national product of—	
				Profits before taxes	Profits after taxes
				Percent	*Percent*
1946	210.7	22.6	13.4	10.7	6.4
1947	234.3	29.5	18.2	12.6	7.8
1948	259.4	33.0	20.5	12.7	7.9
1949	258.1	26.4	16.0	10.2	6.2
1950	284.6	40.6	22.8	14.3	8.0
1951	329.0	42.2	19.7	12.8	6.0
1952	347.0	36.7	17.2	10.6	5.0
1953	365.4	38.3	18.1	10.5	5.0
1954	363.1	34.1	16.8	9.4	4.6
1955	397.5	44.9	23.0	11.3	5.8
1956	419.2	44.7	23.5	10.7	5.6
1957	442.8	43.2	22.3	9.8	5.0
1958	444.5	37.4	18.8	8.4	4.2
1959	482.7	47.7	24.5	9.9	5.1
1960	502.6	44.3	22.0	8.8	4.4
1961	518.2	43.8	21.8	8.5	4.2
1962	554.9	46.8	24.6	8.4	4.4
1963 [1]	575.7	49.6	26.1	8.6	4.5

[1] First half.

Source: Staff of the Joint Committee on Internal Revenue Taxation Nov. 14, 1963.

Senator BENNETT. Well, this tax cut is supposed to give corporations a total of——

Mr. HELLER. $2.3 billion.

Senator BENNETT. After the second year?

Mr. HELLER. After the second year.

Senator BENNETT. The first year, a little less than 1.5—1.435.

Mr. HELLER. Yes, sir.

Senator BENNETT. Now, this is a very small percentage of their before-taxes—their present before-taxes income.

Mr. HELLER. It is in the neighborhood of $50 billion.

Senator BENNETT. Yes. This is 1.5—it is about 3 percent.

Mr. HELLER. And overall, about 5 percent when it is in full effect.

Senator BENNETT. Yes; that is right. Yet you hope that this is going to provide enough stimulus to create enough new investment to help put what—a million people back to work, a million and a half, necessary to get us down into the area of 4 percent?

Mr. HELLER. Something in the neighborhood of 2 million jobs, or even upward of that figure, are necessary to get us down to 4 percent unemployment as of today. As you get closer to 4 percent, the hidden unemployment comes to life, and people reenter the labor force.

Senator BENNETT. Yes. Well, let me go ahead.

This $1.435 billion, how much of that will actually turn up in cash flow next year? How much of it will be eroded away by the speedup in collections?

Mr. HELLER. I do not have the exact figure, but in the period of transition the accelerated payments will offset a good proportion of that for the larger corporations as far as cash flow is concerned—not in profitability, but cash flow.

Senator BENNETT. Is this not also important in determining investment? If these people know that it is going to take 7 years before the full impact of this tax cut is available to them——

Mr. HELLER. Senator, I have made some field studies of investment decisionmaking in corporations. In fact, some of them were made right after the first Mills plan was enacted back in 1950. I found that corporations were making their investment decisions—their yes or no on investment projects—on the basis of the profitability of the proposed projects and not fundamentally on the basis of the cash flow available. I am talking about the larger corporations—corporations like Minneapolis-Honeywell and Minnesota Mining and the like. I think that will take place here as well, because the combination of last year's reductions and this year's—in H.R. 8363—is about 20 percent cut in corporate tax liabilities. In other words, about a 20-percent increase in corporate after-tax income, since profits are divided about 50–50 with Government at the present time. Since much of the tax reduction is focused right on the investment process, the after-tax profitability of an investment will be greater than that.

In our statement, we gave the example that the Treasury calculated of a new investment in a 10-year asset, on which profitability, from these measures combined, would increase by 35 percent. I think that is a very substantial increase in the incentive for investment for modernization and eventually, one would hope, for capacity expansion.

That brings me to the second point that as you increase the sales volume—as you increase markets, as you increase the percentage of utilization of capacity—profit rates will go up. As you look over the years, you will find this to be true. In 1955, when manufacturers were operating at 90 percent of capacity, their profits were 13.6 percent of national income. Then when the operating rate dropped down to 76 percent of capacity in 1958, corporate profits were only 10.2 percent.

Now, profits have not come up all the way since that time, partly because of inadequate markets, partly because more of their total intake is being routed into something labeled "depreciation" rather than something labeled "profits." But if we bring this economy back to full employment, they will have to be close to $30 billion instead of something in the neighborhood of $26 billion of after-tax profits. I think that is a figure we can regard as very respectable, indeed.

Senator BENNETT. And you think this will have a more permanent expression than the similar situation had in 1954?

Mr. HELLER. Yes; I do.

Senator BENNETT. In spite of the fact that the 1954 tax cut was accompanied by some attempt at restraint at spending. But there is no evidence that we have more than words in this particular situation.

Also, of course, from the point of view of investment stimulation, you have the blow that is given to the investors in this bill on the other side of their face, the elimination of the 4-percent dividend credit, which disturbs a lot of people and might serve to channel their investments into something other than corporate stocks.

Mr. HELLER. One has to consider that in the perspective of the balanced whole program. That is, last year's investment credit and depreciation liberalization—together with the improvement of the investment credit by the change with respect to the depreciation requirement in the current bill—are much more closely focused, on the investment process, the process that brings us a more modern and efficient plant and equipment. In comparison, the dividend credit is a good deal further removed from that process. As the Treasury has pointed out, it is a sort of wrong way method of alleviating the so-called double taxation of corporate dividends. I think we are getting a much better buy for the money as far as expansion, efficiency, and eventual profits are concerned, by these direct business tax reductions, rather than we do by the more indirect benefit through a dividend credit to individuals.

Senator BENNETT. Then you think the stockholder is going to be happy because he might get larger dividends, even though he pays a higher tax on the dividends he receives.

Mr. HELLER. I think you have put it very well.

Senator BENNETT. Well, the stockholders do not feel that way.

Mr. HELLER. I am sure they do not at the moment. I think the final results will justify this view, sir. I think the overall results of higher profit rates, lower investment tax rates, and investment stimulants will be very pleasant to the stockholders in the course of time.

Senator BENNETT. You do agree that there is a substantial element of double taxation?

Mr. HELLER. Well, Senator, this is one of those very complex questions among economists that is just extremely difficult to determine. There has always been a great deal of controversy as to whether the corporate tax is passed on in the prices of products, in which case it is not double taxation—instead the yoke of that tax is removed by the increases in prices in the last analysis.

Senator BENNETT. But you are talking in terms of the whole economy and I am thinking in terms of the individual.

Mr. HELLER. I am not saying that I accept the proposition that it is all passed on to the consumer. I am saying that some people urge that it is, and a recent econometric study says that there are lots of situations where this is true.

There are deviations. My own judgment would be that a good bit of it sticks to the corporation and that there is a problem of taxation at both the corporate level and the individual level. Of course, we have examples of double or triple or quadruple taxation throughout the economy and the problem is really whether it is one of discriminatory double taxation. That question is surely worthy of consideration.

Senator BENNETT. Of course, this is so complicated that we cannot open up all the questions of where the discrimination lies and the House very wisely postponed or eliminated consideration of many of them..

Well, Mr. Chairman, I will give the witness back to you.

Senator GORE. Dr. Heller, do you think the debt induced by the tax cut will be or should be monetized or financed from savings?

Mr. HELLER. Well, Senator, I think this should be financed in such a way that the expansionary effect of the tax cut is not offset by monetary policy. That means very probably some expansion of the money supply, which I do not think is the same as saying that it is monetized.

It means that a good bit of it will be financed out of the savings that are created by the higher income. That is to say, when we expand production and expand income and profits, we, of course, create additional savings in that process, which are available for the financing of the deficit.

The core of this question is really what is done in monetary policy to accommodate or restrain the expansion that results from the tax cut?

Senator GORE. To the extent that it is financed out of savings, the stimulative effect of the tax cut would be neutralized?

Mr. HELLER. No; I do not think that is true at all, sir. There would be the possibility that if the screws of monetary policy were tightened at the same time that the tax cut were put into effect, there would be a tendency to offset it. But the basic wherewithal for financing the deficit will come out of the expansion created by the tax cut.

Selling bonds to the pubic to finance a tax cut merely affects the composition of portfolios. It is not a case of taking wealth or income away from people by borrowing it. The bond buyer uses his bank account or savings account and turns it into a Government bond. This does not reduce the stream of income.

Senator GORE. Well, Doctor, no need to be devious about it. If a tax reduction of $10 billion is given, which creates a $10 billion deficit, and the bonds, the sale of which will be necessary to finance the deficit, are purchased from savings, out of the tax reduction, you would have a washout proposition.

Mr. HELLER. This is a simple question to deal with. Economists sometimes get tied up in knots on it themselves, so I am not suggesting that——

Senator GORE. Well, maybe you can understand why someone who is not an economist might be able to see it without so many knots.

Mr. HELLER. That is what I am endeavoring to do: To lay it out as simply as I can even at the risk of not taking some of the qualifications into account. Let us say that we have a $30 billion increase in the gross national product. Let us say that this translates into $27 billion of personal income. Out of that personal income, some 8 percent or so would be saved. Right there, you would have a savings of about $2 billion.

Senator GORE. You are assuming a timelag which may not exist at all.

You have an existing deficit now.

Mr. HELLER. This would occur simultaneously. That is, only as the tax cut, through reduced withholding and so forth, went into effect would you need to do the additional borrowing. Also, some of the corporate part of the GNP increase would normally be saved. So the financing of the deficit will be made possible by the expansion of income under the tax cut itself.

(The following, more complete example was supplied for the record by Mr. Heller:)

Let us say—and the figures are only illustrative—that we have a $10 billion tax cut, all to individuals, and a resulting $30 billion increase in GNP—$25 billion in consumer goods and $5 billion in investment. Of the $30 billion of added GNP, say that $7.5 billion is collected in additional taxes, reducing the deficit to $2.5 billion. Gross business saving may take another $5.5 billion of the GNP, leaving $17 billion added to disposable income. Including the $10 billion of tax cut gives a $27-billion increase in consumer after-tax income, of

which $25 billion is consumed and $2 billion is saved. Since gross business saving rises by one-half billion dollars more than business investment, total remaining saving is $2.5 billion, just equal to the net increase in the deficit.

I think that all this tends to divert attention, however, from the basic question, which is whether monetary policy accommodates the expansion or whether it does not accommodate the expansion. That is really the nub of it.

Senator GORE. We will come to that later, but let us examine this first. You have just said that a considerable part of the deficit would be financed, in your opinion, from the added income as a result of the tax cut.

Mr. HELLER. From the normal saving out of that income; yes, sir.

Senator GORE. All right. Suppose that these operations are simultaneous. You really have three operations: First, you give Senator Carlson a tax cut of $1,000. That increases the deficit by $1,000. Then Mr. Dillon has to sell a $1,000 bond and Senator Carlson buys it. Now, how is the economy stimulated by that transaction?

Mr. HELLER. In the first instance, if the $1,000 bond represents an exchange of his bank account, shall we say, or other form of savings for the Government bond, then he continues his spending.

Senator GORE. Let us say his tax liability has just been reduced by $1,000 and that increases the deficit by $1,000. The Secretary of the Treasury sells a bond for $1,000 and Senator Carlson takes the $1,000 that he got in tax reduction and buys the Government bond for $1,000. Now, just where is the stimulative effect there?

Mr. HELLER. Well, as a matter of fact, when you take all the Senator Carlsons together, now——

Senator GORE. Maybe we should use some other name.

Senator CARLSON. Financially, I think it would be better.

Mr. HELLER. When you take all the beneficiaries of the tax cut together, Senator, and let's take just the first round——

Senator GORE. But you are tying it into knots now. I am asking a simple, elementary question.

Mr. HELLER. You cannot just pick out one individual who happens to choose to save 100 percent of his tax cut, when the average individual will save just 7 percent of his tax cut.

Senator GORE. You say I cannot, but I have.

Mr. HELLER. But we cannot extend that into the economy as a whole.

Senator GORE. I am not trying to extend it into the economy as a whole. I am asking you a question as plain as 2 and 2 makes 4. It is not devious; it is not complicated: it is a very simple operation. The tax bill (1) gives Senator Carlson a $1,000 reduction in his taxes, which means he has $1,000 which is not needed for taxes; he buys that $1,000 bond. Where is the stimulation?

Mr. HELLER. He is $1,000 better off than he was before.

Senator GORE. Of course he is.

Mr. HELLER. Under the earlier situation, he would have had a tax receipt. Now he has a Government bond worth $1,000 and that is a very substantial difference in what he is going to do in terms of his whole spending pattern.

Presumably, since he now has this additional $1,000 locked up in his safe-deposit box, he will be able to spend more out of his preexisting income.

Senator GORE. Well, that is a presumption and that would violate the whole concept that this tax cut is going to result in 92 percent of the money being spent. You meet yourself coming back there.

Mr. HELLER. We must distinguish between the current flow of income and the exchange of assets in estimating the effect of the tax cut on the typical spending pattern of the taxpayers who will be receiving the benefit of this cut.

In other words, typical behavior will not be to salt the $1,000 away in his savings account and then trade that for a Government bond. The average pattern for all the 50 million taxpayers who will benefit is to put, in your example, $70 away in the savings acount and $930 into the consumer markets. That is the difficulty in working from the specific example that you just cited.

Senator GORE. Well, I recognize that this possible example I cite is not typical. But it may very well be typical of many thousands of people, some of whom will have their take-home pay increased 100 percent. I do not see any basis on which you can assume that they are going to spend it any more than you should deny me the theoretical assumption that they are going to turn around and buy Government bonds with it.

Mr. HELLER. Well, we have, though, a pretty solid historical basis, Senator Gore. Consumers have always spent a very large share of every addition to their disposable incomes, and in the past dozen years the consumption share has stayed within the narrow range of 92 to 94 percent.

Senator GORE. I understand. But the question I asked you is this: To the extent, and notice the qualification—to the extent that the tax savings or tax reduction is invested in the deficit, then the stimulative effect to the economy is reduced by that amount, unless you assume there is some time factor that would modify it.

Mr. HELLER. To the extent that people do not spend the tax cut, the stimulus is reduced. And this reduction is taken into account when we assume that 7 percent or so goes into savings rather than into consumption. What they then do with the savings, or with that 7 percent, will of course have some impact on the economy. But the fundamental stimulus of the other 93 percent which is spent will not be lost unless there is a monetary tightening above and beyond the call of duty.

Senator GORE. Off the record.

(Discussion off the record.)

Senator GORE. Thank you, Dr. Heller and your fellow members of the Council of Economic Advisers, for your courteous, diligent testimony.

(At the request of Senator Douglas the following statement made by Dr. Heller on October 28, 1963, before the Subcommittee on Employment and Manpower of the Senate Committee on Labor and Public Welfare, is reprinted below:)

Mr. Chairman and members of the committee, we are pleased to have an opportunity to participate in these hearings on employment and manpower. The employment problem is not only of the greatest importance to the country and at the center of Government economic policy, but is of particular interest to an agency operating, as the Council does, under the mandate of the Employment Act of 1946.

Recent discussions may have generated an impression of greater disagreement among the Nation's economists about the origins and solutions of the employment problem that actually exists. For in fact, the great majority of those who have

studied the matter carefully would agree with the administration's view that our excessive unemployment today cannot be traced to a single cause nor eliminated by a single cure. Rather, it has a mixture of causes which must be dealt with by a mixture—an amalgam—of cures.

One problem, and a central one, is that total expenditures in the economy—total demand for goods and services—are not sufficient to generate an adequate total number of jobs. We can, for convenience, call this kind of unemployment "demand-shortage" unemployment. In our view, demand-shortage unemployment can and must be attacked by vigorous policies—principally tax reduction—to raise the total demand for goods and services.

Another problem is that the characteristics of our available workers—their locations, skills, education, training, race, sex, age, and so on—do not fully match the characteristics employers are seeking in filling the jobs that are available (or that would be available at full employment). In a dynamic, changing economy there is always some of this mismatching, and we call the unemployment that results from it "frictional." But when the pockets of such unemployment become large and stubborn—especially when they impose chronic burdens on particular disadvantaged groups and regions—we speak of the unemployment problem as "structural."

This type of unemployment is also a serious problem, which requires major policy actions to overcome its corrosive effects. Structural problems are not new. And the available evidence does not show that the proportion of our total unemployment problem that we label "structural" has increased significantly, nor that its character has materially changed. But this in no way diminishes the need for attacking these structural problems with vigorous policies—principally education, training and retraining, and special regional programs—to match the supply of labor skills more closely to the changing demand for labor skills.

Along with demand-shortage and structural unemployment, one also hears a great deal about the problem of "technological unemployment"—of men being put out of work by machines and, more particularly, by the process which has come to be called automation. This is, indeed, a serious and continuing problem. But two points should be emphasized at the outset.

First, "technological unemployment" is not a third form of unemployment, separate from the other two. Rather, it expresses itself through these other forms. Technological change causes obsolescence of skills and therefore produces some of the mismatching between available workers and jobs that we call "structural" unemployment. Moreover, by raising output per worker, technological change is one of the principal sources of growth in our potential total output or GNP—which, if not matched by corresponding growth in actual GNP, opens a gap in demand and thereby causes demand-shortage unemployment.

Second, those who maintain that the economy now faces a problem of "technological unemployment" that is somehow new, and more formidable than in the past implicitly assert that the rate of technological change has recently speeded up. Unless this is the case, the problem is not new—it has always been with us and has not proved to be a longrun problem for the economy as a whole. The continuing process of rapid technological change, which has constituted the very core of the American economy's strength and progressiveness for at least 150 years, has always put particular workers and businesses out of jobs and required particular adjustments that have been difficult and sometimes painful. It poses a new general problem for the economy only if technological change becomes so rapid that the demand adjustments and labor market adjustments it requires cannot be accomplished by the economic processes of the past. Whether technological change indeed has accelerated, or is in process of accelerating, is a factual question that we consider at some length in this statement.

These, then—demand-shortage elements, structural elements, and a possible aggravation of both by accelerated technological change—are the principal ingredients of the unemployment problem your committee is examining. It would be unwise and imprudent to ignore any of these ingredients either in diagnosing the problem or in prescribing remedies.

The primary attack on high unemployment must be through fiscal measures to speed the growth of total demand and thereby to create new job opportunities. But this need not—indeed, must not—impede a simultaneous attack on our stubborn structural problems. The two approaches are not merely complementary; they are mutually reinforcing. On the one hand, training and other programs to facilitate labor mobility can ease and speed the process by which demand-stimulated increases in output are translated into increases in employment.

On the other, since structural maladjustments tend to flourish in slack markets, a vigorous expansion in demand helps cut structural problems down to size.

This statement deals first with the overall dimensions of our unemployment problem and the central role of tax reduction in eliminating excessive unemployment. Second, we turn to several issues which have figured prominently in the committee's hearings to date: The nature, extent, and recent pattern of structural unemployment; the current rate of growth in productivity and the labor force; and the fears of automation and consumer satiation. In considering these issues, we are addressing ourselves to three underlying questions:

1. Are the structural elements of the unemployment problem an important barrier to the achievement of the objectives of the tax cut?
2. Are we likely to experience speedier increases in productivity and in the labor force which, while serving our objectives of faster economic growth and balance-of-payment equilibrium, would intensify our problems of re-employing displaced workers and generating enough total demand to achieve full employment?
3. What is the nature of the labor market policies that must go hand in hand with the use of overall fiscal and monetary polices for expansion if we are to achieve our multiple economic goals?

A final section will summarize our observations on these questions.

I. UNEMPLOYMENT AND TAX REDUCTION

The American economy has been plagued with persistently excessive unemployment for 6 years. The unemployment rate has been 5 percent or more for 71 consecutive months. Since 1957, it has averaged 6 percent. Even in the face of annual advances of about $30 billion in GNP (annual rate), unemployment has not been diminishing. Thus, although GNP rose from $556.8 billion in the third quarter of 1962, to $588.5 billion in the third quarter of 1963, the unemployment rate remained the same in both quarters. And even with a prospective increase of $100 billion in the GNP rate from early 1961, to early 1964 (a rise of 20 percent in current dollars and about 15 percent in constant dollars), the unemployment rate will have come down only about 1½ percentage points in that 3-year period.

The persistence of this high level of unemployment is sometimes cited as evidence of structural difficulties which will blunt the effect of the proposed $11 billion tax cut now being considered by the Senate Finance Committee and make it difficult to reach the interim full-employment goal of 4-percent unemployment, let alone, our ultimate goals beyond the 4-percent level. The structural problem will be examined in some detail later in this statement. But here, several points should be noted to indicate why the road to 4-percent unemployment is clearly open to demand-powered measures:

1. The pre-1957 postwar performance of the U.S. economy gives ample evidence of its ability to achieve 4 percent and even lower levels of unemployment without excessive strain.
2. The availability of 1.1 million excess unemployed workers (even by the modest 4-percent criterion and not counting the labor force dropouts resulting from slack job opportunities) and of substantial excess capacity (even after large gains, the average operating rate in manufacturing is running at only 87 percent of capacity) demonstrates that we are still suffering from a serious shortage of consumer and investment demand.
3. There are virtually no signs of economic tension, of the barriers that would divert the force of demand stimulus away from higher output, more jobs and higher incomes into higher prices—there are no visible bottlenecks in the economy, wage rate increases have been the most moderate in the postwar period, and the record of price stability in recent years has been outstanding.

In reference to the first point, the unemployment rates in the first postwar decade deserve a further word. In the period of vigorous business activity in 1947 and 1948, unemployment averaged 3.8 percent of the labor force. After the recession of 1949 and the recovery of 1950, the rate was relatively stable from early 1951 to late 1953, averaging 3.1 percent. Since that time, the rate has drifted upward. In the period of stable unemployment from mid-1955 to late 1957, unemployment averaged 4.3 percent, an increase of more than one-third above the 1951–53 period. In the first half of 1960, unemployment averaged 5.3 percent, nearly one-fourth above the 1955–57 level. Following the recession and recovery of 1960–61, the rate fluctuated within a narrow range averaging 5.6

percent in 1962 and 1963 to date, a little higher than early 1960. Looking at the 1947-57 period, the average unemployment rate was below 4 percent in each of the following years: 1947, 1948, 1951, 1952, and 1953, and below 4½ percent in 1955, 1956, and 1957.

When one looks behind these figures to get a grasp of the economic conditions that produced them, the most notable difference between the pre-1957 and post-1957 periods is found in the strength of market demand. In the first postwar decade, markets were strong. Backlogs of consumer demand had to be worked off. The demands of the Korean conflict had to be met. Outmoded plants and equipment had to be replaced or modernized, and capacity had to be enlarged. Deficiencies in housing, office facilities, and public works had to be made up.

But 1957 marked a watershed. In the ensuing period, demand has slackened at a time when our labor force growth has been accelerating in response to the postwar jump in the birth rate. Business fixed investment dropped off from 10 to 11 percent of the GNP to only 9 percent—indeed, the level of such investment in 1962 barely struggled back to its level in 1956, while GNP was rising by nearly one-fifth (both in constant prices).

Thus, the clearest and most striking change since 1957 is the weakening of demand. So the clearest and most urgent need today is to remove the overburden of taxation which is retarding the growth in demand to full employment levels. Income tax rates enacted to finance war and fight inflation, though reduced in 1954, are still so high that they would yield a large surplus of revenues over expenditures if we were at full employment today. They are, in short, repressing demand and incentives in an economy operating well short of its capacity.

To avoid misunderstanding, it is important to stress that any employment program would be unbalanced and incomplete without determined measures (*a*) to upgrade and adapt the skills and education of the labor force to the more exacting demands of our advancing technology and (*b*) to facilitate the flow of workers from job to job, industry to industry, and place to place. Nevertheless, our principal reliance for a return to the 4-percent-or-better levels of unemployment we took for granted in the early postwar period must be on measures to boost demand for the products of American industry and agriculture.

The amount of the increase in total demand which would be necessary to reduce unemployment to the 4-percent interim-target level can be approximated in several ways. We have made direct estimates of the relationship between unemployment rates and output levels; and we have independently estimated the potential GNP that the economy could produce a 4-percent unemployment. But of these approaches yield consistent estimates of the output and demand requirements associated with 4-percent unemployment at a given time. Except for small differences reflecting cyclical variations in productivity and erratic fluctuations in labor force participation rates, these estimates of potential output (in constant prices) are very closely approximated by a 3½-percent trend line passing through actual GNP in mid-1955. The several methods of computing potential GNP were reviewed in some detail in our annual reports both for 1962 and 1963, and are analyzed more fully in a recent paper by one of the council's consultants.[1] Although estimates of this kind cannot be precise—and efforts to improve and update them as new data come in must continue—the careful cross-checking by different methods provides confidence in their general order of magnitude.

These estimates show that the gap between actual GNP and the potential GNP at 4-percent unemployment has been substantial in every year since 1957. In both 1962 and 1963, it has approximated $30 billion.

Our analysis thus suggests that total demand for goods and services would have had to average some $30 billion higher than it was in each of these past 2 years for unemployment to average 4 percent. The basic purpose of the tax cut is to close that $30 billion gap—and to realize the benefits to employment, growth, and our international competitive position that will flow from this advance.

To be sure, by the time the full effects of the proposed two-stage tax cut will be reflected in demand and output, the economy's potential will have grown considerably, and total demand growth will therefore have to be considerably

[1] Arthur M. Okun, "Potential GNP: Its Measurement and Significance," Cowles Foundation paper No. 190, reprinted from the 1962 Proceedings of the Business and Economic Statistics Section of the American Statistical Association.

more than $30 billion. But when the tax cut lifts the expanding level of private demand in the U.S. economy by the extra $30 billion (in terms of 1963 GNP and price levels) that can confidently be expected, it will have achieved its basic purpose. Had this increase been effective during the past 6 years, it would have eliminated our persistent slack and allowed our unemployment rate to average 4 percent.

The process by which an $11.1 billion tax cut can add as much as $30 billion to total demand has been frequently described and needs only to be summarized briefly here.

If the new proposed personal income tax rates were in full effect today, disposable aftertax incomes of consumers would be approximately $8.8 billion higher than they are, at present levels of pretax incomes. In addition, if the lower corporate tax rates were now in effect, aftertax profits would be about $2.3 billion higher. Based on past dividend practice, one can assume that corporate dividends received by individuals (after deducting personal income taxes on such dividends) would then be more than $1 billion higher, giving a total increment of consumer aftertax incomes—at present levels of production—of about $10 billion.

Since consumer spending on current output has remained close to 93 percent of disposable income in each of the past dozen years, one can safely project that consumer spending would rise by about 93 percent of the rise in disposable incomes, or by over $9 billion.

But this is far from the end of the matter. The higher production of consumer goods to meet this extra spending would mean extra employment, higher payrolls, higher profits and higher farm and professional and service incomes. This added purchasing power would generate still further increases in spending and incomes in an endless, but rapidly diminishing, chain. The initial rise of $9 billion, plus this extra consumption spending and extra output of consumer goods would add over $18 billion to our annual GNP—not just once, but year in and year out, since this is a permanent, not a one-shot tax cut. We can summarize this continuing process by saying that a "multiplier" of approximately 2 has been applied to the direct increment of consumption spending.

But that is not the end of the matter either. For the higher volume of sales, the higher productivity associated with fuller use of existing capacity, and the lower tax rates on corporate profits also provided by the tax bill would increase aftertax profits, and especially the rate of expected aftertax profit on investment in new facilities. Adding to this the financial incentives embodied in last year's tax changes, which are yet to have their full effect, one can expect a substantial induced rise in business plant and equipment spending, and a rise in the rate of inventory investment. Further, higher consumer incomes will stimulate extra residential construction; and the higher revenues that State and local governments will receive under existing tax rates will prompt a rise in their investments in schools, roads, and urban facilities. The exact amount of each of these increases is hard to estimate with precision. But it is reasonable to estimate their sum as in the range of $5 to $7 billion. This extra spending would also be subject to a multiplier of 2 as incomes rose and consumer spending increased. Thus there would be a further expansion of $10 to $14 billion in GNP to add to the $18 billion or so from the consumption factor alone. The total addition to GNP would match rather closely the estimated $30 billion gap.

II. THE PERSISTENT PROBLEMS OF STRUCTURAL UNEMPLOYMENT

The tax cut would thus increase demand to levels consistent with a 4-percent rate of unemployment. It would ease our most pressing unemployment problems. But no one can assume that our worries about unemployment would then be over. Some of its most distressing and inequitable aspects would remain.

To be sure, tax reduction will create new jobs in every community across the Nation and expand employment in every industry. The overwhelming majority of American families will benefit directly from the income tax cuts that will accrue to 50 million taxpaying individuals and 600,000 taxpaying corporations. Their direct rise in aftertax income will soon be translated, through the marketplace, into stronger markets for all kinds of goods and services and a quickening of the business pulse in all communities. With average working hours already at a high level, this added demand and activity will in large part be translated, in turn, into additional jobs and income for the unemployed. Thus, the nontaxpaying minority will, in a very real sense, be the greatest beneficiaries of the tax program.

Experience (which we will review later in this statement) clearly shows (1) that the unemployment rate will decline for every major category of workers and (2) that the sharpest declines will occur where the incidence of unemployment is the highest: among teenagers, the Negroes, the less skilled, the blue-collar groups generally.

But even so, the unemployment rates of many groups will still be intolerably high. Back in 1957, for instance, when the average unemployment rate was just over 4 percent for the whole economy, the rates were much higher for many disadvantaged groups and regions—e.g., 10.8 percent for teenagers, 8 percent for nonwhites, 9.4 percent for unskilled manual workers, and 11.5 percent for workers in Wilkes-Barre-Hazleton, Pa.

These high specific unemployment rates, which persist even when the general rate falls to an acceptable level, are the essence of the problem of structural unemployment. Even a fully successful tax cut cannot solve problems like these by itself. They require a more direct attack.

To reduce the abnormally high and stubborn unemployment rate for Negroes requires a major improvement in their education and training and an attack on racial discrimination. To reduce the persistent high rate for the unskilled and the uneducated groups demands measures to help them acquire skills and knowledge. To reduce excessive unemployment associated with declining industries and technological advance requires retraining and relocation. To reduce high unemployment in distressed areas of Pennsylvania, Michigan, Minnesota, and elsewhere calls for special measures to rebuild the economic base of those communities and assist their workers.

Both the administration and the Congress have recognized that these measures must be taken concurrently with measures to expand aggregate demand. Coal miners in Harlan County are structurally unemployed now, and so are Negro and Puerto Rican youths in New York City. Yet, programs to reduce structural unemployment will run into severe limits in the absence of an adequate growth of demand, i.e., in the absence of rapid expansion of total job opportunities. Such expansion is needed to assure that retrained and upgraded workers, for example, will find jobs at the end of the training period and will not do so at the expense of job opportunities for other unemployed workers. As structural programs create new and upgraded skills, they will in some cases fit the participants for jobs that had previously gone begging. But for the most part, the needed jobs must be created by expansion of total demand.

Quite apart from the human significance of structural unemployment, it also has great economic importance. For only as we reduce structural and frictional unemployment can we achieve the higher levels of total output which would be associated with unemployment rates below our 4-percent interim target. The Council emphasized this point in its 1963 annual report (p. 42), as follows:

"Success in a combined policy of strengthening demand and adapting manpower supplies to evolving needs would enable us to achieve an interim objective of 4-percent unemployment and permit us to push beyond it in a setting of reasonable price stability. Bottlenecks in skilled labor, middle-level manpower, and professional personnel [now] tend to become acute as unemployment approaches 4 percent. The result is to retard growth and generate wage-price pressures at particular points in the economy. As we widen or break these bottlenecks by intensified and flexible educational, training, and retraining efforts, our employment sights will steadily rise."

Every worker needlessly unemployed represents a human cost which offends the sensibilities of a civilized society. But each worker needlessly unemployed also represents a waste of potential goods and services, which even an affluent society can ill afford. More intensive measures to attack structural unemployment are necesssary to reduce the unemployment rate not merely to 4 percent, but beyond

III. HAS STRUCTURAL UNEMPLOYMENT INCREASED?

The preceding section addressed itself to structural unemployment as a human and social problem and considered its role in the process of lowering the unemployment rate to and below 4 percent. But it is also appropriate to ask: Has structural unemployment increased to such an extent since 1957—the last time unemployment was near 4 percent—that it will impede the expansionary effects of demand-creating measures in general and the tax cut in particular?

An affirmative answer would, we believe, represent a misreading of the facts. As we have already pointed out there are serious structural problems, and prompt action is needed both to root out the inequities and hardships they

inflict and to help us reach our employment goals. But this conclusion need not—and does not—rest on a belief that there has been a disproportionate surge in structural unemployment since 1957.

A reading of the evidence on this score must focus principally on what happens, over time, to the unemployment rates of particular groups—teenagers, untrained and unskilled workers, Negroes, and other disadvantaged groups and regions—in relation to the total unemployment rate. It would clearly be misleading simply to compare unemployment rates for such groups in a year like 1957, when the total rate was about 4 percent, with the corresponding rates in 1962–63, when the total rate has averaged 5.6 percent. Rather, it is the relationship between the total rate and the group rates—and its historical development—that reveals whether the structural problem is getting worse or not. And this relationship has been remarkably stable.

The disadvantaged groups almost invariably share more than proportionately—and the skilled and white-collar groups less than proportionately—in both decreases and increases in total employment. In the past, when the overall unemployment rate has risen—or fallen—1 percentage point, the rate for nonwhites and teenagers has risen—or fallen—by about 2 percentage points, the rate for unskilled workers by about 2½ percentage points. But the rate for professional and technical workers has risen or fallen by only about one-fourth of a percentage point.

One obvious reason for the disproportionate impact on teenagers is that they are the most recent additions to the labor force. When new job opportunities are few, there is a backing up at the point of entry. Furthermore, even when they do find jobs, they tend to have the lowest seniority and are therefore first to be laid off. Much the same is true of Negroes. Given existing patterns of discrimination, they are often in marginal jobs or at the bottom of seniority lists. Moreover, when jobs are scarce and labor is plentiful, racial discrimination, where it exists, is more likely to enter into hiring and firing decisions. And at such times, employers are also more inclined to pass over inexperienced and untrained workers and less inclined to press their own efforts to adapt such personnel to their needs via inservice training programs. They tend to be less aggressive in seeking new employees outside their own local labor markets. And labor supply considerations are less likely to determine the location of new plants.

On the other hand, employers do not typically discharge many supervisory and technical personnel when output drops and, as a result, they do not need to expand their employment of such persons proportionately when output rises.

Moreover, there are other reasons why the employment of many categories of workers does not rise and fall in the same proportion as the total. Some disparities arise from the complex interrelationship between the composition and the level of total output. To cite just one example, the rate of inventory accumulation is highly sensitive to the rate of expansion or contraction in total output, and goods that typically are inventoried tend to require large numbers of production workers. In contrast, the service industries, whose output is not subject to inventory accumulation nor to such wide fluctuations in consumption, generally use more technical and white-collar workers.

Thus it is not surprising to find that slackened demand since 1957 has intensified intergroup and interregional disparities in unemployment rates at the same time that it raised the total unemployment rate. Nonwhites, teenagers, unskilled and semiskilled workers have suffered a greater-than-average increase in unemployment since 1957. But these same groups will also benefit disproportionately as demand expands and the overall unemployment rate declines. This point is illustrated in the table below, which shows how the incidence of unemployment changed during the 1960–61 recession and the 1961–62 recovery.

Change in unemployment rate, selected groups and areas

[Percentage points]

	1960-61	1961-62		1960-61	1961-62
Total	1.1	−1.1	Manufacturing workers	1.5	−1.9
			Miners	2.1	−3.0
Teenagers	1.6	−1.9	For illustrative purposes:		
Nonwhites	2.3	−1.5	Michigan	3.4	−3.4
Nonfarm laborers	2.0	−2.1	Wheeling, W. Va	6.9	−7.8
Operatives	1.6	−2.1			

Studies of changes in the incidence of unemployment among unskilled and semiskilled blue-collar workers—whose jobs would seem to be highly vulnerable to technological change—can provide important insights into the structural unemployment problem. One would expect an accelerated rate of technological displacement to be reflected in rising rates of unemployment for these groups—relative to total unemployment. One would also expect to find such a relative rise for workers in industries such as manufacturing, mining, and transportation where automation has so far found its widest application.

To test this possibility, we have correlated the unemployment rate in specific occupations and industries with the rate for all experienced workers in the labor force during the 1948–57 period—in other words, for the period before the main structural unemployment upsurge is alleged to have occurred. These correlations were then used to calculate what the occupational and industrial distribution of unemployment would have been in 1962 if the old relationships had held. If there had been a substantial increase in structural maladjustments, the actual 1962 unemployment rates for what we may call the "technologically vulnerable groups" should have been higher than these calculated rates. But in fact, as table 1 shows, a majority of the rates are lower. For some of these occupations and industries, the actual increase in unemployment was greater than expected, but in most cases it was less. And taking all of the blue-collar occupations and goods-producing industries together, we also find that the rise in actual unemployment was somewhat less than the 1948–57 experience would have suggested.

TABLE 1.—*Unemployment rates in industries and occupations most vulnerable to technological displacement, 1957 and 1962*

[Percent]

Industry or occupation	1957	1962	Change in rate, 1957–62	
			Actual	Expected [1]
All workers	4.3	5.6	1.3	
Experienced wage and salary workers	4.5	5.5	1.0	
Workers in selected industries (goods producing)	5.4	6.4	1.0	1.3
Mining, forestry, and fisheries	6.3	8.6	2.3	1.8
Construction	9.8	12.0	2.2	1.8
Durable goods manufacturing	4.9	5.7	.8	1.4
Nondurable goods manufacturing	5.3	5.9	.6	1.0
Transportation and public utilities	3.1	3.9	.8	1.0
Experienced workers	3.9	4.9	1.0	
Workers in selected occupations (blue collar)	6.0	7.4	1.4	1.7
Craftsmen, foremen, and kindred workers (skilled)	3.8	5.1	1.3	1.3
Operatives and kindred workers (semiskilled)	6.3	7.5	1.2	1.6
Laborers, except farm and mine (unskilled)	9.4	12.4	3.0	2.6

[1] Calculated by use of correlations of (a) unemployment rates by industry with the rate for all experienced wage and salary workers, and (b) unemployment rates by occupation with the rate for all experienced workers, using data for the period 1948–57 in both cases.

Sources: Department of Labor and Council of Economic Advisers.

We do not conclude from this evidence, nor from similar findings by Edward Denison and Otto Eckstein[2] as to the geographic distribution of unemployment, that a reduction in structural unemployment has occurred. Similarly, however, we do not conclude that the unusually high unemployment rates experienced by teenagers this year, or the rather low rates experienced by adult males, prove an adverse structural shift. In some labor market areas, imbalances have lessened; in others they have increased. But this does not suggest that the overall rate of structural unemployment has risen significantly.

One similar piece of evidence relates to job vacancies. Since structural unemployment is a form of joblessness that persists over a protracted period even if unfilled jobs are available, an increase in structural unemployment would be

[2] Edward F. Denison, "The Incidence of Unemployment by States and Regions, 1950 and 1960," and "The Dispersion of Unemployment Among Standard Metropolitan Statistical Areas, 1950 and 1960." Mimeograph. Otto Eckstein, "The Unemployment Problem in Our Day," paper delivered before the Conference on Unemployment and the American Economy, Berkeley, Calif., April 1963.

clearly suggested if it were found that the number of job vacancies were rising along with the number of unemployed men.

Unhappily we have no comprehensive and adequate series designed to measure job vacancies in the United States. The Department of Labor currently is proposing experimental work leading toward the eventual establishment of such a series. This is a proposal we strongly endorse, although we share the Labor Department's awareness that such a series involves many technical problems and will need to be interpreted with care, especially in its early years.

But meanwhile the only available indicator that bears upon the job-vacancy situation is the national industrial conference board's index of the number of help-wanted advertisements published in the classified section of a leading newspaper in each of 33 leading labor market areas. While this series does a good job of reporting what it is designed to report, obviously it provides a comparatively sketchy and imperfect indication of job vacancies. All the same, it is interesting that, after adjustment for changes in the size of the labor force, the help-wanted index was substantially lower in 1960 and 1962 than in 1955–57, when the total unemployment rate was about 4 percent. We have further adjusted the index for changes in the total unemployment rate in order to screen out the effects of slack demand. Even in this form the index fails to rise significantly since 1957—as one would expect it to do if underlying structural unemployment had broadened.

The evidence reviewed above does not yield persuasive indications that structural elements are today a significantly larger factor in our unemployment than in 1957. Nevertheless, it would not be surprising if some particular aspects of structural unemployment have intensified. One would assume that the longer a period of slack persists, the more likely it would be that the detailed structure of skills, experience, and training of the labor force would fail to reflect fully the pattern of job requirements at high levels of employment. High employment in 1967 will call for a somewhat different pattern of jobs than existed in 1957, and a slack labor market does not accurately foretell what that pattern will be. Moreover, there is danger that, after a long period of slack, new hiring standards, habits of mind, and expectations appropriate to an "easy" labor market will have become entrenched, rationalizing increased discriminations against disadvantaged groups. Thus, after the period of prolonged slack since 1957, there is more need than in the usual "cylical" recovery for an effective program of specific labor-market policies to assist demand-stimulating policies in tailoring men to jobs and jobs to men.

IV. SHIFTING EDUCATIONAL REQUIREMENTS AND POSSIBLE SKILLED MANPOWER BOTTLENECKS

In recent weeks—partly before this committee, partly elsewhere—particular attention has been given to one aspect of the problem of structural maladjustments. This is the question of whether a recent shift in the pace and character of technological change has accelerated the long-term rise in job educational and skill requirements in a way that imposes a new bottleneck on expansion. The issue merits special discussion because of the obstacle to the employment-expanding effects of the tax program that this skilled-manpower bottleneck is alleged to present.

The argument is that the nature of recent technological change has caused a rapid shift in the pattern of manpower demand, pushing down the demand for workers with little training and pushing up the demand for the highly educated. Everyone agrees that the educational level of the Nation's population has continued to advance, causing the supply of highly educated manpower to grow rapidly, and the supply of relatively uneducated manpower to decline. Thus the concern expressed is not about keeping pace with an absolute increase in job educational requirements—which have been rising right along—but about being unable to keep pace with an abrupt recent rise in such requirements.

It is feared that as demand increases, there will not be enough highly educated workers to fill the key technical and professional positions that must be manned if production is to expand to levels consistent with 4-percent unemployment; that, in consequence, expansion of output will be frustrated; and that, because of this, high percentages of the remainder of the labor force—including poorly educated workers—will be left unemployed.

It is important to distinguish this quite specific point about near-term bottlenecks from other propositions about the economic importance of education. It is unquestionably true, we believe, that greatly reinforced education is needed to

press the attack on the pockets of long-term structural unemployment that have plagued the economy for a long time.

It is unquestionably true, moreover, that educational attainment enormously affects the employment prospects of the individual. Whether the economy is booming or stagnating, the poorly educated always come off second best. A grade school graduate is five times likelier to be unemployed than is a college graduate. Today's school dropouts are tomorrow's unemployed.

It is further well known that long-term shifts, which can be projected to continue, in the relative importance of various industries, and long-term trends in technological development, are, on the whole, raising (as well as altering) educational requirements. The "Report on Manpower Requirements, Resources, Utilization, and Training" by Secretary Wirtz last March indicated the nature of these continuing shifts, including projections by broad groups to 1970 and 1975. The clearly indicated rise in the requirement for professional, technical, and kindred workers—teachers, scientists, physicians, engineers, technicians, and nurses—pose obvious demands on education in general and higher education in particular. And increased demands for many special skills create needs for expanded programs of vocational education and for more persons with a basic high school education. These long-term trends are not at issue in the present discussion.

Likewise, there can be little doubt about the enormous importance of education as an engine for stimulating the long-term growth of our productive potential. Edward Denison has estimated that 42 percent of the increase in output per worker between 1929 and 1957 was the result of education and another 36 percent the result of the general advance in the application of scientific and technological knowledge to which our educational process and institutions clearly were heavy contributors. All of these are extremely important—in fact, conclusive—reasons for strengthening our educational programs. But they should not be confused with the view that educational deficiencies prevent the solution of our current problem of excessive unemployment, and, specifically, that near-term manpower bottlenecks will significantly restrain a demand expansion—stimulated by a tax cut—from accomplishing its employment objective.[8]

The statistical testing of the educational bottleneck hypothesis turns out, if properly done, to be a very complex undertaking. There are problems of the noncomparability between decennial census data and information drawn from current population surveys; of the lack of appropriate annual series; of calculating appropriate current full-employment labor force participation rates for particular age and educational attainment groups instead of arbitrarily projecting the rates of a remote year; and of including not merely the male but the female components of our population. Members of our staff currently are engaged in preparing a careful analysis of the available and pertinent data that will take these issues into account. We shall be happy to supply the committee with a copy of this staff paper when it becomes available.

Meanwhile, however, some reliable impressions already have emerged from the figures at hand. One is that, while there does appear to have been some rise in the demand for highly educated workers relative to their supply during the postwar period as a whole, the timing of this change is crucial for purposes of evaluating the bottleneck thesis. Since the economy operated at approximately a 4-percent unemployment rate in the midfifties without encountering serious skilled-manpower bottlenecks the key question is whether most of this shift occurred before or after the 1955–57 period. Hence a shift in job educational requirements relative to supply that had occurred before those years, and was not serious enough to obstruct expansion then, poses little threat to a new move back toward 4-percent unemployment now.

The available unemployment data seems to show that whatever shift may have occurred in job educational requirements relative to supply did occur prior to 1957. Indeed it may have been partially reversed since that time. From 1957 to 1962, for example, the unemployment rate for male workers with an eighth grade education or less rose by about one-half, roughly the same as the rate of overall unemployment. But the unemployment rate for college graduates rose from 0.6 to 1.4 percent.

In addition to unemployment rates, the percentages of labor force participation by groups of different educational attainments also have changed during the

[8] The most widely quoted exponent of the bottleneck thesis is Prof. Charles Killingsworth of Michigan State University.

postwar period. Here the data currently in hand do not permit us to locate the timing of these changes to the degree that has been possible with the unemployment rates. And so we simply do not know whether here, too, the shift toward greater participation by the well educated, and lesser participation by the poorly educated, may largely have occurred before 1957.

If, in the absence of information, one assumes that the shift in relative participation rates occurred more recently, one might conclude that there have been some withdrawals from the labor force by poorly educated male workers. Whenever they occurred, they present an obvious challenge to both public and private training programs. But the magnitude of these shifts is easily exaggerated—especially if one fails to make adequate allowance for the improvements in retirement programs during the past dozen years. It is clear that the vast majority of the so-called losses of less educated workers from the male labor force were concentrated in the 65-and-older age group.[4]

In any event, while statistical analyses of the alleged shift in job educational requirements relative to supply will be useful, and are being currently conducted by our staff, none of this goes to the real nub of the issue. That nub is the failure of the bottleneck hypothesis to make any allowance for the proven capacity of a free labor market—especially one endowed with a high average level of education and enterprise and expanding programs to improve labor skills and mobility—to reconcile discrepancies between particular labor supplies and particular labor demands.

If relative shortages of particular skills develop, the price system and the market will moderate them, as they always have done in the past. Employers will be prompted to step up their inservice training programs and, as more jobs become available, poorly skilled and poorly educated workers will be more strongly motivated to avail themselves of training, retraining, and adult education opportunities. Government manpower programs begun in the 1961–63 period will also be operating to help ease the adjustment of specific shortages.

As for the personnel with the very highest skills, many—for the very reason that they are scarce—have been "stockpiled" by their employers and are not working to capacity when business is slack. As business picks up, they will be used more fully—and they will be used more efficiently. As engineers become scarce, and more expensive, their talents will be concentrated on engineering assignments, leaving drafting (for example) for draftsmen, who can be trained more quickly.

Naturally, most college graduates will have jobs no matter how high the unemployment rate in the whole economy, even if they have to work below the level for which they are qualified. If they are already in the supervisory or technical jobs for which they are best qualified, their employers will not have to increase by 10 percent the number of such jobs in order to increase total employment by 10 percent. And to the extent that they are not already in such jobs, they are a hidden reservoir of superior talent.

The highly educated manpower bottleneck argument arrives at its alarming conclusion by projecting to new situations a perfectly static set of educational requirements. The argument makes no allowance for flexibility in the system. Flexibility, of course, is not unlimited. If we were talking about accomplishing a massive increase in output within a few months, manpower bottlenecks might indeed become critical. But we find it unrealistic to believe that they represent a major constraint upon an extra $30 billion of output in what will soon be a $600 billion economy—especially when (*a*) there are virtually no current signs of tension in either labor markets or product markets and (*b*) the demand expansion that will accomplish the closure will be spread over 2 or more years in which continuing new supplies of highly trained manpower will be entering the labor market.

At the beginning of section III the question was raised whether structural elements in unemployment have grown so much since 1957 that they threaten to impede an economic expansion induced by the tax cut. In sections III and IV we have examined this question from a number of directions, and we now summarize our answer.

---

[4] The importance of this point is clear from the fact that its recognition has caused Professor Killingsworth to reduce his estimate of the "real" unemployment rate in 1962 by a full percentage point—from 8.8 percent in his speech of Oct. 7 to 7.8 percent in a speech of Oct. 26. Preliminary inspection of the figures suggests that even further adjustment may be necessary.

The answer is clear: The evidence we have assembled and the tests we have made do not support the thesis that, overall, the incidence of structural unemployment has increased in importance since we last achieved high employement. There may be some problems that seem more serious today than earlier; but in other areas we have probably progressed.

Expansion of the economy in response to a stepping up of the growth of demand will not be impeded by pockets of surplus labor existing in a limited number of categories—we have always had distressing surpluses in certain categories, and the tax cut will not fully eliminate them. Economic expansion could eventually be impeded by shortages in strategic categories of skills and training, but the statistical evidence reveals no such shortages en route to 4-percent unemployment.

It is difficult to believe that an economy that was able to absorb the dramatic shifts needed to convert to war production in World War II, and that operated at unemployment levels as low as 1.2 percent during that war and more recently (1953) at 2.9 percent, could not move rather readily, over the space of 2 or 3 years, to our interim of target of 4-percent unemployment.

Unsatisfied as we all must be with our Nation's achievements in education—and with the distressing problem of school dropouts—we must not disregard the fact that our labor force today is better educated and, as a result, more flexible than ever before. The median level of education among the adult male members of the labor force has risen by an astonishing 50 percent since the beginning of the Second World War. New entrants into the labor force are on the average better equipped than ever before to respond to a changing pattern of demand. By 1966, when the full effects of the tax cut will be apparent, the ranks of trained workers will have been swelled by two or more annual graduating classes from our high schools, colleges, and professional and graduate schools. In each case, the size of the groups will dwarf all previous records.[8]

Our own recent economic history assures us of the economy's ability to adapt to rapid change. Additional assurances along this line is found in the experience of other countries whose systems and values are similar to our own. During the past decade, the Western European economy has undergone staggering structural changes. France and Belgium have adjusted to the decline of important mining areas, Germany to the inflow of millions of refugees from the East, and Italy to the problem of absorbing large numbers of poorly educated rural migrants into urban occupations. And all of Western Europe has adjusted to the replacement of obsolete capital, and of productive methods often unchanged for a century or more, with machinery and methods geared to the most advanced technology in the world. The advance of productivity has been revolutionary. During the 1950's, output per manufacturing workers increased two and one-quarter times as fast in Germany as in the United states, three times as fast in France, and four times as fast in Italy. In their adjustment to these changes the Europeans, though they may have other advantages, did not have the advantage of a labor force nearly as well educated, as well trained, as mobile, or as flexible as ours.

Nonetheless, the Europeans have maintained unemployment rates considerably lower than ours. After adjustment for conceptual differences, the unemployment rate in 1960 was 1 percent in Germany, 1.9 percent in France, and 4.3 percent in Italy. In Italy and Germany these low rates represented a considerable improvement over earlier postwar experience, and the higher Italian rate has subsequently declined materially.

The major explanation for such low unemployment rates in economies undergoing such profound transitions lies in the maintenance of a very high level of demand. During the 1950's the average annual growth rate in France was 4 percent, in Italy, 6 percent, and in Germany, over 7 percent—and both Italy and France have had even higher rates so far in the 1960's. This experience demonstrates beyond any doubt that, under the stimulus of adequate demand, and with the aid of active labor market policies, modern economies are sufficiently resilient to absorb poorly educated workers, to adapt to skill shortages, and to adjust to rapid technological change in a manner which maintains extremely low unemployment rates. This European experience—which in broad outline has been matched in Japan—reassures us that, once high and growing

[8] For example, the projected numbers graduating from college (bachelors or first professional degrees) in 1964 and 1965, will be about 30 percent above the numbers graduated in 1959 and 1960. By 1970, the estimated number will exceed 1960 by 85 percent.

demand presses our capacity, we too will adapt to rapid change and maintain our economic health.

Structural unemployment is a human and an economic problem that we must attack by every means available. But the expansion of total demand through tax reduction remains the crucial central element in our attack upon unemployment.

V. THE RATE OF GROWTH OF PRODUCTIVITY

The preceding section has considered the question whether demand expansion might be unable to reduce unemployment to 4 percent because of the possibility that increased structural unemployment would impede expansion of output. This section considers the question whether the extent of the necessary demand expansion may have been underestimated because of the possibility that the growth rate of potential output is speeding up. These two possible barriers to the reduction of unemployment to 4 percent seem to represent opposite poles of skepticism, but it is conceivable that both difficulties could exist side-by-side.

If potential output at 4-percent unemployment were growing faster than we think, it would have to be for either or both of two reasons. One reason is a faster growth of the labor force. The other is a faster growth of output-per-worker.

A faster growth of the labor force is indeed underway. Annual net gains of potential workers will grow steadily, at least through 1967, and thereafter remain higher than in the 1950's. Our estimates of potential output for the years 1958 through 1963, have been consistent with the current potential availability of labor, and estimates for future years can readily take accelerating labor force growth into account.

Faster labor force growth provides us with a welcome source of faster growth of total output in the years ahead, provided only that the growth of demand also accelerates sufficiently to create jobs for all of the new entrants, as well as for the current excessive numbers of unemployed, and for the current "submerged" or "invisible" unemployed who have withdrawn from, or failed to enter, the labor force because of discouragement about job opportunities.[6]

The second determinant of the growth of our potential output at 4 percent unemployment is the rise in output per worker, or productivity. Productivity grows for many reasons: the increased skill, knowledge, and motivations of workers; improvements in organization and management; the provision of more capital per worker; the provision of more effective machinery as the result of technological advance; economies of scale; the removal of impediments to the transfer of labor (and capital) from industries where productivity is low or slowly rising to those where it is high or rapidly rising.

It is now suggested by some observers that one of the major determinants of productivity growth has recently undergone a revolutionary speedup. The progress of technology, it is asserted, has entered a new phase. Breakthroughs in science, translated into productive technology through enormous investments in research and development, are said to promise productivity advances far more rapid than the average rates of the postwar period to date (roughly 2 percent for output per worker and 3 percent for output per man-hour). The new phenomenon is often characterized as "automation."

What we need to assess, then, is the extent to which "automation" (used as shorthand for technological progress in general) has stepped up the growth rate of productivity. We can readily see its dramatic effects in particular cases; but what has it done to the average rise in output per worker across the whole economy?

The economist looks for evidence of a recent acceleration of productivity; gains in our accumulating statistics on output per man-hour. What we par-

---

[6] Our estimates of what GNP would be at 4-percent unemployment, which we have examined in section I of this statement, make full allowance for currently depressed rates of labor force participation. The actual labor force figures, as reported monthly by the Bureau of Labor Statistics (BLS), do not include all of the workers who would be available for employment if the demand for labor were more adequate. Some people have withdrawn from the labor market or failed to enter it because they consider their prospects of finding jobs too remote. This is indicated by the fact that the reported labor force has fallen considerably short of earlier projections of the "normal" labor force made by the BLS in 1957 (based on the age and sex composition of the population of working ages and on long-term trends in the participation rates of each age-sex group). It is even falling short—by about 750,000 in 1963—of the lower revised projections which the BLS made in 1962. Our estimates of potential output assume that a drop in the unemployment rate will be accompanied by the return of labor force participation rates to a more normal level.

ticularly want to determine is the trend growth in productivity, at a constant rate of unemployment, such as 4 percent. It is essential to remove the influence of variations in the unemployment rate and associated cyclical factors which occasion substantial changes in output per man-hour that have nothing to do with technological change. In trying to isolate the productivity trend, economists—not for the first time—are trying to measure something they do not directly observe.

To begin with, let us review the two official Bureau of Labor Statistics series on labor productivity. The man-hours data underlying the one series are compiled primarily from employer payroll reports; those underlying the other come from the monthly household survey of the labor force. The following are the annual rates of productivity change in the total private economy that the two series provide for the indicated periods:

	Based upon employer payroll reports	Based upon monthly labor force survey
	Percent	*Percent*
1947-62 (average)	3.2	3.3
1957-62 (average)	3.0	2.8
1961	3.3	2.5
1962	3.9	4.4

For the manufacturing sector alone, the payroll-based series provides these estimates for the same periods:

	Percent
1947-62 (average)	2.9
1957-62 (average)	3.4
1961	4.2
1962	4.3

And the preliminary estimates for 1963 also suggest as much as a 4-percent increase in manufacturing.

Now what are we to make of these figures? First, the data for 1957-62 as a whole suggest quite clearly that no newly accelerated trend in long-term productivity has yet become clearly established. This is true even of manufacturing, for which the gains of the past 5 years, although higher than the postwar period as a whole, are approximately in line with those of the early postwar years.

Second, however, the data raise the possibility that trend productivity has started to accelerate very recently. Except for the 1961 estimate for the total private economy, based upon the monthly survey of the labor force, all of the 1961 and 1962 figures, along with the preliminary estimate for manufacturing this year, are high.

Yet, third, it has long been recognized that, compared with trend productivity, year-to-year changes in actual productivity reflect fluctuations in actual output compared with potential output. More specifically, it is well known that productivity spurts to well above its trend value in the earlier stages of a cyclical expansion.[7]

Thus the estimates for 1961, the first year of the current expansion, are no cause for suspecting an upward change of course in trend productivity. However, the strength of the showing for the second year of the expansion is somewhat unusual, and—if the preliminary estimate for manufacturing holds up—the 3 consecutive years of rapid advance there will be most impressive. We have made some preliminary attempts further to probe the data by relating the productivity figures to capacity utilization, but the results are inconclusive.

At this point, therefore, we are left with a judgmental choice. The recent figures may simply represent a rather prolonged "cyclical" surge in productivity that will taper off as the expansion continues, businesses adjust to the higher levels of production, and hiring proceeds more rapidly. We are still inclined to put this interpretation on the recent data—for one thing because it is the part of scientific caution not to leap to the conclusion that every shortrun variation in a time series is the beginning of a new secular trend.

[7] See, for example, Statement of the Council of Economic Advisers before the Joint Economic Committee, March 6, 1961, supplement A.

Yet, the trend productivity rate may be in process of accelerating. Technological change may indeed have speeded up, but its impact upon productivity may be only gradually becoming visible because of the time that must elapse for innovations to become embodied in new capital equipment. There is no clear evidence of such an acceleration in trend productivity, but one cannot, today, make a conclusive appraisal of recent productivity data.

The problem of interpretation discussed above applies equally to some calculations which have recently received considerable public attention. These calculations purport to show that the GNP "cost" of reducing unemployment is rising. They compare the increase in GNP associated with each additional job in the current expansion with the comparable increases in previous cyclical expansions. Such comparisons need first, of course, to be deflated or price changes. When this is done, the figures for the last three expansions appear as follows:

Period	Year-to-year increase in private nonfarm GNP (billions of 1962 dollars)	Increase in private nonfarm employment (household survey series) (thousands)	Additional GNP per new private nonfarm job (1962 dollars)
1954-55	32.3	1,579	20,500
1958-59	31.0	1,423	21,800
1961-62	29.8	1,056	28,200

These figures drawn from the last three expansions imply that the GNP "cost" of an additional job—the marginal "cost"—is enormous, more than three times the average "cost" of a job (which, for example, was $8,800 in 1962). Moreover, they appear to show that the "cost" of an additional job has increased quite rapidly from upswing to upswing.

However, this whole exercise is misleading for two reasons. First, the figures have an upward bias arising from a cyclical lag in hiring. More significantly, they fail to recognize that a substantial part of the increases in GNP realized in each of these periods did not derive from increases in employment. The mere trend increase in productivity is sufficient to permit GNP growth of about 2½ percent per year with constant employment. One must not mistakenly attribute to increases in employment those increases in output which should properly be attributed to the growing productivity of workers already on the job. If we deduct from the GNP increase in each recovery an amount equal to 2½ percent of the through-year GNP, we arrive at the following results:

Period	Year-to-year increase in private nonfarm GNP after deduction for productivity growth at 2½ percent (billions of 1962 dollars)	Increase in private nonfarm employment (household survey series) (thousands)	Additional GNP per new private nonfarm job (1962 dollars)
1954-55	23.4	1,579	14,800
1958-59	21.0	1,423	14,800
1961-62	18.6	1,056	17,600

The above statistics illustrate the extent to which estimates of GNP per additional worker employed are reduced by taking account of trend productivity increase. And since actual productivity advances in 1955, 1959, and 1962—reflecting the early recovery phase of business cycles—were nearly double the trend increase of 2½ percent, the GNP increases per added job, shown just above, overstate the increases "needed" to create an added job in the later phases of expansion.

It is true, of course, that these GNP "costs" typically grow from one upswing to the next. This is exactly what we should expect from improved technology, better management, and better education, which raise the productivity of new workers as well as those already on the job. One should add that it seems paradoxical to worry about added jobs "costing" more GNP as the economy progresses. The same point can be put better by saying that each job returns more—in incomes and output—and thus moves us closer to our domestic and international economic objectives.

VI. THE CHALLENGE OF AUTOMATION

In a way it is surprising how reluctant we are to embrace the higher productivity levels and living standards which "automation" makes possible. Some of the more popular literature on the subject treats it as a new and frightening development. But in fact, it is only the most recent aspect of a continuing process of technological advance that dates back to the beginning of the industrial revolution. Taking full advantage of this process, the United States has built the most productive and most remunerative economy in the world. Through time, brute strength has been progressively replaced by simple machines, mechanical power, complex machines, assembly lines, and today increasingly by sophisticated automatic feedback systems. At each stage of the process individuals were temporarily displaced from existing jobs, new skills were found to be needed and were acquired, and total output and employment expanded as demand increased in line with the new higher production capabilities.

Ultimately the total effect has always in the past been a higher standard of living for almost everyone—higher pay for workers, cheaper and better products for consumers, and larger profits for businessmen and stockholders. On the basis of our historical experience, automation should be recognized for what it is—an open door to a more productive economy, to higher levels of private consumption, to more effective public services, and to larger resources for the support of our international objectives.

Despite this historical record, it is occasionally argued that the newest techniques are becoming so much more productive than those they replace that we cannot possibly adjust to them as smoothly as in the past. As indicated earlier, the evidence available to date does not enable us to draw firm conclusions about the prospective rate of increase in productivity. Yet it is clearly possible that as the newest production techniques are increasingly embodied in new capital, the future growth of productivity will speed up.

Should this possibility be a source of concern? Rather than viewing it with concern or alarm, we would argue that we should work as hard as we can for faster productivity growth—indeed, it holds the key to success of our national policies for faster economic growth and for the cost cutting that is essential to our international competitive position. It is a prime objective of this year's tax bill as well as last year's special tax stimulants to investment.

Doubts about our ability to adjust to automation seem to be based on two questions: Can we really use the enlarged output of goods and services made possible by a rising rate of productivity advance? Will the new speed and character of technological change create impossible problems of adjustment for the labor force?

Those who raise the first question sometimes argue that we cannot possibly consume all that the new techniques can produce—that the persistent high level of unemployment over the past few years is evidence of satiation—that the fantastic productivity of the American economy has outdistanced the needs of the American people. What do the facts show?

First and most obvious, it is impossible to square this notion with the persistence of poverty in the American economy. We are indeed an affluent society, by every comparative standard. Nonetheless, even in this age of affluence, one-fifth of American families still have annual incomes below $3,000—that is, they live in poverty. To them, the suggestion that we are economically satiated must seem ridiculous, if not cruel. Until our society has met the challenge of poverty in the midst of plenty, it is in no danger of being satiated with goods and services.

But—quite apart from the persistence of poverty—there is nothing in the economic behavior of even the more affluent American consumers to support the satiation hypothesis. At all income levels—except perhaps in the top 2 or 3 percent of the income-wealth distribution—the ratio of consumption to disposable income is one of our most stable economic relationships. Year in, year out—ever since 1950—American consumers have continued to spend from 92 to 94 percent of their aggregate disposable income—their income after taxes—on consumer goods and services. During this period total income and average family income have both risen markedly; but there is no evidence of any growing disinclination to spend a stable and high percentage of each additional dollar of income on consumption. Even those in the upper middle income groups who are already able to meet without strain the basic requirements for food, clothing, housing, and transportation find that they have ample, and often urgent, uses for additional incomes. This may take the form of an improved quality or manner in which basic requirements are satisfied—a larger house, a newer car—or

it may take the form of meeting new and different demands: longer and more rewarding vacations, better education for one's children, better medical care, more books and more concerts, and more expensive hobbies.

This does not, of course, rule out the possibility that—as in the past—some, many, or even all of us will prefer to forgo still higher income in favor of greater leisure in the form of shorter hours, longer vacations, or earlier retirements. (There are indications, incidentally, that many people find it easier to become satiated with leisure than with income.)

In addition to unsatisfied private consumption needs, there are pressing needs for goods and services which are ordinarily and in some cases inevitably provided by the public sector. Admittedly there is disagreement as to just which of these "public goods" most need to be increased. There are also differences of opinion as to which levels of government should undertake expanded activities. Nevertheless, almost all major segments of the American community support increases in the level of one or another of such "public" goods and services, whether they be, for example, urban renewal, or improved health services, or better schools, or better roads and airports, or purer water and air, or more adequate facilities in national parks. Certainly none of this bespeaks a satiated society.

In a somewhat different vein, it should also be noted that technologically advancing societies also generate high levels of investment demand, demand for producer goods like machines, equipment, buildings. In large part, of course, this reflects the favorable impact of new technological developments on the profitability of investment. During most of our history, American business has responded to such opportunities by enlarging its investment outlays. Postwar Western Europe and Japan provide examples of economies with impressive rates of productivity increase along with buoyant demand, reflecting—more than anything else—extremely high quotas of investment.

Clearly, we need not fear that the increasing productivity associated with even a speeded-up rate of technological progress will founder upon a contradiction between our needs and our ability to satisfy them. As people continue to receive the extra incomes which our enlarging production can generate, they will also continue to use those extra incomes to buy the enlarged output—for private and public consumption and for investment.

The second question raised about our ability to adjust to automation concerns the labor force adjustments it necessitates.

If the advance of technological progress has speeded up, it is reasonable to suppose that, as a byproduct, the rate at which particular skills are rendered obsolescent is also increasing. But a further and different point is sometimes made, namely, that automation (in its narrower technical sense) is shifting not merely the rate but the character of skill requirements generated by technological change. Previously, it is suggested, technological change simplified the work process and hence created many semiskilled jobs, which could be filled by workers with little training. Automation, however, reintegrates the production process and thus eliminates many unskilled and semiskilled jobs.

Whether this interpretation is correct is a highly complex empirical question. Many of the jobs displaced by automation are low skilled and some of the jobs added are extremely high skilled. The design and installation of automation equipment surely requires highly trained personnel. Yet the need for these people is clearly limited, and they do not stay with the equipment long after installation. Once in operation, the equipment may actually diminish rather than raise skill requirements. Examples of highly automated installations have been cited where all of the maintenance is done by high school graduates with a fairly short trade school course in electronic repair. High skills are required for the programing function, but this also tends to be concentrated in the initial stages and "canned" programs are increasingly available in some applications. A good deal more study and experience is needed before we can safely generalize about the impact of automation on skill requirements for the labor force as a whole.

Beyond the question of how automation (in the narrow sense) affects average skill requirements lies the broader question of the impact on labor markets of any general acceleration that may occur in the rate of technological advance. This broader question involves at least two dimensions.

A "vertical" dimension relates to the impact of speeded technological change on the long-term rate of increase in the average educational content of jobs. As noted repeatedly, our past rapid increase in educational levels has both responded

to and helped bring about our steady technological advance and rising productivity. The exact nature of the complex interrelationships between the average educational accomplishment of the labor force, job educational requirements, and a further speeding up of the pace of technological advance is a matter for some speculation. But whatever the answer, more and better education will continue to have one of the highest priorities among the values of American society.

The "horizontal" dimension of our question requires less speculation. We can be certain that a speeded pace of technological change will increase the rate of job displacement, and will require even greater attention to measures for improving labor mobility, for training and retraining of workers, and for an effective level of basic education to promote adaptability and flexibility. The possibility of an accelerated pace of technical change thus underscores an already powerful case for stronger labor market policies to meet existing problems of displacement.

Our past economic growth has brought unparalleled levels of well-being for all in our society. Today we need and we actively seek even higher levels of productivity, to help us solve both domestic and international problems. If, as a result of our policies to stimulate investment and improve efficiency, or as an unexpected bonus from autonomous developments in technology, the U.S. rate of productivity growth accelerates, we may encounter problems, but we will reap large rewards. If we pursue appropriate policies, we can meet the challenge of automation.

VII. CONCLUSIONS

This statement has been long and necessarily complex. But the issues involved are of the highest urgency and significance for the economic future of our Nation, and they are far from simple. In so characterizing them we know we share the view of this subcommittee, which has been so tirelessly pursuing all aspects of this subject.

We have tried to draw our conclusions from the evidence as we have gone along, and therefore need only pull them together here. These are our principal conclusions:

1. Enactment of the major tax reduction program which is now before the Senate is a necessary condition for solution of the problems that concern this subcommittee. It will directly add $30 million to total output and create 2 to 3 million extra jobs. Without the continuing lift in total demands for goods and services that the tax program is designed to accomplish, little progress can be expected in reducing and elminating problems of excessive unemployment for the Nation as a whole. Had this lift in demand been effective in the years 1958 through 1963, it would have overcome economic slack; achieved a considerably higher level of output of needed goods and services; maintained unemployment rates comparable with those realized in the years before 1957; and—in the process—reduced or eliminated our budget deficits.

2. Although tax reduction will alleviate, it will not by itself cure, longstanding problems of structural unemployment, of incomplete adaptation of the structure of our labor force to the structure of demand, of regional imbalances, and of consequent hardship, inequity, and inefficiency. The need to attack these problems stems, first, from our concern to alleviate unnecessary human distress. Second, it stems from the desire to convert unproductive and unwanted idleness into productive employment, so that we can increase our output of needed goods and services even beyond the potential output associated with our interim target of a 4-percent rate of unemployment. And third, if the rate of technological displacement of workers is in the process of accelerating, it will need to be matched by a similar increase in the mobility and adaptability of our labor force.

This administration has placed high priority upon measures to accelerate our productivity gains—through the stimulation of investment by tax measures, the improvement of technology in lagging sectors of the civilian economy, and in other ways—with the urgent purpose of improving the competitive position of American producers in world markets and of stepping up our long-term growth rate. It has promoted policies designed to realize the benefits of maximum productive efficiency—policies which may require shifts in our resource use and consequent displacements of labor.

It would be irresponsible not to complement these policies with others designed to facilitate the transfer of resources and to ease necessary burdens of adjustment—as, indeed, was done in the "adjustment" provisions of the Trade Expansion Act.

Without attempting to be comprehensive, we can indicate some of the important channels of attack on structural problems:

Improved labor market information services;

Improved guidance and placement services;

Improved programs of apprenticeship;

Strengthened programs to reduce discriminatory hiring and employment practices by race, sex, or national origin;

Expanded and more effective programs of vocational education, general adult education, and retraining;

Basic improvements in the quality of our educational system at all levels;

Measures to enlarge educational opportunities for children of low-income families and minority groups;

Programs to assist the geographical movement of workers; and

Expanded policies to strengthen the economic base and to speed the economic growth of distressed communities and regions.

The tax cut and other measures to expand total demand are no substitute for policies like these; while these policies, in turn, are no substitute for a tax cut. Yet a more vigorous expansion of demand will release forces that will powerfully aid in the solution of structural problems. The existence of a stronger demand for labor will by itself strengthen the incentives for workers to undertake training or retraining and for employers to help provide it; will attract workers to move to the places where jobs are plentiful and stimulate employers to assist such movement; will ease the financial burdens on local communities in undertaking improvements in their educational systems; will reduce discriminatory practices both by employers and by unions; and will increase the effectiveness of the free-market price system in encouraging appropriate adjustments of both labor supply and labor demand, the need for which is now partly obscured by slack markets.

3. Important as is the attack on structural problems, we need not fear that structural obstacles will block a healthy expansion of jobs and output resulting from the tax cut. The feasibility of our 4-percent interim target assumes not some newly perfected system of labor market adjustment but the labor market as it exists today with its present adjustment mechanism. Possible and desirable improvements in our labor market adjustment processes can smooth and accelerate achievement of the interim target. And they can permit us to penetrate beyond it to even lower unemployment rates. But it is on demand stimulus that we must rely to get to the provisional 4-percent objective.

4. There are hopeful hints in the most recent evidence that we may be achieving a somewhat higher rate of average productivity growth than in the past, although it is too early to be sure. If our potential output per worker should grow more rapidly in the future than in the past, it would mean that an even more rapid expansion of total demand would be required to reach and maintain reasonably full employment of the labor force. But we see no basis for fears that our wants and needs are already satiated, or that total spending will fail to rise with potential output and thus thwart faster expansion. It is true that demand does not automatically adjust year-by-year to the growth of potential output. But there is no reason to suppose that demand is more likely to be deficient when potential output is more rapidly growing than when growth in potential output is less dynamic. On the contrary, the conditions that are conducive to faster productivity growth are also conducive to more rapid expansion in private demands.

Instead of fearing an accelerated growth of productivity, we should and do seek it—

To achieve more fully our private and public domestic economic goals;

To help us correct our balance-of-payments deficit;

And to raise the standard and quality of life for all of our citizens.

The CHAIRMAN. The committee will be adjourned until 10 o'clock tomorrow morning.

(Whereupon, at 5:35 p.m., the committee recessed, to resume Wednesday, November 13, 1963, at 10 a.m.)

REVENUE ACT OF 1963

WEDNESDAY, NOVEMBER 13, 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), Douglas, Gore, Talmadge, Hartke, Ribicoff, Williams, Carlson, Bennett, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The Chair submits for the record statements in lieu of their personal appearance by Mr. Mark E. Richardson on behalf of the New York Chamber of Commerce; Mr. John J. Scalon on behalf of the American Telephone & Telegraph Co.; and Col. James W. Roberts on behalf of the National Association of Wholesalers.

(The statements referred to follow:)

STATEMENT OF NEW YORK CHAMBER OF COMMERCE TO SENATE FINANCE COMMITTEE, BY MARK E. RICHARDSON

The New York Chamber of Commerce, which is the oldest business organization in the United States, and which includes in its membership the major business organizations located in the New York metropolitan area, believes that it is essential that Congress provide for an early and substantial reduction in the rates of individual and corporate income tax rates.

In the judgment of the chamber it is necessary to remove the restraints on our economy occasioned by our unduly high rates of taxation, in a fiscally responsible manner; and the chamber holds that it is also urgent that Federal expenditures be kept under firm control if we are to achieve the benefits of tax reduction without unleashing inflation. Tax rate reductions should be contingent on the establishment of a firm ceiling on Federal outlays to the end that a balanced administrative budget is achieved not later than the 1966 fiscal year.

With this qualification, in the opinion of the chamber, the Senate should approve of H.R. 8363 as passed by the House, excepting in the following particulars.

DOUBLE TAXATION OF DIVIDENDS

It is most unfortunate that H.R. 8363 proposes to repeal the present dividend credit; and the chamber recommends that this feature be stricken from the bill.

The 4-percent dividend credit, written into the tax laws in 1954, was generally hailed as an important, although minor "first step" toward the solution of the problem of double taxation of distributed corporate income—taxed first at the corporate level, and then to the individual recipient.

Its repeal now would be a step backward and would run counter to the principal objective of the tax bill, which is the encouragement of the private economy to optimum operation.

As has been pointed out on numerous occasions by the New York Chamber of Commerce and by other groups, one of the principal reasons why the American

economy has not grown as rapidly as might be desired, is the relatively low level of equity investment in new and expanded plant and facilities. There are many reasons for this undesirable situation, but a major reason lies in the fact that the climate for equity investment in the United States is not as favorable as that in most of the other industrially developed countries, because of the unfavorable tax treatment of dividends.

We need a substantial increase in equity investments in new enterprise and in expanding enterprise. The establishment and growth of new ventures has historically been the base of our expanding economy. These ventures have been financed largely through risk capital. However, the existence of double taxation on the earnings of risk capital has served to discourage the placing of such equity investments. In a word—the after tax return on an equity investment does not, in many cases, warrant the risks involved.

The chamber does not agree with the reasons advanced for the elimination of the dividend credit, which may be summarized as—

(1) The proposed reduction in the corporate rate by 4 percent plus the investment credit allowed in 1962 provides more encouragement for corporate investment than does the dividend credit;

(2) The dividend credit has not increased the ratio of equity to debt financing by corporations; and

(3) The present credit discriminaties in favor of high income taxpayers.

As to the first, the fact that the rate of corporate taxation, admitted to be excessive, is proposed to be reduced, is no answer to the basic argument that dividend income is taxed twice—first at the corporate level, and then to the individual recipient—and this existence of double taxation reduces the attractiveness of equity investments so needed if our economy is to grow and prosper.

As to the second, while it may be true that the ratio of equity to debt financing by corporations has not increased since 1954 despite the presence of the 4-percent credit, it can also be argued that the ratio of debt financing may have been even higher had there been no dividend credit whatsoever. If we wish to encourage increased expansion of our economic plant, we need to make equity investment more attractive; and a sure way to accomplish this—as has been proved by the experience of other industrially advanced nations—is to remove present restraints on investment funds. Double taxation of corporate dividends remains one of the principal deterrents to increased equity investment. Rather than eliminate the dividend credit, it should be increased.

And finally, the assertion that the dividend credit is undesirable since it "* * * reduces any double taxation by a much larger percentage for the higher bracket stockholders than it does for those in the lower bracket * * *" can hardly be considered an argument of substance. The need of the economy is to encourage greater savings and investment, particularly in new and therefore more risky, and in expanding enterprises. The individuals who are able to accumulate such savings, and make such investments, are largely those in the middle- and upper-income levels, and we should encourage expanded equity investments by this group. To the extent that double taxation of corporate income acts to discourage such investment it acts as a brake on the achievement of an expanding economy.

The present dividend credit provides only minor relief from an excessive tax burden on distributed corporate earnings. Its repeal would be an unfortunate step backward. The present credit should be retained and, ultimately, increased.

LIMITATION ON GROUP TERM INSURANCE

The chamber is also opposed to the proposal to limit the employee income exclusion for premiums on group term insurance furnished through the employer, to premiums paid for the first $30,000 of coverage. This arbitrary limit, we feel, is unjustified. The chamber agrees with the proposition, stated in the report on H.R. 8363, that, "* * * from the standpoint of the economy as a whole * * * it is desirable to encourage employers to provide life insurance protection for their employees. * * * Rather than set a dollar limit on such coverage, we suggest that a more reasonable approach, and one which would be more administratively workable, would be to relate the amount of permitted coverage to multiples of an employee's salary. Arbitrarily to discriminate against the higher income earners in the matter of company-provided group term insurance coverage is most inequitable and we urge that H.R. 8363 be amended to eliminate such an obvious inequity.

STOCK OPTIONS

With respect to the proposed changes relating to the tax treatment of stock options, the chamber suggests that the effective dates for the new provisions be December 31, 1963, and January 1, 1964, respectively, rather than the dates of June 11, and 12, 1963, as presently provided in the bill.

MINIMUM STANDARD DEDUCTION

The chamber questions the wisdom of the inclusion in the bill of a minimum standard deduction, the effect of which is to relieve some 1½ million present taxpayers of any tax liability whatsoever, and their consequent loss of tax consciousness. With the present and prospective level of governmental expenditures, and in view of the huge responsibilities our Government has assumed for defense and for economic assistance to the developing countries, it would appear that the Federal Government should keep its tax base as broad as possible, to keep the public directly and personally concerned with taxes and spending. Relieving 1½ million taxpayers of any tax liability seems to the chamber to be a step in the wrong direction.

While the chamber has recommended substantial easing of the taxes borne by those with low incomes, it does not agree to their total exemption from taxes, as the bill provides; and the chamber recommends that the provision for the minimum standard deduction be deleted from the bill.

RECOMMENDATIONS OF THE CHAMBER

The New York Chamber of Commerce recommends that the Senate Finance Committee amend H.R. 8363 to eliminate the proposed repeal of the dividend credit; to modify the arbitrary $30,000 limitation on coverage of employer-furnished group term insurance; to revise the effective dates for the new provisions relating to the tax treatment of stock options; and to eliminate the provision for a minimum standard deduction. The chamber urges that the bill, so amended, be approved by the Senate.

The chamber recommends, further, that Congress give leadership to the achievement of greater restraint in Government expenditures to the end that a balanced administrative budget will be attained not later than the 1966 fiscal year. Success in this endeavor is no less important than tax reduction, and we urge that Congress hold Federal outlays rigorously in check, and confined to those programs which truly meet the strict criteria of essential national needs. Tax rate reduction should be contingent on the establishment of a firm ceiling on Federal expenditures.

Finally, the chamber recommends that Congress and the Executive jointly establish a Commission on Federal Fiscal Procedures to map proposals for achieving more responsible coordination between expenditures and revenues and the better control of Federal outlays. Present fiscal procedures do not permit the exercise of true fiscal responsibility. They should be corrected so as to promote such responsibility.

STATEMENT ON DIVIDEND EXCLUSION AND DIVIDEND TAX CREDIT, BY JOHN J. SCANLON, VICE PRESIDENT AND TREASURER, AMERICAN TELEPHONE & TELEGRAPH CO.

This statement is made on behalf of the Bell System companies on the proposal to repeal the 4-percent dividend tax credit and to incerase the dividend exclusion from $50 to $100.

The American Telephone & Telegraph Co., parent company of the Bell System, has approximately 2¼ million share owner accounts, representing about 2¾ million individual share owners. About one person in every six in the United States who owns shares in a corporate enterprise is a share owner in our business.

The Bell System is almost continually seeking new investment capital and would be helped by increasing the dividend exclusion from $50 to $100. The increase in the dividend exclusion would also be of material assistance to American industry in obtaining from investors the tremendous amounts of new capital required for economic growth and employment opportunities in the years ahead.

However, it is our view that repeal of the 4-percent dividend credit would not be in the national interest:

First, the tax bill's overall purpose is to stimulate the U.S. economy. However, repeal of the 4-percent dividend credit would thwart this purpose by reducing incentive to invest in equities and discouraging investment in plant and equipment.

Second, Government policy should be aimed at making domestic investment more attractive to help our competitive position and stem the gold outflow. Repeal of the 4-percent dividend credit would make domestic investment less attractive.

THE BELL SYSTEM'S ROLE IN NATIONAL ECONOMIC GROWTH

The Bell System's postwar financing experience points up the magnitude of possible future financing required to provide service to the public. In the postwar period, the Bell System has had to raise almost $18 billion in new capital from investors. Almost $10 billion of this amount has been equity capital, or over 20 percent of all new equity obtained by U.S. corporations from the sale of securities to investors.

The importance of the Bell System's contribution to our Nation's economic growth is highlighted by the fact that our construction programs have accounted for about 6 percent of all business expenditures for plant and equipment in the postwar period. In 1962 our program represented about 8 percent of total business expenditures for construction. These programs have not only provided an ever improving and expanding service but have been important in creating jobs and sustaining the Nation's growth. I believe it is fair to say on the basis of our experience, that both the dividend exclusion and dividend credit provisions of the 1954 law have been important factors not only for Bell System growth but for the Nation's economic growth. We believe that repeal of the 4-percent dividend credit would hinder new investment and retard economic growth.

THE ORIGINS OF DOUBLE TAXATION

Prior to 1936, dividends received from corporations by individual share owners were not subject to normal tax. The Revenue Act of 1936 introduced the concept of double taxation of distributed corporate earnings. At that time, the Nation's plant and equipment was being used well below capacity and there was virtually no demand by industry for new captial to finance expansion. Consequently, the effect of double taxation of dividend income on the growth of the Nation's economy was not then readily apparent.

FACTORS RESPONSIBLE FOR ADOPTION OF DIVIDEND EXCLUSION AND CREDIT IN 1954

By 1954 it was evident that something had to be done to lift the burden of double taxation on investment incentives. The Senate Finance Committee and the House Ways and Means Committee were explicit in stating that the reason for enacting the 4-percent tax credit and the $50 dividend exclusion was to improve the incentives for investment which had been seriously impaired by the double taxation of distributed corporate earnings. Of primary importance was the fact that companies were relying too heavily on debt because their ability to raise equity capital had been impaired. Double taxtion of dividend income had a particularly harmful effect on small businesses which could not easily borrow funds and had to rely on equity capital for survival and growth. Our only question is whether the changes made in the 1954 Revenue Act went far enough in ameliorating the crippling effects on investment incentives of the double taxation of dividend income.

IMPACT OF THE 1954 ACT

Investors's reaction to congressional action in 1954 in giving partial relief to the double tax burden has obviously contributed to the growth in share owners since that time. Only 7 million individuals owned shares in American corporations in 1954. Today, there are over 17 million share owners, an increase of over 150 percent in only 9 years. It is a rather impressive fact that growth since the passage of the 1954 act substantially exceeds the total ownership recorded in all the years prior to 1954.

Our experience since the passage of the Revenue Act of 1954 confirms this trend. Almost 1,200,000 individuals have been added to our share owner list since that time.

ARGUMENTS ADVANCED FOR REPEAL OF DIVIDEND CREDIT ARE NOT SOUND

I would like to discuss briefly the main arguments advanced for repeal of the 4-percent dividend tax credit provision in the 1954 act because I believe that these positions are not sound.

The argument that the dividend credit did not encourage equity investment

The advocates of repeal assert that the 1954 act has "failed to encourage equity investment." The facts are that the average annual amount of new equity financing by all corporations in the 9 years after the enactment of the dividend provisions increased 68 percent over the average annual amount in the previous 8-year period. On the other hand, new debt financing increased only 47 percent in the same period. Significantly, equity financing has grown 1½ times as much as debt financing since the passage of the dividend exclusion and credit in 1954 as shown in exhibit A.

Proponents of repeal argue that other factors are responsible for rapid increase in stockholders since 1954. They cite the rise in corporate profits but the rate of corporate profits today is actually lower than when the provisions were enacted into law by the Congress. The growth in the amount of equity financing is even more impressive because debt financing has tax exemptions and upper bracket taxpayers enjoy the benefit of tax-free municipal securities.

The argument that the dividend credit has not provided an effective solution to double taxation of dividend income

The position that the dividend credit provision fails to provide an effective solution to the problem of double taxation assumes that the changes in 1954 were enacted as a means of tax reduction. However, the committee reports clearly state that the purpose of the provisions was to give partial relief to the punitive effects on investment incentives of the double taxation of distributed corporate earnings.

Other nations, including England and Canada, allow much more credit for taxes paid on the corporate level, against individual income tax on dividend income than does the United States. If our Nation is to improve its competitive position and balance its international payments, it would seem that the dividend credit should be extended rather than repealed. There is do doubt that repeal of the 4-percent dividend credit would be an incentive for U.S. investors to invest less in U.S. securities and more in foreign securities.

The argument that the 4-percent dividend credit is discriminatory and inequitable

The 4-percent dividend credit is alleged to provide more relief to taxpayers in high income tax brackets and hence is discriminatory and inequitable. The tables and statements used to support this argument merely demonstrate that U.S. income tax rates are too steeply progressive.

The fact is that the 4-percent credit favors the individual in a low income tax bracket by removing a larger proportion of the tax he must pay on dividends than is the case for the individual in a high income tax bracket. Except for this provision a person in the 20-percent tax bracket with $100 of taxable dividend income would pay $20 of tax, while a person in the 91-percent bracket would pay $91. Accordingly, for a taxpayer in the lowest bracket, the saving is 20 percent, while for the man in the highest bracket it is 4.4 percent. Exhibit B shows this trend quite clearly. Both these individuals receive the same dividend credit of $4. Even with the reduced tax rates proposed for 1965, the relief will be five times greater for the man in the lowest tax bracket than for the man in the highest tax bracket.

When the 1954 provisions were being drafted into the law, Marion B. Folsom, then Under Secretary of the Treasury, in testimony before your committee said, "The percentage reduction of tax under the combined dividend exclusion and credit is greatest for the lowest tax rate and declines progressively as income level rises."

The argument that the proposed four-point corporate rate reduction will provide equitable relief

Proponents of repeal say that the proposed four-point reduction in the corporate rate will provide equitable relief from the double taxation of dividend income. Double taxation is not removed by reducing the tax rate applicable to corporations and at the same time imposing an additional tax burden on the recipients of corporate dividends. Furthermore, this will operate to defeat the

benefits hoped to be achieved through the reduction in the corporate tax rates. Exhibit C shows the burden of double taxation will continue to operate with heavy impact, even under the proposed reduced rates.

NEW EMPLOYMENT OPPORTUNITIES AND ECONOMIC GROWTH

To meet the Nation's communications requirements, the Bell System must continue to raise many more billions of dollars in the years ahead. Similarly, industry generally must spend more, not less, for plant and equipment. The supply of investment capital is not an unlimited reservoir but can be great or small depending on investors' attitudes. With an atmosphere of confidence, investors will have an incentive to commit their capital—otherwise they will not.

Today it takes an average investment of about $12,000 to support each job in American industry and some industries require several times this amount. President Kennedy has stated that to reduce unemployment to an acceptable level in the next 2½ years, 10 million new jobs must be created. Accordingly incentives must be provided to channel savings into business enterprise in the immediate future. Clearly, existing incentives for equity investment should not be impaired, rather they should be improved.

The passage of the 4-percent dividend credit in the 1954 act was widely heralded as a first step to eventual elimination of punitive double taxation of dividends. Repeal of that provision would constitute a backward step.

We strongly urge, therefore, that your committee retain the dividend credit by deleting from the bill the provision calling for its repeal.

EXHIBIT A

External financing of all U.S. corporations,[1] 1946–62

[Dollars in billions]

	Equity	Debt	Total		Equity	Debt	Total
1946	$1.3	$5.0	$6.3	1957	$3.5	$8.7	$12.2
1947	1.4	6.3	7.7	1958	3.6	6.9	10.5
1948	1.2	6.5	7.7	1959	3.7	11.3	15.0
1949	1.6	1.0	2.6	1960	3.0	8.0	11.0
1950	1.7	4.6	6.3	1961	4.5	6.9	11.4
1951	2.7	9.0	11.7	1962	2.1	10.5	12.6
1952	3.0	8.0	11.0				
1953	2.3	5.2	7.5	Total, 1954–62	28.4	75.2	103.6
Total, 1946–53	15.2	45.6	60.8	Annual average:			
1954	2.1	3.2	5.3	1946–53	$1.9	$5.7	$7.6
1955	2.7	9.6	12.3	1954–62	$3.2	$8.4	$11.5
1956	3.2	10.1	13.3	Percent increase	68	47	51

[1] Survey of Current Business, U.S. Department of Commerce and Economic Report of the President, January 1963.

EXHIBIT B

Percent of individual income tax on $100 of dividends in excess of dividend exclusion removed by the 4-percent dividend credit

Individual income tax rate		Individual income tax—$100 of dividends		4-percent dividend credit	Percent individual income tax removed by 4-percent credit	
Present	Proposed	Present	Proposed		Present	Proposed
Percent	*Percent*				*Percent*	*Percent*
20	14	$20	$14	$4	20.0	28.6
38	32	38	32	4	10.5	12.5
59	50	59	50	4	6.8	8.0
81	66	81	66	4	4.9	6.1
91	70	91	70	4	4.4	5.7

EXHIBIT C

Tax burden on $100 of corporate taxable income with proposed tax rates

Individual income tax rate (percent)	Corporate income tax at 48 percent	Individual income tax on $52 of dividend	Total tax per $100 corporate taxable income
14	$48	$7.28	$55.28
16	48	8.32	56.32
19	48	9.88	57.88
32	48	16.64	64.64
50	48	26.00	74.00
60	48	31.20	79.20
69	48	35.88	83.88
70	48	36.40	84.40

NOTE.—Assumes $52 distributed as dividends after paying $48 corporate income tax.

STATEMENT OF COL. JAMES W. ROBERTS ON BEHALF OF THE NATIONAL ASSOCIATION OF WHOLESALERS

My name is James W. Roberts, I am chairman of the board of the Henry B. Gilpin Co., a wholesale drug firm of Norfolk, Va. I make this presentation as the chairman of the Government relations committee of the National Association of Wholesalers, a federation of 39 national wholesale commodity line associations representing more than 16,000 individual wholesale firms in the Nation.

We appreciate this opportunity of expressing the views of a large segment of the wholesale industry on the pending tax legislation as passed by the House of Representatives.

The measure now pending before this committee, H.R. 8363, has been termed a tax reduction and tax reform bill. In a release of September 1, 1963, the Treasury estimated the total net tax reduction at $11.06 billion. Those who espouse tax reduction at this time claim it will accelerate economic growth, stimulate demands an incentives to invest, and increase employment. These are indeed all worthy goals. We note that others cling to the traditional concepts of a balanced budget as being the soundest course in peacetime.

We do not express support for or opposition to tax reduction at this time. The complexities which govern such a basic decision are beyond our area of competence. The balance of payments, the level of the public debt, the need for more Federal programs, both defense and nondefense, are just a few of the factors to be weighed before this committee and the Congress can act. Our testimony begins with the premise that if Congress determines that significant tax reduction is desirable at this time, we might contribute by giving our views as to how these reductions should be made.

One of the most pressing arguments the administration has put forth in support of its recommendations for tax reduction and reform has been that it is necessary to help meet the continuing unemployment problem. I point this out, Mr. Chairman, because last year in your consideration of the so-called investment credit the administration also recommended its passage as a stimulant to employment as well as a stimulant to business modernization and expansion.

In presenting the tax message to the Congress this year, the goal expressed by the President—to lift the burden of taxation on the business community and thereby stimulate the economic pulse rate—is commendable. The proposals now lying before this committee, plus the business incentive provisions in the Revenue Act of 1962, need to be critically examined to determine whether or not they meet certain basic premises.

It is vital to economic growth to require that any tax saving be tied to actual additional investment for modernization and expansion of business. In other words, any revenues lost to the Federal Government should result in new capital availability to income-creating, job-producing, and revenue-producing business activity—resulting in increased revenues and employment.

Last year, the Congress provided a tax incentive for increased investment in depreciable personal property. It is too early for any reliable statistical data to be compiled which would indicate the response of the business community to this tax incentive. It is interesting to note widespread press reports of planned

increased investment in plant and equipment spending. Unfortunately wholesaling and distribution had no incentive in the 1962 tax law to encourage expansion similar to the incentive extended to the manufacturing companies, which have 85 percent of their capital invested in depreciable personal property.

Most reports of increased investment come from producers of basic commodities, commodities which must be processed and then moved through the channels of distribution to the ultimate user.

In this country there are many unused and underused productive and manufacturing facilities. Some of these facilities are idle because they are too obsolete to produce at a competitive price. But others are not used to capacity because the products they can produce are not being moved in large enough quantities through the channels of distribution to the ultimate consumer. The Congress should take careful note of this fact and examine three vital uses of capital.

First, capital used in producing goods and commodities. The Congress has granted a tax incentive for this use of capital and the Treasury has overhauled the depreciation rate regulations to add incentive in this area.

Second, capital used to expand inventories. An expanding population and an expanding array of products require vast supplies of new capital if products are to be made available in inventories when, where, and as the consumer needs them. Even though we are trying to increase turnover for profit reasons, we still require more inventory investment as volume grows.

Third, capital used to expand credit—the capital to facilitate the acquisition and purchase of goods and commodities both by distribution and service industries and by consumers.

Unfortunately, the administration's tax proposals of 1962 and 1963 ignore the need for tax incentives to increase business investment in inventories and accounts receivable. Will the increased investment in productive machinery accelerate the movement of goods and commodities into the hands of the ultimate user, or will it merely accelerate their production and piling up on the "loading out" dock of a factory? Are we building a vast generating plant and no new transmission lines? Are we building a pipeline, large at one end and small at the other, and hoping that the small end will expand in some mysterious way to transmit the output from our production lines? Let us not make this same mistake by underrating the value of distribution.

As wholesalers, we are not here to advise this committee on every segment of business activity. Our function is the movement of goods and commodities from farms and factories to business users and retailers. The latter, of course, move them directly into the hands of the ultimate consumer. We consider ourselves highly knowledgeable in this field of distribution, and the requirements to increase the rapidity of flow of goods and commodities to consumers through the Nation's distribution channels.

We view the 1962 tax law as being an unfinished job. We foresee inadequate transmission lines, if I may use an analogy from the electrical industry. Let me describe to you how distributors increase their sales, and the capital requirements needed to accomplish such an increase.

Approximately 85 percent of the capital investment in the wholesale industry, Mr. Chairman, is invested in inventory and accounts receivable. We merchant wholesalers increased our investment in inventory by $395 million in 1962 to increase our business volume by about $8 billion. For every new dollar invested in inventory, it takes just a little less than a dollar of increased investment in accounts receivable to keep goods moving through the distribution pipelines. We estimate that merchant wholesalers increased their investment in inventory and receivables by over $700 million[1] last year or between 8 and 9 percent of the increased dollar volume of our sales, over 1961, of $8 billion.

But 1962 was not an unusual year. That is about the ratio of absolutely essential and necessary new capital we must invest in our wholesale businesses if we are to increase the sales and consumption of the output of our supplying factories, mines, and farms. Without that increased investment in inventory and receivables, Mr. Chairman, by someone, the total sales and total consumption of the output of our manufacturing and producing facilities cannot be sold.

We wholesalers say, "You may eliminate a wholesaler from the marketing system, but you cannot eliminate his function—someone has to perform it." If we don't carry that inventory near the point of consumer demand, the sale may be lost. If we wholesalers cannot extend that credit to the retail or business-user customers of ours, the sales may be lost. It's as simple as that.

[1] National Association of Wholesalers estimate.

Retail dealer and service trade and other business-user customers of the wholesale industry are almost entirely dependent on trade lines of credit granted by us to stay in business.

We wholesalers must obtain most of our additional capital from retained, after-tax earnings. Let's look at that picture.

For the past 30 years, the National Wholesale Druggists Association has published an annual cost-of-doing-business study showing the operating ratios of its member houses. The study is compiled by Dr. Orin Burley, Wharton School of Finance and Commerce, the University of Pennsylvania.

For the year 1961, the latest figures available, the wholesale druggist's net profit before taxes ran 3.18 percent of sales. After taxes, net profits were 1.55 percent of sales, to pay dividends to investors and provide capital for expansion. Now what about the ratio of profit to total assets? For 1961, the after tax profits were only 4.7 percent of total assets.

Between 1950 and 1961—a span of 11 years, these wholesale druggists increased their sales by 85 percent, or an average of almost 8 percent per year. How do we increase sales? By having a wide selection of goods and commodities when, and where needed by our retailer and institutional customers and by extending credit to help the potential purchaser buy the product.

An increase in the volume of sales requires an increase in investment in inventory and accounts receivable. I earlier stated the wholesale druggists' return on assets after taxes was 4.7 percent. If this industry is to attract any new capital it must offer a rate of return somewhere near the level offered by other industries. With Government-insured savings and loan deposits returning 4½ percent and banks up to 3½ percent, the need to pay a larger dividend is strong, leaving precious little of our after-tax profits to increase our investment in inventories and accounts receivable.

But we, in the wholesale drug industry, are more fortunate even than the average wholesale corporations in the United States. In 1957–58, the latest years on which figures are available to me, according to the Statistics of Income,[1] covering over 80,000 wholesale corporations in all commodity lines, the net earnings before taxes was only 1.90 percent of sales. This is only about two-thirds of our drug wholesaler earnings on sales and we have only 4.5 percent profit after taxes on assets to provide dividends to our investors and to expand our business to sell more.

Dun's Review and Modern Industry, November 1962, reports "14 important ratios in 24 wholesale lines of trade." The median net profits on tangible net worth after taxes of 14 of the 24 wholesale lines is reported as between 4 and 6. Three wholesale line ratios are less than four. The average wholesale business very obviously earns a very low return on invested capital.

While we recognize that it is not yet possible to prove, statistically, that the 1962 7-percent tax credit has stimualted increased investment in depreciable property, as defined in the law, we feel that current company and trade paper reports, earlier referred to, would indicate that it has. We know, however, that it will have very little, if any, stimulating effect on the distribution industry as 85 percent of its necessary business investment is ineligible for the credit.

We therefore suggest that your committee consider amending the 1962 tax credit law to extend the credit to aggregate increased investment in inventory and accounts receivable. This could be accomplished in one of two ways:

(*a*) By adopting alternative tax credit formulas. Either the present tax credit formula on the qualified depreciable personal property base, as defined in the 1962 law, or, as an alternative, by applying the 7-percent credit to aggregate increased investment in depreciable assets, inventory and accounts receivable on a moving average base as was developed by the joint committee staff on internal revenue taxation when the 1958 tax law was under consideration by the House committee, or

(*b*) By adopting a completely separate tax credit formula for aggregate increased investment in inventory and receivables only, on a moving average base, available to all business on an equal basis, regardless of whether or not they use the 1962 law with respect to defined, eligible depreciable personal property.

This does not mean a tax credit for inventory replenishment. We are talking about expansion of inventory and accounts receivable to stimulate an expansion of sales—to move more goods to consumers.

[1] Federal Reserve Board (1957–58).

It is well to point out why we tie these two together. The largest volume of retail sales comes in the month of December. In that industry, inventories peak at the first of December, and frequently reach the trough at the first of the year, when their accounts receivable are high. For the wholesaler, the greatest sales volume comes in October and November, and our accounts receivable peak in December. In other words, the capital flows back and forth between these two accounts, as seasonal peaks and valleys in sales generate conversion of investment from inventory into receivables and vice versa.

The new capital requirements of small- and medium-sized business to just keep up with the growth in gross national product and in the economy as a whole are significant. Since 85 percent or more of these businesses are unincorporated, they do not have access to public financing and they must thus look to after-tax earnings as their major source for increased capital to invest in expansion and modernization of their business operations. Unincorporated retail outlets more 50 percent of all retail trade. These outlets are our customers, so we are quite familiar with their problems.

This problem is more complicated in the more successful wholesale and retail business operations. The more successful they are—the more they are expanding their business volume in excess of the rate of growth of the economy as a whole—the greater is their additional capital requirement.

There is almost what one might call a fixed ratio of total dollar volume of sales to investment in inventory and receivables, in the wholesale and retail trade. Both the wholesaler and the retailer must have the goods on hand if they expect to sell them. They must also be in position to extend credit, in practically all cases, at least terms of credit normal to the trade. Neither reduced operating nor increased operating efficiency have much effect on this sales volume to inventory and receivables ratio.

It thus becomes quite clear to us that if you ignore the needs of the distribution and service segment of the business community—the largest and fastest growing employing segment of the economy—in your tax plans to stimulate growth in the economy—you are choking the main fuel line of the whole economic machine, as ours is an economy that feeds only on sales.

There is one other aspect of this tax credit recommendation that should be noted. No credit is earned until after the fact of the increased investment—the stimulation of the economy takes place before the credit is available.

We believe that this recommendation will do much to stimulate distribution, employment, production, and, most importantly, sales and thus consumption of the output of our expanding economy. Such stimulation will obviously produce more Federal revenues.

In summary, Mr. Chairman, we are very much concerned, as an industry, about the fiscal as well as economic problems of the Federal Government and the economy as a whole. We are encouraged that the President has vowed to hold Federal expenditures to the 1962–63 levels and would hope that the Congress may be able to find areas of actual cuts below those levels. Hopeful, therefore, that Federal expenditures can be held or reduced to partially offset revenue losses from tax rate reduction and tax credit formula broadening, we would recommend to this committee—

(1) That the 1962 tax credit law be amended to provide an additional 7-percent credit for aggregate increased investment in inventory and accounts receivable,

(2) That the corporate normal and surtax rates be reversed, as contained in the House bill,

(3) That the corporate surtax exemption be increased from $25,000 to $50,000, as recommended by Senators Sparkman and Saltonstall, ranking members of the Senate Small Business Committee. The staff of the Senate Small Business Committee report that the Treasury estimates the revenue loss from such action at not over $500 million a year. We believe that this would be a significant aid and stimulus to growth investment by many closely held, family corporations whose shares are traded over the counter without ready access to the capital markets. This type of corporation predominates in the distribution and service trades, where, it must be remembered, a majority of all businesseses are unincorporated.

(4) That individual income tax rates be reduced in all brackets by approximately the same percentage, such percentage to be determined by the overall budget situation and the economic needs of the Nation.

(5) That the reduction in the overall corporate tax rates, as contained in the House-passed bill, be approved.

(6) That the repeal of the Long amendment which reduced the depreciation base for investments qualifying for the tax credit, and is now contained in the House bill be approved.

(7) That the estate tax exemption of $60,000, established in 1942, be increased to $120,000 to compensate for the deterioration in the value of the dollar and thus in the real value of small estates exempt from the tax.

We would call your attention to one other economic fact of life that disturbs us greatly and that we believe deserves your careful consideration. There is a disturbing trend toward mergers and acquisitions in the American economy. The so-called "bigs" are getting bigger and the "littles," if I may coin a term, are selling out, especially the successful "littles."

We believe that the estate tax situation has had some harmful effect on this trend and this is why we recommend an increase in the estate tax exemption.

We are even more seriously concerned about one of the administration's reform proposals, the taxation of capital gains on assets transferred at death. It is our firm belief that many mergers and acquisitions in the distribution and service trades are caused by estate tax and other death tax considerations. It is our considered judgment that enactment of the administration's proposal in this area would seriously complicate the death and estate tax problems of many small- and medium-sized proprietorships, and closely held, family-owned corporations. We urge this committee to reject the administration's proposal or any variation of it which would add to estate tax burdens.

We appreciate the opportunity to present these views on behalf of the Nation's wholesalers.

The CHAIRMAN. The Chair recognizes the Senator from Georgia to introduce the first witness.

Senator TALMADGE. Mr. Chairman, it is my pleasure this morning to present to this committee a longtime friend, one of Georgia's most outstanding citizens, Dr. Harry L. Brown, president of the Georgia Farm Bureau Federation.

Dr. Brown is an outstanding farmer in his own right. He has had a long and distinguished career in our State. He started off with the Extension Service. He served during the administration of President Roosevelt as Assistant Secretary of Agriculture. He served with distinction in the Georgia Legislature. He is now president of the farm bureau, and I am honored to have him appear before this committee.

The CHAIRMAN. Mr. Brown, you come forward, sir, take a seat and proceed.

STATEMENT OF HARRY L. BROWN, PRESIDENT, GEORGIA FARM BUREAU FEDERATION

Mr. BROWN. Thank you, Senator Talmadge.

Mr. Chairman and members of the committee, we appreciate the opportunity to present Georgia Farm Bureau's views with respect to Federal tax policy. Georgia Farm Bureau has a membership of more than 43,000 families in 156 counties of our State. The policy of the Georgia Farm Bureau and the American Farm Bureau is developed through an extensive democratic resolutions process whereby farm families discuss problems and develop recommendations on issues which affect them as farmers and as citizens of the United States. Rates of taxation and the system used in assessing taxes are vitally important to Georgia farmers. The comments made in this statement are based on policy recommended by the Georgia Farm Bureau Federation and adopted by the American Farm Bureau in December 1962.

Farm bureau is opposed to the enactment of H.R. 8363. We believe that a tax reduction in the amount proposed in this bill without assured

reduction in expenditures would be fiscally irresponsible. The enactment of this legislation would—

Increase the deficit;
Further enlarge the national debt;
Threaten inflation; and
Retard the national economic growth.

Taxes are undesirably high but our fiscal management in Federal Government thus far has not earned a tax cut. In fact, in recent years we have consistently "borrowed from the future" by deficit spending. The Federal Government has spent more than the revenue received during 27 of the past 33 years. The ever-increasing national debt has become of great concern to the American people.

Since over 80 percent of Federal revenue comes from income tax, either individual or corporate, income tax reductions as recommended in this bill would have a significant effect on the Federal Government's total revenue. If Federal taxes are decreased, this would mean an increased national debt with a threat of inflation and loss of confidence in our economy. This would discourage investment and reduce sound economic growth.

Farm bureau rejects the idea that we can have a tax reduction without earning this reduction through reduced expenditures. We reject the idea that the biggest budget in the history of this country cannot be substantially reduced. We contend that the budget should be cut and must be cut before a basis for a sound tax reduction is provided.

Farm bureau opposes reduction in taxes until effective action has been taken to reduce Government expenditures.

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 $4.7 billion cut achieved thus far by the House 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 thus far by this session of the Senate, House cuts totaling $530 million have been restored. Therefore, Congress has to date reduced the obligational authority requests of $108 billion by only $2.2 billion in appropriation bills thus far completed.

In view of this record, a tax cut has not been earned through effective control of Federal expenditures.

Farm bureau feels that sound fiscal policy must be achieved before tax reductions are made if we are to realistically assume our responsibilities as self-governing people. There is no question that tax reductions could be beneficial and most popular, but we as American citizens have a responsibility to future generations to assure them that the economy of this country is kept sound and vigorous. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Brown. The farm bureau has been a bulwark for sound government for many, many years, and I am very proud of the fact that I have been a member of the farm bureau from the very beginning.

You are, of course, aware when you have spoken of the $108 billion of obligational authority, that there is $87 billion of unexpended balances in addition to that?

Mr. BROWN. Yes, sir.

The CHAIRMAN. In other words, if $108 billion of obligational authority is enacted by this Congress there will be a total of nearly $200 billion which the President can spend.

Now, many people think that Congress alone can reduce these expenditures. As a matter of fact, the President, using the authority he already has, can spend from the unexpended balances of $87 billion, even though the Congress reduces the appropriation bills that are pending.

Mr. BROWN. I realize that, Mr. Chairman.

The CHAIRMAN. So what I want to make clear is that the action of the President is vital, in conjunction with the Congress, in reducing expenditures. The Congress alone cannot do it because of these unexpended balances that are being carried over.

I thank you very much, Mr. Brown.

Senator Talmadge.

Senator TALMADGE. Mr. Chairman, I have no questions, but I do want to compliment Dr. Brown on his statement. I have seen many witnesses spend more than 2 hours to say less than Dr. Brown has said in 5 minutes.

The CHAIRMAN. Are there any other questions? Thank you very much, Mr. Brown.

Mr. BROWN. Thank you.

The CHAIRMAN. The next witness is Mr. Benjamin A. Javits. Mr. Javits, come forward, sir. Mr. Javits is president of the United Shareowners of America, Inc. Take a seat, sir.

STATEMENT OF BENJAMIN A. JAVITS, PRESIDENT, UNITED SHAREOWNERS OF AMERICA, INC.

Mr. JAVITS. I thank the committee for offering me this opportunity to appear. I will read a prepared statement if I may.

I am appearing on behalf of the United Shareowners of America, Inc., the only independent, unsubsidized, nonprofit, general organization of investors from every State of the Union.

I wish to thank you for giving me the privilege of presenting the views of these investors on H.R. 8363, which is now before you.

We have appeared before this Congress several times at hearings on the capital gains tax, asking that both the tax rate and the waiting time be cut in half. We wish now to reiterate that position with the following amendment: that the capital gains tax be waived on securities or property held longer than 2 years by individuals over 60 years of age. This would enable them to increase their buying power, to the benefit of all concerned.

We have appeared previously also on the question of the $50 deduction and the 4-percent dividend credit. Our position is that both the deduction and the credit should be eliminated, and that all dividends be tax free, while the 52-percent corporate tax is retained. If, however, the Congress retains the double taxation on dividends of the owners of American business—the shareowners—the deduction and the credit must, in our opinion, be retained, or indeed increased, to increase the buying power of consumers.

Thirdly, we urge you to adopt a counterpart to the wartime excess profits tax; namely, an excess investing tax. If, in any given year,

a corporation invests in building and/or machinery more money than it did, on the average, in the preceding 3-year period, there should be a 3-year writeoff on all such excess investing. This might put a real dent in the unemployment figures.

In making these suggestions, we are motivated by the belief that the tax burden should be gradually shifted from the individual to the machine in our machine civilization. Our civilization, which has passed on to the machine most of the backbreaking jobs of the past, should now be passing on to it most of the profitbreaking jobs of the present.

Net profits have been much too low and, therefore, the overall rate of economic growth has been much too low. I want to interpolate here that the emphasis on savings is not as important as on increasing the profit rate. When net corporate profits are about 10 percent of the gross national product, as for example in 1950, the economy is practically without unemployment and there is a substantial increase in the buying power of consumers.

Confiscating profits and concentrating taxation on the individual is an outmoded method of "soaking the rich" in order to gain political favor with the masses. But, today, in this country profits of all American people are at stake. Aside from the 18 million direct stockholders, there are 80 million insurance policy holders, over 50 million savings bank depositors, 30 million homeowners, 7 million farmowners, 4 million small businessmen, over 50 million bondholders and other property owners. Today in this country, high personal taxes and high taxes on profits "soak" everybody, and do not really help solve the big problems of unemployment and undercapacity production.

We endorse any reduction of personal taxes and corporate taxes. We endorse the design of H.R. 8363 to put more buying power into the hands of the American people and to increase the flow of funds for investment.

Inflation, created when public money is used for nonprofitable purposes (as for instance, for armaments, welfare, and other efforts which must be undertaken at the present time), is a danger of which we need not be afraid. Our balance sheet—I mean temporarily—in this respect is in good shape. We have a $500 billion private debt and about a $500 billion public debt (including a $300 billion debt of the Federal Government). We have an economy which produces a gross national product of over $560 billion, at the present rate. We have a plant which could not be replaced for less than $10,000 billion. Why be afraid of inflation of $5 or $10 billion if the economy is ultimately to be put on a sound basis through a bold tax reform?

What we need to fear is a weak profit structure. In 1963 our net corporate profits will not be in excess of $28 billion—out of a gross national product of $560 billion. This is supposedly a very good year. But, compare it to 1950, when we had a $24 billion profit net on a gross national product of $260 billion. The comparison shows a 15-percent increase in profits in 12 years against a 100-percent increase in gross national product.

Our trouble is the great disparity between our production power and our purchasing power, as everybody knows. This disparity is caused by a basic weakness in our tax laws which hampers purchasing power. It can be corrected if the Congress and the administration, I mean on a permanent basis, will someday have the courage to put

our tax structure on the basis of excise taxes, sales taxes, land improvement taxes, and other basic taxes, burdening production and machinery to a greater extent and the individual to a lesser extent. No country in the free West can make real progress with personal tax rates as high as they are in this country. Even the Socialist countries, or most of the Socialist countries, for example, a country like Mexico, have a top personal tax rate of 30 percent.

Business cannot operate (in the public interest) on the basis of mass production, unless you help raise mass consumption by increasing mass buying power.

It has been estimated that about $10,000 is required to create a useful job in modern industry for one man. This means that $50 billion must be made available to American business in order to put 5 million unemployed back to work. And another $10 billion in profits yearly must be in sight for American business to keep these people at work, especially with the increase in population. Here the tax bill also becomes of vital importance.

Turning to the world beyond our borders, we find ourselves faced with the necessity to fight the cold war and to aid developing nations. That effort, too, takes billions, and further billions could be usefully spent on it. With sound profits, we could help people all over the world achieve an economic plateau similar to ours, and in the process take care of communism and all the other evils emanating from poverty, insecurity, disease, and ignorance.

We urge the Congress to help the American economy through the best features of the bill now before you and through the improvements we sponsor. We hope that the next Congress will then go on to a basic overhaul of the tax laws which, along with the antitrust laws, are a great barrier to substantial, noninflationary economic growth, prosperity, and security. Thank you.

The CHAIRMAN. Thank you Mr. Javits. Any questions? Thank you very much, sir.

The next witness is William H. Peterson, professor of economics, New York University Graduate School of Business Administration.

Mr. Peterson, take a seat, sir, and proceed.

STATEMENT OF WILLIAM H. PETERSON, PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY GRADUATE SCHOOL OF BUSINESS ADMINISTRATION

Mr. PETERSON. Mr. Chairman, thank you for this opportunity of appearing before this very distinguished body.

I have a prepared statement, as you know, a rather long statement, but I know your time is more precious than mine, and I would like, if I may, just to make some extemporaneous remarks, basing my remarks, if I may in part not only on my own statement but on that of Dr. Heller.

I may add I had the pleasure and the very edifying experience of being in this hearing room yesterday when Dr. Heller gave his statement.

I will disagree some with Mr. Heller and, let me say at the outset, I regard Mr. Heller as an outstanding economist, a scholar, and a gentleman, a man of many more accomplishments than my own, and

while I agree with his goals, I do disagree with the means by which he wants to arrive at these goals.

The two points of agreement between my paper and Dr. Heller's are that we both want a tax bill, and we both want greater economic growth. The problem arises how are we going to get this growth.

Dr. Heller is of another persuasion, and he believes that public demand and private demand are really indistinguishable from one another in their effect on the economy.

On page 9 of his statement yesterday, for example, he makes this remark, and I quote:

> There can be no serious quarrel with the proposition that relative to the strength of public plus private demand, taxes have been too high since 1957.

I do not believe the equation between public and private demand is entirely equal. I would like to say that public demand is always at the expense of private demand; that every tax dollar is necessarily withdrawn from private demand, and to the extent that you have public demand you necessarily lose private demand.

Now, I think I disagree with Mr. Heller on three major points. The first is the matter of unemployment. There is little doubt that tax reform can improve the unemployment situation, but I do not think that we can make the tax bill the burden for curing the entire unemployment problem.

For example, in my own paper on page 1, I quote from the President's Economic Report, and you will see there a line—I presume it was under the authorship of Dr. Heller—where it indicates, and I read:

> The source of high unemployment rates in recent years, even in periods of cyclical expansion, lies not in labor market imbalance, but in the markets for goods and services.

In other words, he is again stating his "inadequate demand" theory.

Now, in the President's Economic Report and in his statement of yesterday I saw no reference, Mr. Chairman, to any sense of understanding the problem of unemployment insofar as it relates to excessive wage rates.

I hold that part of the unemployment problem, and a big part, happens to occur because of the excessive union bargaining power and excessive minimum wages.

We all know that it is basic economic theory that a high price does two things: it encourages supply and discourages demand. We have seen our farmers, for example, losing markets because of support prices set at such a high level as to discourage demand and encourage supply.

I submit, Mr. Chairman, that you have a relationship, an analogy, between surplus farm products and surplus American labor. Both are in large measure attributable to overpricing, on the one hand, of a commodity and, on the other, a service.

I feel this very strongly, and in my paper on page 13 I quote from Senator Douglas' study which he wrote in 1934 as follows:

> If wages are pushed up above the point of marginal productivity, the decrease in employment would normally be from three to four times as great as the increase in hourly rates so that the total income of the working class would be reduced in the ratio indicated above.

That is a remarkable statement, and it shows, and I think it is a true statement, that there is a very great degree of elasticity of demand for American labor. If the price is excessive, it will necessarily follow that workers will be unemployed to some marked degree.

I think, for example, that I bring this out in my paper, that coal miners and our steelworkers, both of whom are heavily organized industries, have relatively high unemployment because of excessive union bargaining power.

The only reason I mention this is, of course, that you cannot expect the tax bill to do the impossible. It can do a great deal but it cannot do everything.

Now, another point related to this unemployment problem is the entire question of productivity. I think you Senators have to consider, please, the problem that according to the BLS our war babies are growing up, and our labor force is about to expand very dramatically. The increase in labor supply, in our labor force, in the 1950's has been on the order of 1.2 percent. In the 1960's that rate will go up to about 1.7 percent or almost 50 percent more. This means that we need a vast amount of capital. I do not believe we can do this through the consumption approach of the administration.

Senator RIBICOFF. May I interrupt, Mr. Chairman?

Mr. PETERSON. Sir?

Senator RIBICOFF. The question I pose—since you were here when Dr. Heller was testifying, and now you raise the question of the so-called war babies—what would you do to put to work these 725,000 unemployed youngsters between 16 and 19 years of age? Will this tax bill do it?

Mr. PETERSON. Sir, I would have to think about that. I would say this: that part of the problem, as I have indicated before, is the problem of minimum wages.

There are those among us, among the American people, who cannot earn the minimum wage required, that is to say, their productivity does not warrant the $1.25 which is in our minimum wage legislation. That is one problem.

You also have the problem of unemployment compensation, which to some degree induces some workers to actually avoid jobs.

Senator RIBICOFF. Would there be jobs? Let us say even those youngsters worth $1.25, what jobs would there be available in our industrial plants for these boys and girls even at $1.25?

Mr. PETERSON. Senator, I think you made some very fine points yesterday when I was in the audience, and I do think your stress on automation as requiring great skills is valid to a degree. We do need highly educated, highly trained, highly skilled individuals. But I also believe that there is a great growth potential, and we have seen it in the past decade, in the service industries. Now, in the services, I believe there is much less skill required than on many automated assembly lines, and so on. So I personally am not convinced that we have the problem of skills in the dimension you indicate.

Senator RIBICOFF. What, for instance? Once upon a time these people would run elevators. Today there are very few new buildings in the United States where the elevators are not automated, so you eliminate this unskilled labor that used to run an elevator.

Even cleaning buildings—today if you go into a modern building you see all this machinery that replaces people to do much of this type of work.

Even in washing automobiles, you go into an automobile wash place, and your car goes through and all the brushes do the work instead of this unskilled labor that did it by hand. Now, you are an economist,

you have given thought to this. How do you go about putting these youngsters to work?

Mr. PETERSON. Well, I get the implication, Senator, from your statement that automation is a preclusion to full employment.

Senator RIBICOFF. It is not a preclusion to full employment, but it is just one of the problems.

After all, here you have a disproportionate amount; in this age group you have unemployment of over 20 percent as against the general population of 5.6 percent; so, therefore, you have a disproportionately larger number of this age group unemployed.

As each year goes by with this present group in our society, the chances are if you do not do something about it they end up as a permanent part of our welfare rolls. They get married and have children, they have no skills and no jobs. Now, what would you do for these people?

Mr. PETERSON. I would have to develop that a little more, Senator, and I will bring it out in my further remarks, but I would like to leave you with this thought, that the problem of automation is obviously not a new one. In my judgment, it extends all the way back to the industrial revolution. In fact, I see no gap, no break, in the growth of what we presently call automation; I do not regard this as the second industrial revolution; it is merely an extension of the first, and I do not believe there is any limit on the amount of work to be done. I do not believe there is any so-called slump of work; there is literally an infinite amount of work to be done, and in the service industries we have seen, and in the service trades we can have, examples of what can be done.

Clearly, for example, we have had a great rise in beauty shops, for example. More women, apparently, because of our rising standard of living, can afford to have people, cosmeticians and the like, take care of their beauty needs, and I think there are many more examples which, if we both thought about it for a while, would come to mind.

And I do see perhaps that there is a lot of yardwork around the Ribicoff residence where, if you have some young people, they might be willing to work, but many are not, in fact, willing to work. Their instinct of workmanship is missing.

What I am mainly trying to establish, however, is the need for an economy where prices are reasonably flexible and where we can ever therefore adjust supply to demand.

The great problem, as I see it, is that we have wage rigidity, to some extent induced by law, but to a larger extent induced by trade unions. I believe in trade unionism, but I question whether we have not armed our unions to a degree where inadvertently they are pricing themselves out of markets; and this, I think, is a small tragedy.

I am not at all critical of our labor leaders but I am critical of legislation under which they operate. I think it is so one sided as to create imbalance, the exact word that Mr. Heller used, but he denies——

Senator RIBICOFF. Do you think that the wage structure alone will deter our technology from advancing at as rapid a rate as we can? The inventive genius in this country and other industrial nations will naturally keep pushing ahead with new techniques and methods, and the wage factor——

Mr. PETERSON. That is most desirable.

Senator RIBICOFF. And the wage factor is not controlling.

As Senator Gore has brought out in question after question, when you look at the problems of productivity, even with our high wages, we are much more productive than even our competitive nations. I think Senator Gore has done a masterful job in bringing these facts together.

Mr. PETERSON. I am sure he has.

Senator RIBICOFF. So it is not a problem of wages. It is a question of "how" you relate the hourly wage into the production you are getting per worker. So wage levels alone are not the answer.

Mr. PETERSON. I am sorry to disagree with you, Senator, but I do believe that the price of labor is a bar to its employment if it is excessive in the mind of the buyer. Nobody will buy any product, anything, if he regards the price as beyond his means, and there are many cases where we have wages beyond the ability of employers to pay, and it is really the consumers who are involved, who will hire labor. That is why I think the tax bill is most important, but it will not do the impossible.

Senator GORE. Will the Senator yield?

Senator RIBICOFF. Certainly.

Senator GORE. I want to thank both Senator Ribicoff and the distinguished witness for their generous references to me. I doubt if there is really sharp disagreement between you and Senator Ribicoff, as I understand you.

The increased productivity per man-hour to which Senator Ribicoff has referred is in sophisticated industry. It comes about through the combination of talented men with sophisticated machinery and investment. What Senator Ribicoff says about that, I think, is borne out by the facts.

Mr. PETERSON. It is.

Senator GORE. I cited yesterday, maybe you were here, that in 10 years there had not been a single new net job in manufacturing, agriculture, transportation, mining. Indeed, in our basic industries, although production is vastly greater now than a decade ago, employment is less. So in this regard I think what Senator Ribicoff says is undoubtedly true. There is an area of employment or unemployment, as you may view it, of a marginal character, marginal in talent, marginal in the application of the human being to machinery which multiplies the productivity of his effort.

Here, I think, the wage level is certainly a factor in the employment of that labor because the person who employs it is not going to benefit from the multiplication of productivity which has occurred in sophisticated industry, but must take the meager return which results from the talent of the man, and if the talent of the man is low and the wage is high, then, it seems to me, there will be no job created or filled.

I offer this as a possible resolution of what appears to be a difference between you and Senator Ribicoff. I do not think really there is one.

Senator RIBICOFF. Here is what I think Senator Gore and I, although I do not want to speak for Senator Gore, are driving at. A bill has been presented to achieve certain objectives. I think most of us are for these objectives. We may get there through different means.

Now, the question arises would this tax bill solve the problems of unemployment in America. Do you think it would?

Mr. PETERSON. Well, I think it would help on balance. But what I am trying to bring out is that it will not do everything. It will not, for example, solve the main problem, apart from the wage problem, which, I think, is inadequate capital formation. I would like to talk about that in a moment, but before I say that, I think Senator Gore has made an excellent point, and it clarifies my own thinking because he points out that there are industries and there are industries, and while it is true that productivity gains and automation are very extensive in manufacturing and the other basic industries that Senator Gore enumerated, there are many other fields where automation has not made any dent whatsoever. To name one, the barber shop; to name another, the public schools, where productivity and automation have not seen much evidence——

Senator RIBICOFF. Let us take the barber shop. What does a haircut cost today?

Mr. PETERSON. Much more.

Senator RIBICOFF. But basically unless you want to get chopped up, you are going to a skilled barber.

Mr. PETERSON. Correct.

Senator RIBICOFF. Maybe there is a shortage of barbers.

Mr. PETERSON. There may be.

Senator RIBICOFF. But these youngsters between 16 and 19, who is teaching them how to barber, who is teaching anybody how to be a tailor or a cobbler? You just cannot take a society like ours and forget basic skills. What is this society doing about the skills needed in the so-called service trades, whether it is a haircut or whether it is knowing how to sew a suit of clothes or whether it is to cobble a pair of shoes?

To train these people is going to cost money.

Mr. PETERSON. Senator, do we not already have, and I think you know this much better than I, the best educated children in the world, plus probably the greatest vocational training establishment in the world? And isn't it a commentary of some sort that vocational training is not doing the jobs that you suggest?

Senator RIBICOFF. It certainly is. There is city after city in America in which you have no vocational high schools. There are large cities in the United States with inadequate numbers of vocational schools. In the city of Washington, you have great problems; you have youngsters who want to get into vocational schools, and there are no places for them to go.

To have adequate vocational schools and vocational teachers, and do a job of vocational education is going to cost money.

Now, if you try to tie together these proposals for a tax cut with a commitment that you are not going to spend any more money, what are you achieving? There are places you are going to have to spend money.

There are 40 million people in this country who are considered poor. They are more or less forgotten, their voices are not heard, people do not know much about them. The people who run the society do not see them very much.

People used to live in a community and know everything that was going on in a community. Now they go out to the suburbs and take their throughways to their jobs and do not know what is happening across the other side of the railroad tracks. There are communities

that are all on the other side of the railroad tracks, but it is going to be a big job and an expensive job if we are not going to forget 40 million people in the United States—whether these 40 million people are in the large cities of Chicago, Detroit, New York or whether they are in the hills of Kentucky or West Virginia. And Senator Gore gets around and he does not think this tax bill will help the people in the hills of Tennessee with some of their problems. It has bothered Senator Gore.

Senator GORE. I doubt if in this tax bill there is anything that is going to help the overcrowded conditions of the schools in Washington. I doubt that this bill is going to help solve the inadequacy of hospitals, the lack of vocational training. It may be highly unpopular due to the political climate that has been created, partly by the press, partly by the administration, partly by those who want tax reduction ahead of all things, but I recall to you that 2 or 3 years ago great columnists like Walter Lippmann were writing eloquently about the pressing needs of our society, that those needs were in the public sector. Where is the press that 2 years ago was singing this song? It seems very quiet, and yet those needs are more pressing today. The needs are unmet, and yet we have under consideration a bill which is advocated on the basis of virtual repudiation of the stimulation of the public sector.

Thus, it does not propose to meet the needs of our people but, instead, by permanently reducing the level of governmental revenue, will permanently hamper the capacity of the Government to meet those needs.

It seems to me that many a voice should be crying out against the catastrophic mistake which we are urged to make.

Senator RIBICOFF. As an economist you must be aware of the changing pattern of American society. We have had philosophies of government and laws and congressional points of view based upon an agrarian economy, yet by 1970, 75 percent of American people will be living in urban areas, which brings many new problems. What are we going to do about these new problems to develop a country that is changing so rapidly?

Mr. PETERSON. Here I would join hands with Dr. Heller and say that a partial solution to both of the problems raised by you, sir, and by Senator Gore would lie in the area of economic growth. The critical question is how we get that growth, what will make this country advance, and what will add to your production; the answer, I think, is a more intelligent tax structure. We need——

Senator RIBICOFF. How will an intelligent tax structure solve the problems of mass transportation when private investment will be the the first to admit that they do not see any profitable economics in mass transportation, and they are reluctant to place any more investment into this type of transportation. Yet as we are moving our people into big cities and you have this spread in the urban and suburban areas, what are you going to do about mass transportation? Who is going to pay for it if private industry is unwilling to do it?

Mr. PETERSON. I can only answer your question, Senator, by asking indirectly, by pointing out, that what we need is more production to enable tax revenues to rise with the rising productivity of the country, and I think the next question we ought to ask ourselves is where does capital come from; that is, where does growth come from? I am

trying to suggest it comes virtually entirely from tools, from capital, from capital formation, and as capital formation can only proceed out of savings, I would like to read but a part of my statement on page 10——

Senator RIBICOFF. But as Senator Byrd has brought out, if we are committing ourselves not to make any added expenditures until our budget is balanced, and I believe the figure given by Senator Byrd was 1970 for a balanced budget——

The CHAIRMAN. Dr. Authur Burns has said 1972. Secretary Dillon said fiscal year 1966 or 1967.

Senator RIBICOFF (continuing). How many more years can our Nation wait to solve some of our basic problems?

This question of housing, we have urban renewal, that is fine. But if you study urban renewal, you find it compounds and complicates the problems of the core cities because urban renewal is basically taking care of the middle class, and shoving the people in the slums into other slums or even a worsening condition where they live.

Private investment is not going into the problem of housing for the poor because it will bring them no economic return.

It is a question of changing indsutry. You say it is a question of economics. Take the coal miners in West Virginia and Kentucky. People are not going to hire them because they are not going to pay the minimum wage. Well, who is going to bring new industry down to that area?

Mr. PETERSON. Well, that is my whole point, Senator, that through growth we can see that capital is more mobile than is labor, and that if the poor of Tennessee will not go where the jobs are, then capital will go to Tennessee, and in certain areas it has.

Senator RIBICOFF. So capital goes out of Illinois or Connecticut to West Virginia, from Senator Dirksen's area or from my area, where labor is receiving for their work $2 or $2.50 an hour. Do you advocate that they move those plants and pay 90 cents an hour or a dollar an hour in the hills of Kentucky or West Virginia?

Mr. PETERSON. My point, sir, is traceable to what you said earlier, that here you seem to imply that there is only so much work to be done, and now you say there is only so much capital.

Senator RIBICOFF. I do not agree—I agree with Senator Gore——

Mr. PETERSON. Capital is expansible with new savings.

Senator RIBICOFF (continuing). There is a lot of work to be done. There are untold needs.

Mr. PETERSON. There is an infinite amount of work to be done.

Senator RIBICOFF. There is an infinite amount of work to be done by this Nation for its many needs, and there are many ways to reach that, and I think what bothers Senator Gore and myself is the fact that this tax bill is represented as being able to do all the jobs.

Senator Gore is against the bill. I am for it. I am for the tax bill because I think it will do part of the job. But I am bothered over the fact that it won't do the job that really has to be done.

Mr. PETERSON. It will not do the entire job, you are absolutely right, Senator.

Senator GORE. Would the Senator yield there?

Senator RIBICOFF. I would be pleased to yield.

Senator GORE. I dare say my colleague from Connecticut is also disturbed that we and the country and the Congress have been given one

promise after another that the passage of this bill is going to bring more repressive expenditure policies. We have also been told that the passage of this tax bill is going to bring higher interest rates, a more restrictive monetary policy. So when you look at the whole package it does not appear stimulative to me. We run the grave risk that this bill may create a more repressive economic climate even than the present one.

So instead of solving the problem, this is the wrong thing to do, the wrong way to do it, and yet it may be proposed to reduce taxes permanently.

Mr. PETERSON. There are features which I would like to bring out about this bill which are repellent to economic growth. And if my premise is right, that the real cause of growth is savings put into investment, I find a good deal of support from Prof. Simon Kuznets of Harvard. Professor Kuznets, in a recent National Bureau of Economic Research study, called "Capital in the American Economy," has pointed out that the rate of investment as a percentage of gross national product has been falling for a long time. He points out that the fall has been from 14.6 percent of GNP in the period 1869–88 to 7 percent of GNP in 1946–55.

This means that the basic food of growth—capital—is being denied to our body economic; and to supply capital, I think we need more intelligent taxation.

In my paper I have extended Dr. Kuznets' ideas into the current situation. I have appended a table at the end of my statement to show that capital formation in terms of business expenditures for plant and equipment from 1957 to 1962 has fallen significantly, in fact, it was lower in 1962 than it was in 1957, despite the gain in population. In fact, if you project the 4-percent annual growth rate, as I have, you find that the amount of business spending for plant and equipment is very much off, and it is a most alarming trend.

Where I think I can meet some of the objections that Senator Gore has to this bill is in my own statement in part II and part III. I have asked for a flatter rate of taxation on the basis that a flatter rate would release two things, more funds for investment, and more incentive for productivity.

Senator GORE. Mr. Chairman, could I ask a question there?

The CHAIRMAN. Senator Gore.

Senator GORE. I do not find a pressing need in our economy for either of those things. You say more investment in plant and equipment——

Mr. PETERSON. Yes.

Senator GORE (continuing). And more incentive for productivity.

Mr. PETERSON. Correct.

Senator GORE. Our problem is idle plant and not lack of productive capacity.

Our problem is not incentive for greater man-hour production or more factories to produce. The real incentive we need is consumer demand.

As one who believes in the private enterprise system, and engages in it in a small way, I know what the stimulus for investment is. It is the expectation of a profit.

Mr. PETERSON. Correct.

Senator GORE. This expectation of a profit may occur irrespective of availability of investment capital.

A businessman who sees what he thinks is a reasonable chance for a profit is very apt to go and borrow the money to invest if he does not have it. But the availability of investment capital is not one of our needs either. It is running out of our ears. Insurance companies, banks, personal savings, savings and loan associations, liquidity of corporations, we have the greatest surplus of investment capital this country has ever known.

We have a surplus of plant facilities. The element of our society that needs stimulation is the low 25 percent, that is either living in poverty or on the verge of it. This constitutes the great reservoir of unmet consumer demand. There is a need which is not being translated into demand.

Will you address yourself to that?

Mr. PETERSON. Sir, I will try.

You are quite right that profit, which you brought out, is decisive in investment. Profit, as you also know is the difference between price and cost. The cost, in turn, is a problem of plant in part. Indeed, sir, you pointed to idle plant.

Senator GORE. May I interject there?

Mr. PETERSON. Please.

Senator GORE. You say profit is the difference between cost and price. On a single item, yes. But realistically considered in our mass economy, there is also the question of volume.

Mr. PETERSON. Correct.

Senator GORE. It is also volume, because without volume you simply cannot market enough items.

Mr. PETERSON. No question about it.

Senator GORE. All right.

Mr. PETERSON. Profit is so important that it is the raison d'etre of investment, as you brought out.

The cost is significant. You pointed to idle plant, but you did not address yourself, sir, to the quality of plant. It is true that we have some degree of idle capacity. The question is what is the quality of that capacity. There are machines and there are machines; there are plants and there are plants. But what we need is modern high production, high quality plants, and this I do not think we have. We do have a certain amount of it, but I believe other witnesses have brought out that the average age of our plant and equipment is older than that of the major countries of Western Europe and of Japan.

If that is true, then our businessmen are at a disadvantage, and it means, in turn, that our working people are at a disadvantage because it is the quality of plant that counts. This problem has been met partly, of course, through accelerated depreciation schedules, and that is a good thing. I think more should be done on that score. But then I address myself——

Senator GORE. May I point out here that there may be a problem of obsolescence in this industry or that. Even so, productivity in the United States is incomparably greater than that of any of our most advanced industrial competitors.

Mr. PETERSON. But at a price, Senator, because the wage level has taken advantage of that—and rightfully so—but has taken advantage of it to too great an advantage, I submit, because of the problem of the relatively excessive wage structure.

Senator GORE. I understand.

Now, let us assume for the sake of our colloquy that there is a need for modernization of plant and equipment. You say that the depreciation changes——

Mr. PETERSON. Helps.

Senator GORE (continuing). Has already helped stimulate this.

Mr. PETERSON. Correct.

Senator GORE. In fact, I think depreciation may be criticized as being overly generous. But let us say that it has greatly stimulated modernization.

Now, on top of this we have the investment credit enacted last year and presented to the Congress as being far more stimulative of investment than an across-the-board tax cut, and I think that I agree that it is more specific.

If you add depreciation charges and investment credit on top of the tax cut of 1954, and you have $5 billion of tax reduction and incentives for investment, and one of the results is that we have more automation.

I would not stop this process. I do not know how to solve the problem, but I come back to the fact that with all of the improvement of plant and equipment we have vastly greater production, but also much less employment in these basic industries.

How is more of the same thing, which will mean more of the other things, more production and less jobs, going to solve the unemployment problem, going to solve the problem of overcrowded schools, hospitals, inadequate highways? These are the things that are pressing upon us for solution, and yet here we are considering a bill that instead of helping in that direction is going to permanently impair the solution of these pressing problems.

Mr. PETERSON. I can only say, Senator, that I am beginning to sound like an economics professor——

Senator GORE. I beg your pardon?

Mr. PETERSON (continuing). Which I fortunately am, but it is a problem of labor pricing and of labor mobility, and if we overprice labor, whether it is at the top of the scale or at the bottom of the scale, we are going to pay a stiff price in unemployment.

If I insisted on twice my stipend from New York University, I rather think I would be out of a job, and yet we have much the same situation repeated many times over in the economy. This, I think, is something we have to address ourselves to.

I also think we have to address ourselves to the fact that all economic theory and logic and all the empirical evidence points to the fact that a progressive income tax rate destroys incentive to a marked degree, although not entirely; it also destroys a good deal of potential capital, and that is why in my statement I criticise H.R. 8363 very strongly for having brought about between the top rate and the bottom rate an exacerbation of this entire problem of progression. The new bill's rate structure is even more progressive than that we presently live under.

With so much progression we are hurting those enterprising people, the doers, the creators, in our society from doing more for the very poor people that you and I are so conscious of.

In the same regard I have in my paper come out for continuation of dividend credit on the theory that growth is a function of capital formation, and investors should not be hurt any more than they already

are. Four percent is modest enough, and I ask this committee to kindly consider the continuation of dividend credit as it presently exists.

Another problem I would like to allude to is that of inflation. I think the inflationary problem is very great, and it impinges upon our balance of payments.

You have been very generous with your time, but I would like to develop this point of inflation which I regard as a monetary problem whereas Dr. Heller yesterday seemed to indicate that it was mainly a pricing problem.

Now, higher prices, of course, are the result of inflation, in my view, but not the cause. I look at the cause as the increase of money and credit, and this increase of money and credit is almost certain to operate if we engage in serious deficit financing.

I think it was Senator Smathers yesterday who asked Dr. Heller if he believed in a balanced budget and, as I copied down his answer, he said, "Yes, I do believe in a balanced budget if you have a high employment balanced economy," and there was a good deal of discussion, as you recall, on the question of restraint: What is restraint?

But to tie in the inflation discussion into the balance-of-payments problem, I would like to call your attention, if I may, to some statistics that I have put in my paper. To me these are most disturbing.

I say as follows:

A red flag is up. Our gold stock as of last Wednesday amounts to $15.6 billion. But this amount does not include $800 million owed to the IMF. This leaves us with a real balance of $14.8 billion, and of this amount there is a 25-percent reserve requirement against Federal Reserve note and deposit liabilities, or about $12 billion. So, in effect, we have but $2.8 billion of gold to cover more than $25 billion of foreign short-term dollar balances.

I comment that perhaps this was the reason why Dr. Heller in Paris last week indicated some degree of support, presumably official support, for a revised system of international liquidity to cope with the world's balance-of-payments problems, especially our own.

The situation of so many dollar claims impinging on so small an amount of U.S. gold is critical, and it could get out of hand if a policy of growth through deficits is long continued.

In other words, I believe, gentlemen, that persistent longrun deficit financing could trigger a crisis in the dollar, and I would hope that the restraint that you gentlemen are looking for will be found. But I request that you do not construe this to mean that I am, because of that statement, against a tax bill.

Senator GORE. You referred a moment ago to the danger of inflation. Do you think the deficit would hold the greater danger of inflation if monetized or if financed from savings?

Mr. PETERSON. There is no doubt that the former is far more the problem. Much depends, of course, on how the debt is financed. If the debt is financed out of the savings of the people and other private organizations, there is no inflation by definition, at least as I define it. There is no increase in the money or credit supply. It is simply a transfer of purchasing power from one entity to another.

However, if the definition goes through the commercial banks, through the Federal Reserve System, debt is monetized, and this money, although it takes time, comes into the economy and strongly

tends to raise prices. I would suggest that this is very much a clue to what is going on in Brazil today.

Senator GORE. Well, if the deficit, the added debt occurring as a result of the deficit, is financed out of the savings directly resulting from the tax cut, there would be a tendency to wash out the operation so far as stimulation of the economy is concerned. Do you agree with that?

Mr. PETERSON. You say if the tax cuts—will you continue your train of thought, sir?

Senator GORE. Let us take the group of guests in this room as an example. They are an affluent-looking group. Suppose this tax bill gives to each of them $10,000 per year and, as a result of that tax reduction our national debt must be increased. Let us further assume that each citizen in this room, who got a tax reduction of $10,000 per year, went directly to the Treasury and used that $10,000 in tax cuts to buy a $10,000 bond.

What would be the economic effect—stimulation, contraction, or will it be a washout operation?

Mr. PETERSON. I believe, sir, it will be a washout operation. So far as I can see it from the facts you gave me, you would simply have a washout operation. The monetization of the debt would be washed out because the debt would be financed with the savings which I would regard these bonds to be.

Senator GORE. Well, I agree with you on that, and this illustrates two points. One is that to the extent that the added debt, as a result of a tax cut, is financed out of savings resulting from a tax cut, then there is no stimulation. I do not know to what extent this would be the case, and I would not want to deny anyone the opportunity to invest in a Government bond from his savings already on hand or those accruing from the tax cut. But insofar as the tax cut is financed out of savings, then it is not stimulative of the economy.

Mr. PETERSON. I want to correct my previous answer, if I may, Senator.

Senator GORE. All right.

Mr. PETERSON. To the degree that we flatten that rate structure we will release incentive, release potential capital formation, and to that degree get a high GNP.

Senator GORE. All right.

Mr. PETERSON. That is a side effect.

Senator GORE. All right.

Now, you also said a moment ago that if instead of the added debt being financed from savings it is monetized, then to the extent that it is monetized, it may be inflationary.

Mr. PETERSON. Correct.

Senator GORE. The example I used here which, as I say, is an extreme hypothesis, proves another point. Let me state it. It is one of the major basic faults of this bill.

If each of our guests here in this room receives from this tax bill $10,000 in tax reduction, and each buys a $10,000 bond to help finance the debt that is created as a result of the deficit because of the tax bill, then there is no economic stimulus so far as these people are concerned. But one other thing would have happened. These people would be vastly better off because instead of owing the Government $10,000 as a portion of tax on their lucrative income, the Government

would be owing them $10,000, and the rest of the people would be paying the interest on it.

So this bill represents a major shift, a major redistribution of the Nation's income. It, in a thousand different ways, feathers the nest of those whose nest is already fluffy.

Mr. PETERSON. Well, I think your point is most dramatically put, Senator, but I would——

Senator GORE. Well, thank you.

Mr. PETERSON. I question again—you see, I have the idea that those who feather their nests are those who helped to make this country grow.

Senator GORE. All right.

Mr. PETERSON. But, you see, I believe that the so-called rich—and I dislike using that word because it has a certain connotation which I find somewhat distasteful—have a function to perform, although they may not be conscious of it, and that is to contribute to the capital stock of the country.

Obviously those who have more have more to save, and those who do not are forced to consume all they take in the form of income. But to the extent that we release incentive, to the extent that we do not repel these people who, as you say, fluff up their nests, I think that was the phrase you used, to that extent we encourage production and encourage saving and investment which, I think, is the key to growth.

Senator GORE. Thank you. I have enjoyed the exchange.

Mr. PETERSON. I have, too, sir.

Senator GORE. I have enjoyed the exchange with you. You have permitted me to make a point that I have been trying to get to in some positive way, and that is that this bill is not only a major attack on the progressive character of our income tax system, but if enacted it will accomplish a major redistribution of income, and in the wrong direction. Instead of redistributing the income directly in accordance with the needs of our society, it redistributes it in the opposite direction. It enriches the private sector of an already rich element of our society, and enriches the individuals who earn the greatest amount of income and places added debt upon all of the people in order to do so.

This seems to me utterly wrong, and I have been crying out and crying out, as you know, but I will desist further crying out this morning.

The CHAIRMAN. Mr. Peterson, have you finished?

Mr. PETERSON. Yes, Mr. Chairman; I am finished.

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Mr. Peterson, I must apologize for not having been here earlier to hear your testimony verbally, but I had another hearing I had to attend.

Mr. PETERSON. Of course.

Senator DOUGLAS. I had a chance hastily to read your paper. I take it if you had your way you would not have a progressive Federal income tax but a proportional one.

Mr. PETERSON. Sir, yes, that is exactly right; and being realistic I do not think I am going to get it, but I do argue the flatter the tax the greater the incentive, and so on.

Senator DOUGLAS. Yes. And, of course, ultimate ideas have a way of shaping immediate action, at least in part.

Now, I wanted to ask if you had considered the fact that $10 billion of Federal revenue is derived from excise taxes primarily on tobacco and liquor, but on other items, as well, and that these taxes are regressive in nature, with those with the smaller incomes paying a larger proportion of their income for excise taxes, and also, as I remember the figure, approximately $12 billion of State and local revenues are collected in the form of retail sales taxes which exempt capital investment and services, and fall on consumers' commodities, and that these are probably even more regressive in nature.

So it has been argued that even if you were to believe in proportionality in the overall system of taxation, you would have progression in the Federal system to compensate for regression created by excise and retail sales taxes.

What would you say to that?

Mr. PETERSON. Well, I would say two things, Senator. First of all, I think it was Dr. Roger Freeman whom you had before you who had in his testimony and, hence, I did not have it in my own, that no other major country in the world besides America puts so heavy a dependence on income taxation that we do.

Now, granted that we have some $10 billion in Federal excises, and granted that the State and local governments also have such a marked dependence upon such taxation, the fact remains that even when you combine all taxes, as I recall the statistics, we as a nation still are in the lead in this, what I call, rather dubious race in putting so great a weight on income taxes as opposed to, let us say, consumption taxes.

Senator DOUGLAS. But your position is different from that. You are saying that so far as the Federal income taxes are concerned they should be proportional, and I am raising the question of whether the regressive nature of excise and sales taxes do not compel some progression in the Federal system even if you were to have proportionality in the overall system, and I have not thrown in the $18 billion obtained from the general property taxes which, on buildings, are certainly shifted and borne in the main either by small home owners or by tenants, generally in the lower income groups; and I might even say that investigations which I have seen made on the assessment ratios in localities indicate that the home of a workingman is assessed at a much higher proportion of its sales value than the estates of the wealthy or the factories of corporations. We have had a good deal of testimony in past years on this point.

So I think that one can say, in general, that the general property taxes also tend to be regressive.

If you add all of these factors together, 10 plus 12 plus 18, you have $40 billion of regressive taxes, and I believe the receipts from Federal income tax are not really much, if any, greater than that, because from the report of Current Economic Indicators, on page 37, column 1, it is stated that the personal tax and nontax receipts of 1962 came to $49 billion, and that includes the nontax receipts.

I wondered if that makes any impression on you?

Mr. PETERSON. The only impression I have, Senator Douglas, is the one I recorded; that the fact remains that other countries whose growth rates happen at the moment to be higher than ours, put a much greater weight on consumption taxes than we do.

Senator DOUGLAS. Yes. But are other countries necessarily right? Must we always imitate other countries? The United States was the

innovator in democratic government. We were the first country in the Western World to establish a republic. If we had followed European countries we would have had a monarchy. The United States had prided itself throughout its history in being a pathbreaker and a pathbreaker in general for what the community believed to be the interests of the great masses of the people.

Now, are we going to say that because the European countries do this we must necessarily change?

Mr. PETERSON. No. I think your point is well taken, Senator. But I would say that you and I, perhaps, differ as to how much of an evil regression is. Regression to me is usually an extension of an argument that I always do not find myself happy with, because I even noticed in your own statement, sir, you indicated "regressive in nature."

I know of no regressive tax as such. Now, it is true that a sales tax is really, is it not, sir, a proportional tax; that the more you buy the greater proportion of taxes you pay.

Senator DOUGLAS. That is right. It is proportional on specific items, consumer goods.

Mr. PETERSON. Correct.

Senator DOUGLAS. It is, the tax is, not levied on services, health, education. It is not levied on investment.

Now, you, as a professor of economics know that as incomes increase the proportion of income which is spent on commodities, on consumers' commodities, diminishes.

Mr. PETERSON. Correct.

Senator DOUGLAS. This is conspicuously true in the case of food, but it is also true in the case of clothing.

Although you may have a 3-percent sales tax on commodities, so far as the effect on income is concerned, the tax takes a larger percentage of the income of the low and middle income groups, and a smaller percentage of the income of the upper groups. This is, I state it, just as a fact.

Mr. PETERSON. I know the arguments.

Senator DOUGLAS. Yes; and, therefore, the effects are regressive. That is all I am trying to say.

Mr. PETERSON. All I am trying to say is that the base does not change, the base of the tax is the sales, and the sales tax is strictly a proportional tax.

Senator DOUGLAS. But not proportional in accordance with income.

Mr. PETERSON. Yes. But it is in accordance with the base that is taxed. The sale is proportional, and it always requires the shift as you have made it, to jump from the base of the tax to the income of the individuals paying the tax, and it seems to me that that is not always a scientific——

Senator DOUGLAS. It is out of income, it is out of income that we purchase commodities, services, and make savings.

Now, I wish you would think this over.

Mr. PETERSON. I will, sir, but I would only say that I am so capital conscious that the less capital taxation——

Senator DOUGLAS. I know.

Mr. PETERSON (continuing). We have, the more we can release the funds.

Senator DOUGLAS. I know. I would say you are extremely capital conscious, and as you quote in your paper, I think it is true that an increase in capital used in comparison with the labor force does increase the productivity of labor. I devoted some years of my life to trying to find that out, and I think I demonstrated that. That is true, we will accept that.

Let me ask you this: What do you think about the exemption of a minimum of physical subsistence from taxation? I have just received some figures from Chicago, and for a single person the relief standard which, I assure you, is a scanty one, comes to $1,296 a year. For a husband, wife and two children it comes to between $2,500 and $3,000 a year.

Do you think that this physical subsistence and, I think, both of us would hate to try to live on that——

Mr. PETERSON. Correct.

Senator DOUGLAS. Do you think that physical subsistence should be taxed? Should you tax something which is essential to bare life or should the taxation be on the surplus over and above the minimum regardless of whether there is a progressive rate or a proportional rate on that?

Mr. PETERSON. Is there not already in existence a personal exemption to meet that very problem?

Senator DOUGLAS. Yes. But here is another point, two points. First, there is not this exemption so far as sales taxes are concerned. The man with physical subsistence who buys his groceries pays a sales tax on the groceries, and this directly diminishes the amount of food which he can receive.

Senator HARTKE. Will the Senator yield at that point? I want to make a point that I was very disturbed when we passed the sales tax in Indiana which, in effect, reduced the average working man's salary by 2 percent.

Senator DOUGLAS. That is it exactly.

Furthermore, you will notice this exemption of $600, the exemption is only $600 per person. If it costs a single man $1,296 or $1,300 a year to have a physical subsistence on relief, and I assure that is a scanty standard, and yet if he were to get an income, earn an income, of $1,300 a year, he would be taxed on about $700 of this. If he had, say, $26 a week, he would be taxed on $700. He would pay 20 percent of that or he woud pay $140 a year.

Now, I just ask you, Do you think that is proper to tax a person on the absolute physical minimum and, therefore, force him down below the physical minimum?

Mr. PETERSON. Well, I must say this is a new one before me. I am well aware, of course, that there is a personal exemption. Whether that is adequate or not I do not think I am prepared to say. I have not studied the problem.

Senator DOUGLAS. If the Senator from Tennessee or the Senator from Illinois would make amendments to increase this personal exemption, I hope that you, as a teacher of economics at a great university, will not proceed to denounce this as unsound and improper; that you, at least, will consider it.

As a final parting shot, may I say that I had always thought that additional increments of income were applied to commodities which yielded less satisfaction, that you go down the utility scale with addi-

tional units of income and that, therefore, if you admit democratic principles as well as mere capital formation into your theory, this would argue, Mr. Peterson, that we should take more dollars from those with upper income groups or a larger proportion of the dollar from the upper income groups than from the smaller one.

In other words, I just ask you to consider the diminishing, marginal utility of income to see if this does not introduce an argument for progression even beyond the minimum subsistence figure. Up to now I have been arguing on true proportionality.

Mr. PETERSON. Well, Senator, you know from your university days there was quite a debate about the so-called welfare economics.

Senator DOUGLAS. Yes.

Mr. PETERSON. And it has been pretty well established that interpersonal measurements of marginal utility are not tenable, and I could cite an example.

Senator DOUGLAS. You cannot brush that aside now with just a general statement because there is nothing more fundamental than that there is a diminishing marginal utility of additional units of income. Now, efforts in the past have been made to defend the inequality on the ground that the people in upper income groups own better pleasure machines, that they enjoy a dollar more than the poor enjoy a dollar and therefore, they should have more dollars because of their greater capacity for enjoyment, and that if you give units of income to base people whose baseness is indicated by the fact that their incomes are low, what you are really doing is transforming or transferring dollars where they would yield great satisfaction in art or pate de foie gras or champagne to plebeian tasts for plug tobacco and beer.

Now, you can argue that, but it is something that is assumed generally rather than argued. I have not really heard it crop up into the literature since Mr. W. H. Mallock wrote a book which, curiously enough, was called the New Republic. But it is underneath the surface in the long discussion.

Mr. PETERSON. Senator, I know a wealthy man, a billionaire, a fact——

Senator DOUGLAS. I congratulate you.

Mr. PETERSON (continuing). Not personally, unfortunately. His name is Jean Paul Getty, and in his London mansion you have perhaps read that some of his house guests were continually using his telephone to make long-distance calls all around the world; and although we assume his marginal utility of added increments of money was very minute, he could not stand that, and he installed a pay telephone in his London mansion to preclude this kind of gouging by his own house guests.

Senator DOUGLAS. May I say this, without indulging in any denunciation of individuals, that I never thought that Mr. Getty should be be held up as an example of prudent or puritanical spending.

Senator GORE. I really think it is beyond the standard of good taste for guests to do some gouging of their host, but there would be some temptation to do this in this case.

Senator DOUGLAS. I heard of a millionnaire, not a billionnaire, who put in slot machines in his house with the understanding that he would get the take so that guests who had a temptation to gamble would gamble to his profit.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. I think we could prolong the hearings about another 6 months if we could talk about Getty's incidents. Thank you. That is all I have.

The CHAIRMAN. Thank you very much, Mr. Peterson.

Mr. PETERSON. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you for an interesting statement.

(The prepared statement of Mr. Peterson follows:)

COMMENTARY ON H.R. 8363 BY WILLIAM H. PETERSON, PROFESSOR OF ECONOMICS, GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, NEW YORK UNIVERSITY

My name is William H. Peterson and I am a professor of economics at New York University's Graduate School of Business Administration.

My interest in H.R. 8363 is broad, for I think this bill is far reaching in its impact on our national economic growth, our individual well-being, and the critical nature of our balance of payments. For the purposes of this statement, however, I wish to look at the underlying theory involved in H.R. 8363. This theory was best expressed in the President's Economic Report of 1963, as follows:

"In the past 5 years, the economy has been consistently out of balance—with too little demand to match our supply capabilities * * *. Inadequate demand remains the clear and present danger to an improved economic performance * * *. The source of high unemployment rates in recent years, even in periods of cyclical expansion, lies not in labor market imbalance, but in the markets for goods and services * * *. Accordingly, the President is recommending a major program of tax reduction and tax reform to expand private purchasing power and to strengthen private incentives—a program which will thus attack the problem of idle men and machines at its source and provide new vigor to the forces for expansion of the U.S. economy." [1]

This statement goes both to the content and the theory underlying the bill before you and, accordingly, I divide by statement into three parts, the first two dealing with the proposed individual income tax rate structure and the repeal of the dividend credit as included in the bill, and the third part with the theory involved in planning the largest peacetime deficit ever: the theory of growth through deficits.

In brief, my position can be summed up in a single paragraph:

Tax reduction and rate reform are matters of national concern. I favor tax cutting as would be accomplished by H.R. 8363, but I do not favor, among other things, the remaining steepness in the proposed individual income tax rate structure, the proposed repeal of the dividend credit provision, nor the underlying theory that our basic economic problem today is one of stimulating demand. I believe that the bill can and should be made sounder, in its content, and through firm congressional control and limitation of Federal spending to achieve a balanced budget except in cases of extreme emergency.

Before I move into a discussion of my three points, I wish to reaffirm the wisdom of Chief Justice John Marshall who noted in *McCulloch* v. *Maryland* "the power to tax involves the power to destroy." I believe a great amount of destruction of potential capital formation, of individual and corporate incentive, and hence of economic growth, has taken place, although the damage done is not precisely measurable.

I stress economic growth throughout this statement, following the lead of the President in his tax message to Congress on January 24, 1963, in which he said that the present Federal tax system is "the largest single barrier to full employment of our manpower and resources and to a higher rate of economic growth." And I stress the need for flattening the rate structure to the maximum extent possible, following another lead from the President, this time from his television address of August 13, 1962, in which he said that our tax rates "are so high as to weaken the very essence of the progress of a free society—the incentive for additional return for additional effort."

PART I—INDIVIDUAL INCOME TAX RATE STRUCTURE

In criticizing the remaining steepness in individual income tax rate progression (from 14 to 70 percent of taxable income) in H.R. 8363, I wish to point out that there is too little rate relief in the upper brackets and much too little in

[1] Pp. 22–38.

the middle brackets. Truly, as other witnesses have already testified, the taxpayer in the middle bracket is the forgotten man in H.R. 8363.

The middle and upper brackets are prime sources of America's capital formation and hence of economic growth. Further flattening their rates would release capital for investment. This is why, in my testimony before the Ways and Means Committee last March, I supported the Herlong-Baker bill which would reduce the basic personal income tax rate to 15 from 20 percent, and the top rates of both individuals and corporations down to 42 percent over a 5-year period.

I subscribe to the theory that the less progression the better. Indeed, the very theory of progression is vulnerable to criticism. One point to be considered is the lack of scientific evidence in support of the theory of progression—a point recognized by many but by no means all economists. Scientific evidence appears to be lacking on presumptions of equality of sacrifice, ability to pay, benefits conferred, economic stabilization, economic equalitarianism, and Federal revenue needs, all of which are used to bolster the case for progressive taxation.

The unscientific nature and even sheer caprice of graduated rates and income brackets over time or at any one time is amply seen in the history of the income tax since passage of the 16th amendment in 1913. Originally the rate on highest incomes was but 7 percent. In 1929 the top rate was but 24 percent. But out of the social turbulence of the thirties emerged a top rate of 79 percent. World War II brought an upper rate of 94 percent, and it is virtually at this rate under which we live today, with the 50-percent level reached at but $16,000 of taxable income for the unmarried individual.

So the Federal income tax rate structure in its relatively brief life of 50 years has grown like Topsy, rather haphazardly, without scientific basis, subject to no end of whim and pressure, and producing rates which Dan Throop Smith, former special assistant to the Secretary of the Treasury in charge of tax policy, has said, "are not only repressive but appear to be excessive by almost all ethical standards except those based on extremes of equalitarianism."[2] Smith's raising of the question of ethics is indeed a pertinent question. For does not graduation constitute discrimination against a minority? Proportionally is nondiscriminatory. It recognizes ability to pay. It recognizes equality before the law. It gives no vent to envy and vindictiveness, to—to use a blunter phrase—soaking the rich.

Surely the history of Federal graduation attests to the wisdom of Scottish Economist John Ramsay McCulloch who noted:[3]

"The moment you abandon * * * the cardinal principle of exacting from all individuals the same proportion of their income or their property, you are at sea without rudder or compass, and there is no amount of injustice or folly you may not commit * * *. In such matters the maxim sof obstra principiis should be firmly adhered to by every prudent and honest stateman. Graduation is not an evil to be paltered with. Adopt it and you will effectually paralyze industry and check accumulation, at the same time that every man who has any property will hasten, by carrying it out of the country, to protect it from confiscation."

The McCulloch observation seems to be based upon sound economic logic. No proponent of graduation has ever been able to prove just how much faster, if at all, ability to pay is supposed to increase than income. No demonstrably scientific method appears to be used to determine the height of the graduated scale or the brackets of income covered. At best the graduated rate structure becomes the result of rule of thumb, arbitrary conjecture, and conflicting pressures of different groups and organizations in and out of Government. Contrast this makeshift and complex result with the simplicity of proportionality, seen, for example, in the Judaeo-Christian practice of tithing, with the tithe at 10 percent, varying proportionately with a man's income and with good times and bad.

Frequently it is argued that apart from ethical and scientific considerations, the Government has budgeting needs that can only be satisfied by rate progression. Yet, Dan Throop Smith has noted that progression beyond 50 percent of taxable income yields the Treasury only about $1 billion annually, or less than 1 percent of what the Government spends.[4]

Indeed, it is arguable that rates beyond 50 percent and likely much less do

---

[2] "1962 Proceedings," National Tax Association, p. 541.

[3] John Ramsay McCulloch, "Taxation and the Funding System" (1845), quoted by Walter J. Blum and Harry Kalven, Jr., in "The Unseasy Case for Progressive Taxation" (Chicago: University of Chicago Press, 1953), pp. 45–46.

[4] "Morgan Guaranty Survey," July 1960.

not in fact yield long-term revenue but reduce it because of their inhibiting effect on incentives to produce and invest.

Incentive is the thing. It accounts for enterprise and ingenuity. It is the secret of American prosperity. And yet we seem to be killing off this tremendous force for social good for a relative pittance in terms of Federal revenue. For it has been well established that all the graduation—the 71 percentage points above the bottom personal rate of 20 percent—yields but 15 percent while the bottom rate yields 85 percent of the personal income tax revenue. This means that a flat 20-percent rate on all taxable income would still yield 85 percent of the present personal tax revenue, even assuming no increase in income as a result of rate reductions. This assumption, however, is not tenable because of the effect of released incentives on production and investment, and of released funds presently consumed by taxation that could otherwise be used for capital formation.

Thus the illogic of rate graduation strongly suggests that a reduction from present rate levels is more likely to increase revenue than to reduce it. As Geoffrey H. Moore of the National Bureau of Economic Research noted in the American Economic Review, high taxes have "no doubt operated to reduce income before taxes in the upper income groups."[5] Simon Kuznets of Harvard University reached much the same conclusion in his 1953 study, Shares of Upper Income Groups in Income and Savings,[6] observing that, among other things, the top 5 percent has incurred a marked decline in its share of total income. Let me stress that steep progression has meant more than mere redistribution of income; it has meant, I am convinced, reduction of income—the national income. In other words, not only reduced income for the rich and hence reduced capital formation, but reduced income thereby for the poor—for everybody.

It is not the rich, however, as people that we are primarily concerned about. It is that in attacking the rich—foolishly, I may add—through taxation, we have somehow managed to hamper financially and psychologically the most productive inventive, talented, and veturesome members of our society—the people who would like to get rich. We have also forced many of these do'ers, builders, and job-creators to divert much of their energy and talent to ways and means of outwitting the tax collector, to cut back on their output, or to quit work entirely. As the late Sumner Slichter of Harvard University remarked in 1942: "The tax history of the United States in recent years has been fairly sensational. A visitor from Mars would suspect that a Communist fifth columnist was writing the laws for the purpose of making private enterprise unworkable."

To be sure, Federal revenue needs are vast but this fact should not blind us to the diminishing rate of revenue return on high graduated rates, or to the necessity for not succumbing to the elastic ethic that the end justifies the means. For clearly there are different means to the same end of achieving the Government's revenue needs. Let us consider one of these means—a flat rate.

Economist Milton Friedman of the University of Chicago demonstrates that a flat rate of 23.5 percent on taxable income as presently reported, defined, and with presently allowable deductions would produce as much revenue as the currently highly progressive rate structure of 20 to 91 percent. Indeed, argues Dr. Friedman, this flat rate would yield a greater revenue for three important reasons: less tax avoidance, meaning less incentive to adopt legal but costly schemes to reduce the amount of reported taxable income; less tax evasion, that is less incentive to fail to report income that legally should be reported; and less disincentives to production and investment and hence to greater national income and Federal revenue.[7]

Furthermore, graduation tends to blur into a theory of equalization or semi-equalization of income, or perhaps more exactly, a redistribution of wealth. But redistribution assumes a standard of distributive justice different from the standards of our market economy. It assumes that the market knows least and Government knows best. But what is our market economy but the American people, constantly and voluntarily adjusting the incomes of each and every one of us, financially rewarding those who produce more and financially penalizing those who produce less? This democratic market system, this incentive system, is precisely the means by which, I am convinced, we have become the richest and freest people in all the world.

---

[5] Geoffrey H. Moore, "Secular Changes in the Distribution of Income," American Economic Review, May 1952, p. 542.

[6] New York: National Bureau of Economic Research, 1953, pp. xxxv, xxxvi, 610, 635.

[7] "Capitalism and Freedom" (Chicago: University of Chicago Press, 1962), p. 175.

Even the Russians seem to be catching on to this incentive idea—deviating sharply from the Marxist-Leninist concept of from each according to his ability and to each according to his need—for a recent issue of Voprosy Ekonomiki, official periodical of the Soviet Institute of Economics, disowns "petty bourgeois eqalitarianism" and explains in an article:[a]

"The many years of experience in the organization of social labor under socialism have shown that equalitarianism is incompatible with the interests of the development of socialist production * * *. In order to create the abundance of products * * * the principle of personal material incentives to all personnel * * * is of major significance * * *. It is necessary to give industrial and institutional management the right to raise the salaries of persons showing maximum initiative, capacity, and conscientiousness * * *. At the same time it is necessary to improve the system of bonuses to managerial, engineering, technical, and office personnel."

Yet while the Russians seem to have learned the lesson of incentive remuneration—of additional return for additional effort (the phrase is the President's, as cited earlier)—we seem to be moving in the opposite direction: toward less return for greater effort. For, despite all the talk of the evils of heavy progression, the bill before you increases the rate of progression between the lower bottom and top rates. The combined effect of proposed rate and structural changes in H.R. 8363 provides a reduction of tax liability of 38.3 percent to the lowest bracket, decreasing to a reduction of 26.2 percent for the $3,000 to $5,000 bracket, 19.9 percent in the $5,000 to $10,000 bracket, 16.4 percent in the $10,000 to $20,000 bracket, 15.1 percent in the $20,000 to $50,000, and 12.6 percent in the $50,000 and up bracket. Plainly, tax relief at the lowest bracket is better than three times that of the highest bracket. Indeed, some 1.5 million taxpayers presently in the lowest brackets of taxable income are to be lopped off the rolls. This is unfortunate, for part of the checks and balances in our democracy is not only that each citizen has a share in our political direction but a share in the cost of democracy.

At any rate, discriminatory treatment toward the middle and upper brackets is, I believe, shortsighted, for in the long run equal treatment for all brackets would have redounded to the advantage mainly of the lowest brackets as capital formation accelerates.

In sum, while a flat rate may be the ideal, I believe that a realistic goal of the committee should be a flattened curve of graduation, with a maximum rate of 50 percent.

PART 2—DIVIDEND CREDIT REPEAL

In his 1963 tax message to the Congress, the President recommended repeal of both the $50 exclusion and the 4 percent credit. The House increased dividend exclusion to $100 but repealed the dividend credit in two stages.

I believe dividend credit should be restored. Discrimination against equity investment—and hence against capital formation—exists because dividend income is the only income under our combined individual and corporate income tax structure subjected to some degree of double taxation.

The main thing to keep in mind, it seems to me, is the impact of dividend credit repeal on our investment climate. Investment is the key to growth and hence discrimination against investors amounts to discrimination against growth. The proposal to raise from $50 to $100 dividend exclusion would cost the Treasury an estimated $70 million in lost tax revenue, but repeal of dividend credit as it now stands would release some $370 million to the Treasury. Hence we see that the investor group would be taxed an additional $300 million. Clearly this makes investment less attractive and therefore is a step backward from our goal of advancing economic growth—of improving the investment climate, of equipping our economy for new jobs.

Repeal of the 4 percent dividend credit would tend to have one other distorting effect on the investment picture: This is the fact that the high corporate tax rate has encouraged long-term corporate borrowing at the expense of equity financing largely because of the full deductibility of interest payments. To be sure, the 4 percent credit has not apparently corrected the disproprotionate share of corporate debt in total company financing, but this is probably attributable to the relatively small relief accorded to investors. (Canada, in contrast, has a $100 exclusion coupled to a 20-percent credit.)

In sum, the 4 percent dividend credit should be restored in H.R. 8363.

---

[a] Quoted by First National City Bank of New York Monthly Economic Letter, December 1959.

PART 3—THE THEORY OF GROWTH THROUGH DEFICITS

As cited in the introduction to this paper, the President and his Council of Economic Advisers, through their program of tax reduction and structural reform, would stimulate consumption by those currently employed in order to increase aggregate demand, which in turn according to them, would accelerate capital formation and provide jobs for the unemployed.

To my way of thinking, however, the question remains whether the problem of the American economy is inadequate demand or inadequate capital formation. I believe it is wholly the latter. And I believe that tax reduction to stimulate consumption via an increase in deficit-financed dollars is self-defeating because of the impact on inflation. Moreover, because of the critical nature of our balance of payments, resumed inflation could be an invitation to a dollar crisis.

Permit me to examine some of the implications of the administration's approach. If capital formation is the source of growth, we must be concerned with the rate of capital formation in the United States. The rate is not encouraging. Economist Simon Kuznets has pointed out in his National Bureau of Economic Research study, "Capital in the American Economy," that net capital formation as a percentage of gross national product has been falling for a long time. The fall has been from 14.6 percent of GNP in the period 1869–88 to 7 percent of GNP in 1946–55, measured in constant prices. It follows that the rate of saving has similarly fallen off. Ironically, as the rate of saving has been falling, the rate of technological advance has been, apparently, rising, with the result being a relative shortage of capital and the shelving of many fruitful investment projects—which could create jobs and more of the good things of life at less cost for more people. As Dr. Kuznets observed, the persistent bottleneck in the exploitation of new technical knowledge as been the scarcity of capital funds. And noting the U.S. population boom upon us, especially of new entrants into the labor force and of new family makers, he writes: "The demand for capital over the coming two and a half or three decades is likely to be large."[9]

Dr. Kuznets' data dealt with the situation as it had developed up to 1955, before the contemporary slowdown in capital formation began. As indicated by the amended table, if his data were projected through the intervening years, they not only would confirm his thesis but would reveal an alarming extension of the trend. In constant dollars, business expenditures for plant and equipment dropped sharply back after 1957 and had not returned to the 1957 level at the end of 1962. If such expenditures had increased at an annual rate of 4 percent over these years, the total in 1962 would have been nearly $10 billion greater, or enough, I believe, to have held the unemployment rate down to a much less disturbing level.

To be sure, economists who hold that consumption is the right road to greater growth and employment argue that there is overcapacity (euphemistically, "economic slack") in railroads, textiles, steel, coal, lead, zinc, paper, timber, and so on. It should be noted that overcapacity statistics are generally deficient, as the Joint Economic Committee's Subcommittee on Economic Statistics held in its report last year on "Measures of Productive Capacity." (The subcommittee's distinction between "engineering" capacity and "economic" capacity is significant.)

So I believe the administration's stress on overcapacity misses the point. For the real point is not simply overcapacity, but the nature and causes of excess capacity—the composition of capacity, the relative age and efficiency of plant and equipment, and the cost structure, including wages, of output. Overcapacity, in short, seems to be a function of cost and, hence, of price. If cost and price are excessively high—that is, high in the mind of the purchaser or the consumer—there will be but a partial sale or perhaps no sale at all.

Basically, then, overcapacity is a matter of excessive costs leading to excessive prices. Much of our overcapacity stems from marginal, high cost, obsolescent plant and equipment. To an extent, the new equipment tax credit and the Treasury's accelerated depreciation schedules ameliorate this situation. More should be done on this score.

Much of our overcapacity also stems from obsolete work practices and excessive union bargaining power which raise the unit cost of production and lessen effective demand. This latter problem, I know, is not a direct legislative concern of this committee; nonetheless, inasmuch as tax reform and demand-type tax cuts have been made the fulcrum for pushing back unemployment, I believe

[9] New York: National Bureau of Economic Research, 1961, pp. 391, 450.

it is a mistake to assign to tax measures, however important, such an exclusive burden.

That the administration has such a goal in mind, however, there can be little doubt. Commenting on Dr. Walter W. Heller's appearance before the Senate Labor Subcommittee on Employment and Manpower, John D. Pomfret in a New York Times dispatch of October 28, 1963, commented as follows: "A chief economic policymaker insisted today that the best attack on high unemployment must be a tax cut to stimulate demand and thereby create jobs."

Yet just what is the source of jobs, of employment? From where do wages spring? Perhaps it seems too elementary to state that wage rates depend on the marginal product and that, therefore, wages—and jobs—can only come from production; that is, from solid production. Hence, wages are paid essentially by customers; that is, consumers. In short, employers are but intermediaries. In effect, they don't pay wages, they don't create jobs; consumers do—if they are willing to pay what they consider a reasonable price.

But suppose the consumer won't pay what he considers too high a price for a pair of shoes or a ton of coal. What then? Then employment turns to disemployment to unemployment. In other words, in substantially insulating trade unions from competition, and thereby in aiding and abetting in a cost-price spiral, public policy has apparently given trade unions too much of a seemingly good thing, with the result that trade unions have all too often priced many of their members out of markets, out of jobs. Worsening the problem of hard core national unemployment, the wage floor was raised 15 cents in September 1961, and was given yet another lift of 10 cents in September 1963.

Note two relatively slack industries in our economy: steel and coal. In both, unemployment is quite heavy. In both, wage rates are quite high. Is this a coincidence? I think not. I think the demand for labor is highly elastic. Permit me to quote from Paul H. Douglas' study, "The Theory of Wages," in which Senator Douglas offered some most interesting arithmetic: "If wages are pushed up above the point of marginal productivity, the decrease in employment would normally be from three to four times as great as the increase in hourly rates so that the total income of the working class would be reduced in the ratio indicated above." [10]

At any rate, if I rightly understand the underlying theory of the administration, it rests on the premise that an increase in the Federal deficit through a tax cut will yield a net addition to consumption: that is, total demand, for it is abundantly clear that there is little official wish for actual reduction in Federal spending to accompany the tax cut.

Yet we must ask ourselves: Can demand be created out of thin air, out of monetized debt? Or might not such a policy be self-defeating, defeated by the inflation to which it necessarily gives rise? The answer appears to be that the policy of debt monetization was long tried in the decade of the thirties to little avail, for we still had over 10 million unemployed almost right up to Pearl Harbor. Again, quite a number of our partners in the Alliance for Progress—most notably Brazil—are case histories in the futility of persistent debt monetization. In fact, we have officially prevailed upon Brazil to stop inflating its currency and credit and to plug its balance of payments.

Our own balance-of-payments problem turns in part, I believe, on the integrity of the dollar, and the integrity of the dollar in turn rests on maintenance of its purchasing power, on avoidance of inflation. To be sure, there has been an appearance of stability in our price level in recent years and the appearance of stability in our balance of payments in recent weeks. I believe steadiness in our gold reserve, after a loss of $7 billion, is traceable to the numerous swap transactions and other arrangements we have concluded with foreign central banks and the International Monetary Fund.

And I believe the relative steadiness in our price level is still temporary and is traceable to the fact that our easy money policy and large budget deficits have caused an outflow of American capital so that the inflationary effects are seen mostly in Western Europe and Japan. As John Exter, senior vice president of the First National City Bank of New York and formerly a Federal Reserve System official and head of the central bank of Ceylon, has commented: [11]

"The paradox is that easy money has been so futile. It has increased the reserves of other banking systems, not our own. As money has run out of

[10] New York: Macmillan, 1934, p. 501.
[11] Address before the Conference on the Atlantic Community, sponsored by the University of California and the Atlantic Council, San Francisco, Mar. 29, 1963.

our reservoir in the form of payments deficits, it has run into others' reservoirs in the form of payments surpluses, so the whole of our $7 billion gold loss since 1957, plus perhaps as much as $3 billion that other central banks have willingly absorbed, has flowed from us to them."

So all this steadiness in our price level and balance of payments may well be illusory. A red flag is up. Our gold stock, as of last Wednesday, amounts to $15.6 billion. But this amount does not include $800 million owed to the International Monetary Fund. This leaves us with a real balance of $14.8 billion, and of this amount there is a 25-percent reserve requirement against Federal Reserve note and deposit liabilities, or about $12 billion. So, in effect, we have but $2.8 billion of gold to cover more than $25 billion of foreign short-term dollar balances. Perhaps this was the reason why Dr. Heller, in Paris last week, indicated support for a revised system of international liquidity to cope with the world's balance-of-payments problems and most especially our own. But this proposal, like the proposed interest equalization tax, simply misses the point.

Another angle in the economic growth situation that might be made is the profit squeeze. Quite some correlation exists between the lag in growth and the lag in profits. The First National City Bank of New York has noted that the return on net assets of leading corporations has declined from a high of 13.3 percent in 1950 to 11.3 percent in 1956, and has never been above 10 percent since 1958. In 1962, it was 9.1 percent. Economist George J. Stigler of the University of Chicago has demonstrated in his new book, "Capital and Rates of Return in Manufacturing Industries," published by the National Bureau of Economic Research, that there is a close relationship between rates of capital investment and long-range rate of return in manufacturing. Thus the profits lag has unquestionably contributed to the investment lag, to slower economic growth.

The role of profits cannot be overestimated. As the late Lord Keynes noted in discussing the sorry economic conditions in Britain in 1931:

"We live in a society organized in such a way that the activity of production depends on the individual businessman hoping for a reasonable profit, or at least to avoid an actual loss. The margin which he requires as his necessary incentive to produce may be a very small proportion of the total value of the product. But take this away from him and the whole process stops. This, unluckily, is just what has happened. The fall of prices relative to costs, together with the psychological effect of high taxation, has destroyed the necessary incentive to production. This is at the root of our disorganization. It may be unwise, therefore, to frighten the businessman or torment him further."

There are important public policy implications in this observation of Maynard Keynes. The profit squeeze is, of course, created from costs pressing upon prices. From where have these costs arisen? I have already commented on the labor problem. Another clue may lie in the fact that the U.S. Government has, through its foreign aid program since World War II, furnished about $120 billion to foreign governments and peoples. The Government has undergone a vast increase in size—and cost. In 1932, for example, the combined revenues of Federal, State, and local governments in the United States amounted to 17.3 percent of the net national product; in 1942, the percentage rose to 21.3; in 1952, to 31.8; and, in 1962, to 34.1 percent.

In other words, the growth of government is extensive and greatly adds to the cost of goods sold, and clearly affects the value of the dollar. One out of every eight civilian workers in the United States is employed by government; Federal, State, and local; workers on public payrolls number 9.5 million. In no way have State and local governments lagged behind the Federal Government. From 1942 to 1961, according to the Tax Foundation, the Nation's population increased by 36 percent, while in the same period State and local spending rose 138 percent in constant dollars. Senator Byrd estimates that in the 2-year period beginning July 1, 1962, the Federal Government will have hired 86,000 additional workers. Ironically, while the number of farms has gone down markedly by about 2.2 million since 1946, the number of employees in the U.S. Department of Agriculture has gone up dramatically, to an estimated 121,000 as of last July 1, compared with some 53,000 as of July 1, 1953. So while Federal farm spending amounted to $125 per farm in 1946, it rose to $495 per farm in 1954, and to $1,720 in 1962.

In view of all this, the last point I wish to make is to express my agreement that this committee study carefully the upcoming Federal budget for fiscal

1965 to see if it incorporates the administration's pledge to exercise an even tighter rein on spending.

Growth trends

[Billions of 1962 dollars]

Year	Gross national product		Personal income		Personal consumption expenditures		Business expenditures for plant and equipment	
	Actual	4-percent annual growth rate	Actual	4-percent annual growth rate	Actual	4-percent annual growth rate	Actual	4-percent annual growth rate
1957	$478.5	$478.5	$374.6	$374.6	$303.6	$303.6	$38.8	$38.8
1958	471.1	497.6	376.5	389.6	306.3	315.7	31.2	40.4
1959	502.6	517.5	396.6	405.2	323.6	328.3	32.6	42.0
1960	515.8	538.2	408.1	421.4	334.3	341.4	35.6	43.7
1961	525.5	559.7	420.2	438.3	341.3	355.1	34.4	45.4
1962	553.9	582.1	440.5	455.8	356.7	369.3	37.4	47.2
1962 deficiency:[1]								
Dollars	$28.2		$15.3		$12.6		$9.8	
Percent	4.8		3.4		3.4		20.8	

[1] 4-percent growth less actual.

The CHAIRMAN. Our next witness is Mr. A. L. Reed of the Public Information Committee of the Cotton Industries.

Mr. Reed, take a seat, sir, and proceed.

STATEMENT OF A. L. REED, MEMBER, PUBLIC INFORMATION COMMITTEE ON THE COTTON INDUSTRIES

Mr. REED. Mr. Chairman and gentlemen of the committee, my name is A. L. Reed, and I reside in Dallas, Tex. I am appearing for the Public Information Committee of the Cotton Industries, which I shall refer to as the Public Information Committee.

We appreciate the opportunity to appear before this committee and present our views with reference to H.R. 8363.

I have a written statement which I will ask be incorporated in the record, and I will briefly discuss its contents.

The CHAIRMAN. Without objection that will be done.

Mr. REED. It is with heavy heart and deep regret that I must correct the front page of that statement. It states that Leonard Calhoun is appearing with me as cocounsel. Leonard passed away yesterday, and he will not be here. I lost a good friend, and everyone lost a most gracious man, the most gracious man that I have ever known.

The Public Information Committee membership is related to the area of production of cotton, and it includes cotton gins, compressors, warehouses, merchants, and cottonseed oil mills. We are not speaking for the cooperative organization engaged in this business. Neither are we speaking for the spinning mills.

The membership includes approximately 1,600 cotton industries. Such cotton industries are essentially small business. They are large enough to be hurt by this bill and not quite large enough to receive any of its benefits. We come within the area of income ranging from $100,000 to not over $1 million.

Our principal competitors are the cooperative corporations. They pay only a single tax. We pay corporate taxes, and the dividends

which we distributed are always taxed, with the 4-percent-dividend credit considered.

We are not opposing a tax reduction. We strongly favor a real tax reduction which will reach the base of our economy.

We have four suggestions to make concerning H.R. 8363 which are well within the purposes of the bill, as stated by House Ways and Means Committee.

It stated that the principal purpose was to lower the taxes, and then it added the idea of equity in the tax laws and to remove hardship provisions and unfair provisions of our tax laws.

Our first suggestion is that any tax reduction be tied in with reduced Government spending. We are aware of the suggestion that since the Congress controls approriations it can, by this power, control expenditures. This argument overlooks outstanding authority to spend some $85 to $90 billion.

The recent increase in the debt limit to $315 billion is a fact alone which causes us to be alarmed over runaway inflation.

We have faith in the ability of this committee to find ways and means to reduce taxes and, at the same time, control expenditures.

Our second suggestion is that if we are to reduce taxes, that loopholes should be closed which would produce revenue for the Government. We have one particular loophole which we wish to call to your attention.

The 1954 Internal Revenue Code, section 1382, permits cooperative corporations to use free of corporate taxes Government money paid for the storage of surplus commodities to make dividend distributions to members, patrons and stockholders, but no dividends are paid to the Government which owns the surplus commodities and which pays the money for the storage business. The loophole involves all surplus commodities, but the principal ones are grain and cotton.

The cotton industries are interested in the cotton storage. From the Commodity Credit Corporation's New Orleans office we have a list of the payments of storage to warehousemen of over $100,000 per year.

For the year ending December 31, 1962, we have selected one illustration from that list which shows the largest cotton warehouse in the Nation for the year 1962 received over $1,200,000 in storage revenue from the Government for the storage of Government-owned cotton. That was a cooperative corporation.

The Government revenue was nearly 75 percent of its total gross storage revenue. The profits earned by this cooperative corporation paid no corporate income tax, but the profits were distributed free of taxes to their members, patrons, and stockholders. They pay only a single tax.

Forty-six percent of our revenue, storage revenue, comes from Government storage business, but we are taxed twice on it, and our principal competitor is permitted to use that Government money to buy business from us.

Our third and fourth suggestions are closely related. We are asking you not to cancel the dividend credit. It is a small, token relief for the small industries and the small corporations.

We also ask that you reject the speedup provisions for the prepayment of corporate taxes. The cancellation of the dividend credit combined with the speedup provision actually results in increased taxes for corporations of the size for which I speak.

The reason advanced by the Ways and Means Committee for the cancellation of the 4-percent-dividend credit are neither valid nor logical. Attached to our written statement is a copy of the statement of this committee from its 1954 report on the Internal Revenue Code. From it you will see the answer by mere arithmetic that the Ways and Means Committee gave an erroneous reason for the cancellation of our dividend credit.

We shall not go into that question to any great extent, but we hope that in the consideration of this bill this committee will not endorse the principle of double taxation as applied to our business and, at the same time, give to our principal competitor the maximum reduction in a single tax which they pay, and they are located in the same communities where we have our business.

I thank you very much for your attention and I hope that you will find it convenient to grant us some of our suggestions.

Senator GORE. Thank you.

(The prepared statement of Mr. Reed follows:)

STATEMENT BY A. L. REED, MEMBER, PUBLIC INFORMATION COMMITTEE OF THE COTTON INDUSTRIES, PRESENTED NOVEMBER 13, 1963, IN RE H.R. 8563, A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954

Mr. Chairman and gentlemen of the committee, my name is A. L. Reed and I reside in Dallas, Tex. I am appearing for the public information committee of the cotton industries (hereinafter referred to as "the public information committee"). The headquarters of this organization are in the Cotton Exchange Building, Dallas, Tex. My address is 4408 Westway, Dallas, Tex. I am appearing as a member of that committee.

First, we wish to thank the Senate Finance Committee for the opportunity to appear here and present our views concerning certain provisions of H.R. 8363.

The public information committee is an informal organization of certain members of the cotton industries which seek to obtain tax equality and tax justice for its members. Its members are cotton merchants, cotton gins, cotton compresses, cotton warehouses, and cottonseed oil mills. The cotton spinning mills are not associated with us and we are not speaking for them. Generally the public information committee membership relates to the industries associated with area of production of cotton and, therefore, the cotton spinning mills are not included.

There are approximately 1,600 firms, corporations, and individuals participating in the activities of this organization and supporting its efforts to obtain a fair and just income tax law as related to their business.

We are not speaking for the members of the cotton industries represented by the cooperative corporations of the Nation.

Mr. Leonard Calhoun, 411 Washington Building, Washington, D.C., is associated with me as counsel for this group and he is available here today for such questions as the committee might desire to ask concerning the Internal Revenue Code of 1954 and the provisions of H.R. 8363.

The cotton industries are essentially small business. The largest of the cotton industries, other than cooperative corporations, are, in fact, small business as compared with corporations generally. The net profits of the cotton industry corporations represented by this organization would seldom reach the million-dollar class, although the profits are such that H.R. 8363 affords such cotton industries little or no reduction in taxes for several years to come.

On the other hand, H.R. 8363, because of the peculiar method of taxing the income of cooperative corporations, will provide maximum reductions for the principal competitors of the members of our organization. Hence, we are appearing here seeking a fair consideration of our conditions as related to this bill. The committee wishes to make it clear that it is not opposing a tax reduction. Our purpose here will be presented under four points, stated below, in which we ask—

(1) That any tax reduction be definitely related to reduce governmental expenditures;

(2) That certain loopholes in the tax structure be closed;

(3) That the dividend credit be increased, not canceled; and,

(4) That you reject the speedup provisions for the advance payment of the remaining half of the corporate taxes above the first $100,000.

The requests which we are making are well within the purpose of the bill as stated by the Ways and Means Committee.

In presenting H.R. 8363 to the House, the Ways and Means Committee stated that the principal purpose was to lower tax rates and added that:

"The purpose of this bill also is to improve the equity of the tax laws by removing or altering features of the tax provisions which are generally considered to be unfair and by meeting certain hardships which exist under the present structure."

Our first point is that the tax reduction should be tied in with reduced expenditures.

We believe, based on the experience of the past, that unless this tax reduction is definitely connected with an effective control of governmental expenditures we will lose all the benefits which should come from a tax reduction and the stimulation of our economy. We are aware of the arguments which have been presented that the Congress controls appropriations. However, we also know that appropriations are made for future expenditures and that there are many billions of dollars now available, under the control of the various Bureaus, for expenditures without regard for the income to cover such governmental expenses. Of course, Congress has the authority to control future appropriations, but the difficulty here lies in Government expenditures which have been previously authorized and are now available for the puropse of increasing the deficit and the debt of our Government.

The recent approval of the Congress of an increase in the Federal debt limit to $315 billion should be a warning sufficient to create alarm over the dangers of runaway inflation. The members of this committee are experienced both in legislative matters and economics and we are sure that you will find a way to give us the benefits of a tax reduction and, at the same time, control expenditures and the national debt.

Our second point concerns one particular loophole in the revenue possibilities of the Internal Revenue Code.

The 1954 Internal Revenue Code, section 1382(c)(2) permits certain cooperative corporations engaged in the business of storing surplus commodities for the Government to distribute the profits which they make from the storage of Government surplus commodities, in this instance we are particularly concerned with cotton, free of corporate taxes. This is no small matter and it affords an opportunity to find revenue to reduce some of our deficit spending. Cooperative corporations do not pay taxes on the storage revenue paid to them by Commodity Credit Corporation, and, in turn, are permitted to distribute the profits from such storage charges as patronage dividends, not to the Government as a patron, but to use it as a patronage dividend to control the storage business at its source and to unfairly take it away from competing taxpaying industries. The principal commodities involved in the storage of surplus commodities are grain and cotton. There are others, and the storage charges are substantial, but these two are sufficiently illustrative. The Public Information Committee and its members are interested in cotton storage. We pay taxes on all moneys which we receive from the Government, not only at the corporate level, but now you are proposing to cancel the meager dividend credit of 4 percent which our stockholders enjoy after we pay the 52-percent corporate tax. The New Orleans Office of the Commodity Credit Corporation has prepared a list of all payments over $100,000 for the calendar year 1962. From this statement, we have selected one example. It shows one cooperative corporation engaged in the storage of cotton which received $1,227,744 in Government storage revenue as of December 31, 1962. The gross storage revenue of that cooperative corporation, for approximately that same period, shows that the Government payment was substantially 75 percent of this cooperative corporation's gross storage revenue. Seventy-five percent of its storage business was Government money, covering Government commodities, and for service rendered to the Government, on which the cooperative corporation paid no taxes on its earned profits. That cooperative corporation competes with an independent taxpaying industry located in the same community, and it distributes the profits from that more than $1 million to our prospective customers to influence the movement of their business into the nontaxpaying plant. This is just one instance, but we ask that you multiply it by the storage revenue of all cooperative corporations received from the storage of all surplus commodities. It produces a substantial loophole which we earnestly urge you to close. The

revenue loss is not limited to the payments made to the cooperative corporations. Obviously, privileges of this character force the independent taxpaying industry to meet the competition, and it can only do it by offering inducements to the same customer to bring his cotton to the taxpaying warehouse for storage. As a result of this competition, there is a loss in tax revenue to the Government from all sources, not just from the cooperative corporations. It, however, sets the competitive standards which the rest of us must meet. I have attached to my written statement a proposed amendment to the 1954 code and to H.R. 8363 which will close this loophole. It will prohibit the use of Government money to pay patronage dividends out of Government money earned on Government business.

Our third point seeks to have this committee increase, rather than cancel the dividend credit.

The cotton industries' principal competitors, as I have previously pointed out, are cooperative corporations. They are engaged in the same line of business as the members of the public information committee, yet the cooperative corporation and its members, its stockholders, and its patrons pay only a single tax and that tax is paid only by the patrons or members. No tax is paid by the cooperative corporation. The 4-point reduction in the basic tax rate will not offset the increase in double taxation of our members which will result if you cancel the 4-percent dividend credit because, at the same time, you have provided for a speedup in the prepayment of our corporate income taxes which has the effect of largely nullifying the reduction in the rate which has been proposed in H.R. 8363. Thus, the major reason given by the Ways and Means Committee for the cancellation of the 4-percent dividend credit has no validity.

The other reasons given by the Ways and Means Committee for the cancellation of the dividend credit was that the ratio of equity to debt financing had not increased despite the presence of the 4-percent dividend credit. This statement of the Ways and Means Committee is particularly discouraging to the cotton industries because, as shown in exhibit 2, hereto attached, the original dividend credit designed to increase equity financing as compared with debt financing was, in fact, never given to the industries of this Nation.

Exhibit 2 is a quotation from the Senate report with respect to the 1954 tax law. First. I am sure you will remember that the President, in his budget message, recommended a 15-percent dividend credit to be granted in three stages—5, 10, and 15 percent. This committee reduced this proposal to a 10-percent dividend credit to be made effective in three stages of 2, 7, and 10 percent. This corresponded substantially with the action of the Ways and Means Committee. The proposal of the 10-percent credit was defeated on the floor of the Senate, and a 4-percent compromise was inserted in the bill by the Senate and House conferees. Therefore, what the Ways and Means Committee states today with respect to H.R. 8363, that it has not increased equity financing, is due to the fact that the House and the Senate have failed to give to the industries of this Nation an opportunity to build up equity financing by permitting the stockholders of the corporation to have the benefit of the taxes paid by the corporations. The 4-percent credit helped, but certainly it was not sufficient, as shown by the facts, to accomplish the desired result, but that is no reason for canceling it. Certainly, this is true in view of the fact that the 4-percentage-point reduction in the basic corporate rate is withheld for several years to come.

Another reason given by the Ways and Means Committee for the cancellation of the 4-percent dividend credit was the statement that it was discriminatory against low-bracket taxpayers, and in favor of the high-bracket taxpayers. Exhibit 2 is an excerpt from your report on the 1954 law, and it shows by simple arithmetic, that this statement by the Ways and Means Committee is in error. The 4-percent dividend credit gives the 20-percent bracket a 20-percent reduction; the 30-percent bracket a 13.4-percent reduction; the 50-percent bracket an 8-percent reduction, and the 70-percent bracket a 5.7-percent reduction. These calculations have been worked out in the same manner as the calculations in the Senate report on the 1954 law, and are based on simple arithmetic. There can be no basis, in fact, for the repeal of the 4-percent dividend credit on the basis of discrimination against the low bracket taxpayers.

Our fourth point is that the speedup of payments for the remaining half of taxes above $100,000 should be rejected.

Under this particular point, we wish to emphasize again that our principal competitors are cooperative corporations, and further that their earnings are subject only to one single tax which is paid by the members, stockholders, or

patrons. Little or no tax is paid by the cooperative corporations as such. The needed relief which is partially offered by the 4-percentage-point reduction in the tax rate for our corporations is practically nullified by the speedup in payment for an extensive period. This speedup provision serves to deprive corporations of the size represented by the Public Information Committee of any substantial reduction in taxes for several years because it deprives them of funds which they normally need to operate their business. The situation here is that as to our principal competitors, paying taxes only at the membership level, receive a substantial reduction in taxes which is made effective with the passage of H.R. 8363. While, at the same time, the corporation's members of the cotton industries will not receive the benefit of your so-called 4-percentage-point reduction in the tax rate until approximately 1970. Does that seem fair to anyone—that you give the cooperative corporation and its members a single tax, give them the maximum reduction in that single tax, and then withhold from us any reduction until approximately 1970? We submit that the four reasons which we have given you for amendment to the H.R. 8363 are valid, reasonable, and fair, and we hope this committee will adopt them.

Exhibit 1

That section 1382(c)(2) of the Internal Revenue Code of 1954 (relating to deduction for nonpatronage distributions, etc.) is amended to read as follows:

"(2) amounts paid during the payment period for the taxable year—

"(A) in money, qualified written notices of allocation, or other property (except nonqualified written notices of allocation) on a patronage basis to patrons with respect to its earnings during such taxable year which are derived from sources other than patronage but in no event from business done for the United States or any of its agencies, or

"(B) in money or other property (except written notices of allocation) in redemption of a nonqualified written notice of allocation which was paid, during the payment period for the taxable year during which the earnings were derived, on a patronage basis to a patron with respect to earnings derived from sources other than patronage but in no event from business done for the United States or any of its agencies."

Sec. 2. The amendment made by the first section of this Act shall be effective only with respect to taxable years beginning after December 31, 1963.

Exhibit 2

Senate Report—1954 Law

IV. CREDITS AGAINST TAX

A. Dividends received by individuals (secs. 34 and 116)

(1) House changes accepted by committee—

Under present law the earnings of a corporation are taxed twice, once as corporate income and again as individual income when paid out as dividends to shareholders. This is due to the fact that dividends unlike wages or interest do not constitute a deduction to the corporation.

This results in a higher tax burden on distributed corporate earnings than on other forms of income. In addition, it has contributed to the impairment of investment incentives. Capital which otherwise would be invested in stocks is driven into channels which involve less risk in order to escape the penalty of double taxation. This restricts the ability of companies to raise equity capital and has forced them to rely too heavily on borrowed money. The penalty on equity financing has been especially harmful to small business which cannot easily borrow funds and must rely on equity capital for growth and survival.

The House and your committee have reduced double taxation by adopting two related provisions: One (sec. 116) affords complete relief from the double tax on small amounts of dividend income. Under both versions of the bill an individual may exclude from his gross income up to $50 of dividend income received from a domestic corporation during a taxable year ending after July 31, 1954, and before August 1, 1955. In subsequent taxable years he may exclude up to $100 of his dividend income. These exclusions are granted for each taxpayer which means that a husband and wife filing a joint return will have two exclusions where each is a dividend recipient.

In addition, the other provision (sec. 34) under both versions of the bill provides relief by making available a dividend-received credit for part of the corporate tax paid on the dividends in excess of the amount excluded. This is a credit against tax, equal to 5 percent of dividend income above the exclusion received after July 31, 1954, and before August 1, 1955, and 10 percent of dividend income above the exclusion received after July 31, 1955.

The amount of the credit is limited to 2 percent of taxable income in 1954, 7 percent in 1955, and 10 percent in subsequent years. This limitation restricts the credit to the amount of dividend income which actually enters into the tax base. The use of 2 percent and 7 percent for 1954 and 1955 removes the necessity of prorating income in the 2 years.

The August 1 date for the credit was selected in order to minimize the likelihood that corporations will change the dates of dividend payments in the year in which the credit is introduced or increased.

The relief offered by the dividend-received credit is limited to situations in which double taxation actually occurs. Accordingly, the dividend-received credit is not allowed with respect to dividends paid by foreign corporations or tax-exempt domestic corporations. Moreover, it does not apply to dividends of exempt farm cooperatives or to distributions which have been allowed as a deduction (in effect treated as interest) to a mutual savings bank, cooperative bank, or building and loan association. In addition, the dividend-received credit is not available to nonresident alien individuals not subject to the regular individual income tax. (For differences in the treatment of dividends of insurance companies under the House and your committee's bill see (2) below.)

The proposed dividend exclusion and credit confers partial relief for double taxation in the most administratively feasible manner. Moreover, the method of adjustment adopted 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. For example, in the case of a married couple filing a joint return, the 10-percent credit alone will reduce existing tax liabilities on dividend income in the $4,000 first bracket (subject to a 20-percent rate) by 50 percent; on dividend income in the $12,000 to $16,000 bracket (subject to a 30-percent rate) by 33 percent; and on dividend income in the $32,000 to $36,000 bracket (subject to a 50-percent rate) by 20 percent. At very high income levels, the percentage reduction in tax on dividend income will be about 11 percent.

The combination of a dividend exclusion and a credit for dividends received was adopted in preference to various other methods to relieve the existing double taxation of dividend income. A credit to corporations for dividends paid would be unsatisfactory because it would in effect make the remaining corporation income tax an undistributed profits tax, or a tax on retained earnings, the principal source of equity capital. Also, a dividend-paid credit for corporations would completely relieve from tax dividends received by tax-exempt organizations.

The method of relief from double taxation selected is a modification of the dividends received credit adopted in Canada in 1949. However, the present Canadian credit is 20 percent instead of 10 percent. Moreover, limiting the credit to the amount of taxable income, when it is less than the amount of dividends, is a restriction not imposed under the Canadian system. On the other hand, the dividend exclusion provided is more liberal than the Canadian method for persons receiving small amounts of dividend income.

In effect, the 5- or 10-percent credit exempts dividend income from 5 to 10 percent of the tax rate applicable to an individual's income. In this country, prior to the middle 1930's dividends were exempt from the normal individual income tax, which was generally the first bracket rate. This gave recognition to the fact that the income from which they were paid had already been taxed at the corporate level. It was not considered appropriate, however, to give a credit equal to the entire 20-percent first bracket rate.

Another suggestion has been to give the dividend recipient a deduction in computing taxable income for some specified percentage of dividends received instead of the credit against tax. However, this proposal was rejected because it gives higher proportionate tax relief to stockholders in the upper income brackets.

Senator GORE. Senator Williams?

Senator WILLIAMS. No questions.

Senator GORE. The committee will be adjourned until 10 tomorrow.

(By direction of the chairman, the following is made a part of the record:)

THE PECK CO.,
Michigan City, Ind., November 8, 1963.

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

DEAR SENATOR BYRD: I believe that the value of any proposals purporting to stimulate the economy should be appraised on the basis of their expected effect in creating jobs, and the rate at which they can be expected to terminate our 30-year-old tragedy of unemployment.

Not even the authors of the plan to cut taxes in order to stimulate the economy, their desciples and champions—nor the formulators of H.R. 8363—claim any degree of effectiveness for H.R. 8363 in reducing the critically unacceptable levels of unemployment.

This diffidence is prudent, to say the least, because a tax cut, this tax cut embodied in H.R. 8363, is a murderously complex version of the same new-economics prescription of more spending, in either the public or private sectors, or both, that has failed, over a period of 30 years, to revive our economy by creating sound and useful jobs for the unemployed, and their blood relatives, the featherbedders, goldbrickers, and their like.

This preoccupation with spending, with consumer buying power, rather than with the creation of values for the marketplace, explains the failure of the new economics to effect a cure of our economic stagnation, and the failure to achieve economic health, strength, and the desired rate of growth.

And along with the 30-year preoccupation with spending, we have acquired an abnormal dependence on economists and their attendant hordes of experts who have in turn developed a totally unwarranted preoccupation with, and reverence for statistics.

We ordinary mortals, we nonexperts, seem to have lost our talent for thought, analysis, and understanding of simple fundamentals.

So the experts lead us—and themselves—astray.

For example: All during 1958 and 1959 we were told by the experts to get ready for the soaring sixties. This forecast of unprecedented prosperity during the 1960's was based on the statistics of the coming population explosion.

The 1960's didn't soar, and they won't, unless we provide the conditions that will create sound, useful jobs.

Now the same experts, use the same statistics on the population explosion to view with alarm these massive additions to the work force, and the roles of the unemployed.

Both forecasts are unwarranted.

Another example of the extreme care needed in interpreting statistics has to do with education.

It has apparently been established, that college graduates earn a lot more money during their working lives than do we "barbarians" who are not of the elite—although that isn't the way I read Horatio Alger.

From this statistic, we derive the comforting premise that the persistance of unacceptable levels of unemployment, is due to lack of sufficient education, and not to our economic fumbles.

Fortunately, Dr. Walter Heller, who presumably inspired H.R. 8363 to stimulate the economy, recently stated that even though the entire work force became college graduates, we would still have the tragedy of unemployment, unless we provided those conditions that would create jobs.

It is our misfortune, but more especially the misfortune of the unemployed, that we have abandoned our own independent thought, in favor of the experts of the new economics, whose only remedy is some form of more spending, rather than old-fashioned improvement in performance.

These matters are cited here, not for the purpose of belittling the sincere efforts of the experts to solve our critical economic problems, but merely to confirm the fact that we must quit kidding ourselves that Government experting and planning is a possible source of our material well-being.

We must reaffirm the simple fundamental that it is the rate of industrial progress, in terms of the efficiency of our economic facilities—and the degree of effectiveness of use of these facilities—that determines the degree of our economic health, strength, and rate of growth.

Strangely enough, it was recognition of this fundamental that provided the foundation for the Marshall plan that restored the economy of Europe.

And it is this principle that underlies our current economic aid to underdeveloped countries.

To whatever degree economic foreign aid fails, the fault can be charged to the unavoidable ineffectiveness of political handling and operation, and not to the principle involved.

Russia's surge of economic strength is admittedly due to a rapid rate of industrial progress—and this we recognize.

In the light of these facts, it is strange indeed that our domestic policies are marked by a widespread hostility, intolerance, and even fear of the industrial progress that alone can restore our economic vigor.

Perhaps this hostility and intolerance is just a carryover from the era of economic royalists, princes of privilege—the era of the academic whiz kids, who knew more about everything, and who could run everything better, than the millions of specialists, who devote their lives to building and operating our industries and our commerce.

For example, Senator Mike Mansfield, who is I'm sure, universally respected, was asked his opinion of the administration's tax cut proposals. I believe this was on the occasion of the Congress return from Easter recess.

The Senator was reported to have said that he would support individual tax cuts, but that he would oppose any further cuts for industry, and he was reported to have said: "We have done enough for business."

That is an astonishing and disturbing statement. It plainly establishes the fact that our political leadership (presumably the entire Federal Establishment) does not recognize the impossibility of doing something for people's material well-being, except through measures that will induce a more rapid rate of industrial and business improvement and progress.

Among other things, economic illiteracy has been blamed for our economic woes—and of course, this illiteracy is attributed to the ordinary guys and dolls--to the common man—to the man in the street.

I've got news for you.

The really dangerous area of economic illiteracy, of failure to understand the simple fundamentals of our material well-being—these are found throughout our social, political, and economic leadership—and that is why our economic woes have persisted for 30 years.

I've been in Washington most of the time during the past 2 or 3 months, trying to sell the Congress on a sound and constructive alternative to the dangerous H.R. 8363.

The most disturbing thing that I have encountered is apparent acceptance of unemployment as a continuing condition of our modern economic society. We seem to have accepted defeat.

We rationalize our surrender in many ways.

The most astonishing of the rationalizations is the widespread denial that there is any unemployment, except of the voluntary variety, on the part of "those no-good bastards who would rather be on relief than work." Tragic nonsense.

From there, the rationalizations range all the way to the one proffered rather recently by the economists and their fellow experts, to the effect that the major technological and scientific breakthroughs are primarily responsible for unemployment—and that the inevitable adjustments to such rapid progress will be a steady and to-be-expected level of unemployment equal to "about 4 percent of the work force. I wonder how the 4 percenters will like that?

In short our leadership has accepted defeat on unemployment.

In the area of racial unemployment we offer the unnourishing "sugar tit" of civil rights and fair employment practices legislation—a lousy substitute for jobs.

And across the whole field of unemployment, we offer the other "sugar tit" of tax cuts, sweetened (?) with the tragic inadequacies of unemployment compensation and relief—inadequate, even though these measures nearly break the financial backs of the taxpayers despite the misery they sustain.

But who can deny that unemployment is our No. 1 social, political, and economic problem—the source of unmitigated misery, not only for the millions of unemployed, but for their millions of dependents, relatives, neighbors, and friends.

First, let's admit, right out loud, that H.R. 8363, like the scores of increases in consumer spending allowances that have preceded it, will not cure, or even measurably alleviate unemployment.

Second, let's junk H.R. 8363 because it fails to meet this critical test, while actually carrying the seed of increased unemployment if the tax cut, increased debt, and spending bring about even a very modest dose of inflation.

Third, let's refuse to admit defeat in solving the unemployment tragedy.

Fourth, let's start our search for the answer to this stubborn, 30-year-old source of misery, racial tensions, delinquencies, etc., etc., etc., by asking and answering a few very simple, basic questions about jobs.

And don't give up, or brush the questions and answers aside because they are too simple.

For too long we have been the victims of the cult of complexity in economics that was introduced as the remedy for the awful depression of the early 1930's.

So—What creates jobs? Customers create jobs.

What creates customers? Values create customers.

What creates values? Industrial progress, in terms of improved efficiencies (modernization) of our economic facilities, and in terms of the effective use of these facilities (no featherbedding) for—production; transportation; communication; service—these create the values.

In short, intensive moderization of the whole range of our economic facilities, together with the elimination of costly featherbedding and goldbricking, and together with a halt on wage and fringe benefit increases until industry has caught up with the unearned increments of the past.

These measures would definitely—

Provide the tremendously improved values (lower prices);

That would create millions of additional customers—who alone can create wanted and useful jobs.

So why aren't we engaged in intensive modernization?

The answer to that is as simple as A B C.

The Federal Government's tax rulings or schedules on amortization and depreciation absolutely prevent a more rapid financing of this sound and constructive modernization of economic facilities that would definitely solve our unemployment problem.

Here is an example that can be confirmed by calling on Mr. Daniel P. Loomis, president of the Association of American Railroads.

The following figures come from the member railroads:

Under present amortization and depreciation schedules, American railroads spend on moderization annually, the very limited figure of $300 million.

If amortization was made optional, so that rate of writeoff could be tailored to the condition and situation of each unit, then the annual rate of modernization would be $1,600 million.

Just for the railroads, this annual increase in rate of modernization equals $1,300 million.

Figuring 70 percent of this amount for "labor," there would be 91,000 additional jobs created, at $10,000 per year average, in the capital goods industries that directly and indirectly provide the railroads with the means of modernization—in the capital goods industries that are the foundation of our economic strength and potential.

And of course this rate of modernization would rapidly strengthen the operations of the railroads.

And of course the 91,000 additional jobs would take care of the 40,000 featherbedding diesel firemen, plus 51,000 unemployed.

Therefore the first step in stimulating the economy through the creation of jobs, is to defer any action on H.R. 8363.

The second step is the scuttling of those massive deterrents to the industrial progress, the modernization of our facilities—that creates the values; that creates the customers; who create the desperately needed jobs.

Scuttle the amortization and depreciation schedules, make writeoff optional, and you will quickly induce the intensive modernization that is needed to really "stimulate the economy."

It should be noted that under this alternative to H.R. 8363 no tax is forgiven until after a new tax has been earned through greater activity in the capital goods industries.

And every unemployed that is given a job makes the tax collector win the daily double by getting rid of a liability and acquiring an asset—a taxpayer.

The third step is the elimination of the threat of the inadequacies of unemployment compensation and/or relief, by providing for financially painless transition of a featherbedding railroad fireman, for example, from that excrutiatingly boring and wasteful occupation, to a needed and useful job at Pullman-Standard,

or elsewhere, helping to provide the means of railroad modernization and improvement of services.

This third step should come easily. Certainly it doesn't make any sense to ask workers to pay for our industrial progress through the miseries of unemployment.

So, set up industry-labor "schools for new skills" to show the railroad firemen how to be useful at Pullman-Standard for example. These should be industry-labor schools—not Government.

One hundred percent attendance and 100 percent application to learning and our fireman is paid, while learning, 100 percent of the wage he received as a fireman. No reason to featherbed to keep the family going.

No attendance and/or no application to learning, no pay.

Hundreds of workers that I've discussed this with have given unanimous approval. It makes sense.

I'm certain that if you or I were faced with the alternatives that face the railroad firemen as of now; namely, featherbedding, or the inadequacies of unemployment compensation, and relief for the family, we too would elect to featherbed.

Incidentally, it would soon be discovered that 100 pecent of pay for the few weeks that it would take to teach American workers a new job, would be less expensive than 26 weeks of unemployment compensation at 50 percent of previous pay.

So the sound and constructive alternative to the extremely dangerous H.R. 8363—the alternative that will definitely create jobs by reviving the health, strength, and needed rate of growth of our economy—is the scuttling of amortization and depreciation tax rulings to induce intensive modernization of our facilities—the facilities that mark the economic difference between the United States and the underdeveloped nations that we bust a suspender to help acquire just such facilities. And we must then provide the measures for the financially painless transition from featherbedding or unemployment to useful, constructive work.

I can hear the experts saying that "this is greatly oversimplified."

But 60 years ago my dad used to tell me that Leonardo da Vinci's greatness was largely attributable to his credo—translated into dad's fine Vermont-ese "If it ain't simple, it ain't good." I bought that one years ago. How about you?

Maybe a word about myself in connection with this statement on H.R. 8363 would be in order.

I am very much a "senior citizen."

I feel reasonably well qualified to submit this statement because, in one capacity or another, I have been concerned with industrial operations for over 50 years, beginning as a machinist before World War I at the Beverly, Mass., plant of United Shoe Machinery.

For many years I was a fairly important cog in industrial publishing, first with the A. W. Shaw Co. and then McGraw-Hill.

And now I am still active in industry (but a lousy typist), serving in that refuge of all guys past the payroll age who don't want to quit—I'm a "consultant" as you will perhaps have noted on the letterhead.

I've been fighting any and all deterrents to industrial progress for something more than 30 years.

I've been working at this "crusade" here in Washington since August 21, strictly on my own expense and without sponsors or help of any kind—except for a ride from the Senate Office Building to the House Office Building, courtesy of Senator Strom Thurmond in his car, to keep an appointment that he had made for me with Colin Stam and Mr. Vail.

Numerous others have "lent me their ears," and for that, and this opportunity to help in terminating the American tragedy of unemployment, I am extremely grateful.

I have overstayed my financial means here in Washington and will therefore head for home as soon as I have filed this statement with that charming and diligent lady, Mrs. Elizabeth Springer.

Thanks to you, Senator Byrd, for insisting on hearings that provided me with this opportunity.

Sincerely,

JAMES O. PECK,
Industrial Marketing Counsel,
(*Every now and then*).

(Whereupon, at 12 noon the committee was recessed, to reconvene at 10 a.m., Thursday, November 14, 1963.)

REVENUE ACT OF 1963

THURSDAY, NOVEMBER 14, 1963

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

The committee met, pursuant to recess, at 10:15 a.m. in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Gore, Talmadge, Hartke, McCarthy, 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 a very prominent Virginian, Robert B. Delano, representing the Virginia Farm Bureau Federation. I want to express my great sorrow at the death of Maury Hubbard, who headed the Farm Bureau in Virginia. He died a few days ago.

Mr. Delano, we are delighted to have you, sir, and you may proceed.

STATEMENT OF ROBERT B. DELANO, PRESIDENT, VIRGINIA FARM BUREAU FEDERATION, INC.

Mr. DELANO. Mr. Chairman and distinguished members of the committee, my name is Robert B. Delano. I am a general livestock farmer from Warsaw, Va.

I am also serving in the capacity as president of the Virginia Farm Bureau Federation.

I appreciate the opportunity to appear before the committee on behalf of our 22,000-member farm family organization.

We compliment this committee for its foresight in giving all interested parties an opportunity to offer testimony on H.R. 8363.

The recommendation for national policy adopted by our voting delegates concerning Federal budgets and spending states:

> We cannot hope to prevent inflation if the Federal Government engages in deficit spending. The Government must exercise strict economy, eliminate duplication of effort, and promote efficient operations.
>
> Congress must take effective measures to regain control of Federal expenditures. The practice of authorizing expenditures from public debt transactions as a means of avoiding annual review by the Appropriations Committee should be discontinued.
>
> We insist that provision be made in the budget for an orderly reduction of the national debt. We oppose further increases in the national debt limit.
>
> We will support a reduction in income taxes when a comparable reduction in expenditures is effected.

We in Virginia Farm Bureau recognize the urgent need for a complete overhaul of our taxing system, with special emphasis given to downward adjustment of income taxes. It is obvious that the present

high rate of taxation upon personal income is hindering our economic growth. However, it is the position of Virginia Farm Bureau Federation that a tax reduction must be earned by the Federal Government through reduction in expenditures, and until such time that the reductions have been made, we feel that a tax cut would be unwise.

It is difficult to understand how fiscal soundness can be promoted through a tax cut when at the same time Federal expenditures are expected to increase. Our farmers know only too well that if their income is to be lessened in any given year, they must reduce their expenditures, or they will be in deep financial trouble.

We feel that the same principle of adjustment must become a part of the fiscal policy of the Federal Government.

The Commonwealth of Virginia has been stricken this year with a very severe drought which is affecting the income of our farmers very adversely. Yet, in spite of these conditions, our farmers are firm in their position that, before they would favor a tax reduction, a comparable reduction in expenditures should be effected.

The threat of inflation is the greatest enemy that our economy faces at the moment. Inflation not only lessens the buying of power of the dollar but also causes many persons on limited and pensioned income to face financial hardship. We feel increased deficit spending, which the tax cut and increased expenditures obviously would result in, would threaten inflation and compel Congress to expand the national debt well past the proposed $315 billion ceiling.

Our members insist that the Congress of the United States assert itself in its rightful responsibilities by making provisions in the national budget for an orderly reduction in the national debt. The deception of ever increasing the debt limit in order that deficit spending can be increased must be stopped.

We in Virginia have been operating on a pay-as-you-go basis for a great many years with considerable success. This sound financial policy was implemented under the leadership of the distinguished chairman of this committee when he was Governor of the Commonwealth. We would urge that the Federal budget be similarly operated.

We would pose this honest question to you gentlemen of the committee: If in this unprecedented era of economic prosperity, our Federal Government cannot operate within its income and retire some of our unreasonably high national debt, when can the American people ever hope to see the budget balanced and debt decreased?

We feel strongly that a tax reduction is needed and needed now and should be earned by reduced Federal expenditures and debt reduction, thereby leaving more earning power in the hands of those who create wealth. A dollar invested privately will earn more than when invested by the Government and at the same time create taxable assets.

We reject the theory that ever-increased Government spending is necessary in order to keep our economy healthy. Our members endorse strongly the American Farm Bureau Federation recommendations to congressional committees on budget reductions and point out that, if our recommended agricultural programs were inaugurated, it would cut $1 billion from agricultural appropriations.

Finally, Mr. Chairman, it is the firm conviction of the members of our organization that in the final analysis it is the sole responsibility

of the Congress of the United States to inaugurate fiscal soundness in this country. In spite of requests by any administration for tax increases or tax cuts, budget increases or cuts and increases in the debt ceiling, it is still the constitutional duty of the Congress to collect and expend funds—no one else has the authority.

We would respectfully urge the Finance Committee of the Senate to begin now to promote fiscal integrity in this great land of ours by insisting that expenditures in future budgets be cut in accordance with any specific cut in taxes. If this step is taken, future generations whose credit is being prostituted by present-day deficit spending will reserve for you a place of honor in history.

Thank you, sir.

The CHAIRMAN. I certainly want to thank you for a very able statement, and I want to express my appreciation for your comment with respect to my service as Governor.

I think that the sincerity of the farm bureau is clearly shown when it advocates a reduction of $1 billion from agricultural appropriations; in other words, you are willing to do your part, the farmers are, in the balancing of the budget, and you oppose the tax reduction of $11 billion, which necessarily must be added to the public debt, regardless of what some of the advocates of that plan say. So I thank you very much for making this sound contribution to the consideration of this bill.

Senator Gore?

Senator Carlson?

Senator CARLSON. Mr. Delano, only this: The Kansas State Farm Bureau recently held their State convention in Wichita, Kans., and they adopted resolutions which follow very closely the statement you made this morning. I thought you might be interested to know that there are other farm bureaus in the Nation who are thinking along the lines you are in Virginia.

Mr. DELANO. Thank you.

The CHAIRMAN. Senator Talmadge?

Senator Dirksen?

Senator DIRKSEN. I just want to say that is certainly a redoubtable and strong statement, and I appreciate it.

Mr. DELANO. Thank you.

The CHAIRMAN. Thank you very much.

The next witness is Mr. William Jackman of the Investors League.

STATEMENT OF WILLIAM JACKMAN, PRESIDENT, INVESTORS LEAGUE, INC.; AS PRESENTED BY ROBERT A. GILBERT, CHAIRMAN, INTERNATIONAL DIVISION, INVESTORS LEAGUE, INC.

Mr. GILBERT. Mr. Chairman, Mr. Jackman is unable to speak today. I am an officer of the league. My name is Robert Gilbert, and he asked me to give his statement, and to be prepared to answer questions, unless you object to it.

Senator DIRKSEN. Mr. Chairman, I might say, at the outset, I have known Mr. Jackman for a long time. I understand he is suffering from laryngitis, and it is virtually impossible for him to make a personal presentation.

Mr. GILBERT. Yes, sir.

The Investors League is a nonprofit, nonpartisan, voluntary membership organization of thousands of individual investors, small and large, residing in every State of the Union. Founded in 1942, it is America's largest and oldest "Union" of investors.

The CHAIRMAN. Would you please identify yourself for the reporter.

Mr. GILBERT. My name is Robert A. Gilbert, and I am chairman of the International Division of the Investors League, and I was, for 10 years, the Director of the organization until an operation forced me to take a little less active part.

Mr. Chairman and distinguished members of the Senate Finance Committee, on behalf of many investor members, I wish to thank you for the privilege of appearing before this distinguished committee for the purpose of presenting the viewpoint of American investors on H.R. 8363, the tax bill recently passed by the House of Representatives and now before you for consideration.

Widely advertised as a tax "reduction" and tax "reform" bill designed to "get the economy moving again by stimulating investment incentive," it turns out to be no such thing at all as it affects most corporate investors.

The great bulk of new capital required to "get the economy moving again" must come from the savings of individuals in the middle and upper income brackets and from their retained earnings in the corporations which they collectively own. These are the people whose incentives to invest in the job-creating, profit-building, new plants and machinery and new industries, were to be stimulated by meaningful tax reduction.

These, gentlemen, are the people, the only people, who can provide the $30,000 of capital needed to create each new job in industry.

They had every right to expect administration recognition of the inequity of double taxation of corporate earnings by providing in this tax bill some increase in both the $50 dividend exclusion and 4-percent credit; a drastic reduction in the confiscatory miscalled capital "gains" tax rate; a narrowing of the progressive feature of the individual income tax; some acknowledgment of the inequity of the inheritance tax now approaching a maximum rate of 77 percent; some guarantee that their tax savings would not immediately be wiped out by planned price inflation. These, gentlemen, are the steps, mild as they might have been, that might best get the economy moving again—steps that would give substance to the fact that we have a national tax policy redirected toward preserving the property rights of the individual.

But instead of this, what did the investor really get? Where is the stimulant to investment incentive? And why all the administration pressure to rush this through Congress without ample debate?

I now wish to address myself to several specific aspects of this proposed legislation that would tend to defeat its avowed purpose.

DIVIDEND EXCLUSION AND TAX CREDIT

Starting almost a year ago, spokesmen for the administration insisted that, in the new tax bill, the presently effective $50 exclusion of dividend income and the 4-percent tax credit on dividend income, as endorsed by Congress in 1954, be completely repealed. This was a warning to America's 17 million taxpaying investor-owners of Amer-

ica that this administration, all professions to the contrary, was interested in destroying, not advancing investment incentive.

On June 10, an unexpected victory for investors seemed apparent on this issue when 4 Democrat members of the House Ways and Means Committee joined with 10 Republicans in voting 14 to 11 against repeal of the exclusion and credits. The following morning's press reported that the administration would use every effort to "persuade," I quote gentlemen, "persuade" these four Members of Congress to reverse their votes. I am quite familiar with the political art of so-called "persuasion."

Two of the four involved yielded to this carrot stick, but only after compromising the issue by increasing the dividend exclusion from $50 to $100 and eliminating the 4-percent dividend credit completely. This is a "sop" to the small investor and a deceit to the millions of investors who provide the bulk of new investment capital. So the bill now comes to you gentlemen in this form.

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 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 shareowners 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 incomes 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 proposal to raise the exclusion from $50 to $100 would cost an estimated $70 million in tax revenue, 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 economy of our country can progress only if there is a favorable climate for risk capital, the kind which may produce dividends.

Many other countries—England, Canada, Japan, and West Germany—give more favorable tax treatment to dividends than we do under present law. Our present law treats corporate earnings and dividends, as follows, and there you see the table which indicates that

only $28.80 out of each $100 earnings before taxes is retained by the individual after both corporate and individual taxes are paid.

The individual in the 40-percent bracket has left to him only $28.80 of the $100 pretax corporate profits, as I have said.

1. Corporate earnings before taxes	$100.00
2. Corporate income tax at 52 percent	52.00
3. Corporate earnings after taxes	48.00
4. Individual income tax on dividends, at assumed rate of 40 percent	19.20
5. Balance of corporate profits left to individual after corporate tax and individual tax are paid	28.80

Salaries or wages or business profits of $100 received by an individual partnership, or sole proprietorship in the 0-percent bracket, would yield $60 after income tax, or more than twice the after-tax income resulting from corporate profit distributed as dividends.

In this big economy of ours, it seems essential that most business must be conducted in the corporate form. If we penalize profits earned through the corporate form, are we not stifling the incentive for investment of the risk capital needed to achieve full employment and economic progress?

We believe that dividends, which are not really "income" but only a transfer of income already heavily taxed, should be free of additional tax. To remove, or curtail, the small tax relief that dividends now receive, would hurt our economy, make unemployment more critical, and "scare" capital into tax-free investments.

We urge you gentlemen to amend the House bill to restore the 4-percent dividend credit. We would further suggest that taxpayers, in reporting dividend income, be given an option to elect either:

(1) Accept a $100 exclusion only; or

(2) Accept a $50 exclusion plus a 4-percent dividend credit.

TREATMENT OF CAPITAL GAINS

The original administration proposal urged that a long-term capital gains tax be imposed on gifts and estates payable at the time a gift is made, or upon death, on property so bequeathed over and above the cost to the original owner. This proposal was eliminated from the House-passed bill, but unless the Senate puts it back, the Treasury Secretary insists that the provision included in the House bill providing for a modest reduction in the maximum tax on long-term capital gains (from 25 to 21 percent) should be eliminated, in spite of the fact that the Treasury would gain $300 million in revenue from this modest reduction.

Gentlemen, we urge that this provision be at least left intact. As a matter of fact, the maximum long-term capital gains tax rate should be cut in half and the Treasury could then recoup a truly large harvest. It seems to be the only tax cut that would substantially increase Federal revenues.

WHAT IS OUR NATIONAL TAX POLICY?

Gentlemen, I doubt if we have one. If so, it seems to be dictated by political expediency. Give the benefits to the low-income groups. Get them completely off the tax rolls. (This tax bill would get 1,500,-

000 voting taxpayers completely off the tax rolls.) Develop new spending programs on borrowed money. (Democrat Congressman Clarence Cannon, chairman of the House Appropriations Committee frankly states, "We are spending money we do not have for things we do not need.")

Deficit financing, all protestations to the contrary, are heading us into a new inflation, as many of the illustrious members of this committee are well aware. If the purchasing power of the dollar decreased only 2½ percent, which seems inevitable, all the benefits of tax reduction provided in this bill, even to the low-income groups, will completely disappear, and here may I implement the printed statement by saying that the same change in the price level will also raise the cost of Government and increase the deficit.

Gentlemen, when H.R. 8363 cleared the House Ways and Means Committee it was sent to the floor for action under a rule that permitted only one amendment by the minority.

Representative Byrnes of Wisconsin, senior minority member on the House Ways and Means Committee, offered the amendment which stipulated that reduction of tax rates for fiscal years 1964 and 1965 would not take effect unless in the January budget message of the President the estimated administrative expenditures for fiscal year 1964 do not exceed $97 billion and for fiscal year 1965 do not exceed $98 billion.

The amendment was rejected by a vote of 226 to 199.

Perhaps this proposal should be put back in the bill. The following article from the authoritative Wall Street Journal of November 1, 1963, may well cause some misgivings. Gentlemen, I quote:

BUDGET MAKERS ARE NOT BUDGET CUTTERS

Budget makers slyly shape spending plans to avoid wrecking tax cut chances. They figure the tax bill will still be pending when the budget goes to Congress in January; conservatives will rebel unless spending boosts are limited. So policymakers warn agencies that big new job-creating projects must be kept out of the original budget. They promise to seek extra funds for some later on, when the tax bill is out of the way.

Kennedy men sweat as lawmakers try to pin down their stand on big new public works outlays now. Officials try to assure liberal Democrats they favor antiunemployment projects generally, but within Kennedy's promised budget holddown. The administration holds careful briefing sessions before Capitol hearings, to make sure all its witnesses get the delicate line straight.

Approach of 1964 elections promises to sharpen tax cut versus spending disputes among Congress Democrats. Kennedy strategists fear embarrassing clamor by liberals for bigger job-creating outlays.

We are at incessant war, cold war today, with the international Communist conspiracy. They are going to bury us without firing a shot. How? In Karl Marx's "Communist Manifesto" they clearly tell us: The theory of the Communists may be summed up in a single sentence: "Abolition of private property." This means all private property, yours and mine included.

Marx further states:

In a word you reproach us with intending to do away with your property. Precisely so, that is just what we intend. The middle-class owner of property—must be swept out of the way and made impossible.

Marx gives 10 specific steps by which this can be done, 2 of which have to do emphatically with taxation. These are: (1) "A heavy

progressive or graduated income tax." (2) "Abolition of all right of inheritance."

Gentlemen, how far down this road to our own destruction have we already gone? When are we going to wake up and try to walk back?

Unless we are to resort to socialism and Government ownership and control of business and industry, it is vitally in the national interest that individual savings and investment be encouraged in every way possible, and that investment incentive should not be further destroyed or weakened by unwise legislation urged upon us by some pressure group for a temporary advantage.

It is our opinion that the most damaging features of our present tax laws, affecting dynamic economic growth, job abundance and sound capital formation, are—

(1) The progressing (not the proportional) feature of the income tax.

(2) The confiscatory tax on so-called long-term capital gains.

(3) Double taxation of earnings of our major corporations at outrageous rates starting at around 67 percent to owners in the lowest bracket and around 85 percent to owners in the highest bracket.

(4) Our grossly unfair, inequitably proportioned, Federal excise taxes.

(5) Our unconscionably high inheritance taxes running to 77 percent.

Gentlemen, in considering the tax bill now before you, we urge you to keep these things in mind. There is no time left in the world in which we are living to treat these matters at the level of political expediency.

Gentlemen, we thank you very much indeed for giving us a chance to appear.

The CHAIRMAN. Thank you very much, sir.

Mr. GILBERT. May I implement this statement by one brief series of statistics? This entire legislation seems to be aimed at increasing the incidence of taxation on capital.

I have before me a table from a new book on international investment, at chapter 10, page 129, which shows the United States of all civilized nations in the world has the lowest taxes on consumption, and the highest, the very highest, on capital. The U.S. taxes consumption at 22.3 percent. The list of all the other leading nations ranges from 27.5 percent to 49.7 percent. The balance of the tax burden in the United States is borne by capital, and it is obvious that we are becoming uncompetitive as a capitalistic nation by the tax policy or what we call the tax policy what we are following.

(The table referred to follows:)

Distribution of tax levies, all levels of government, fiscal year 1960

[In percent]

	Taxes on income [1]	Taxes on capital [2]	Taxes on consumption [3]
United States	63.5	14.2	22.3
New Zealand [4]	61.8	10.8	27.5
Japan	60.3	6.7	33.0
Netherlands	63.3	3.3	33.3
Switzerland	[5] 66.1		33.9
Canada	48.8	17.1	34.1
Germany	62.0	3.2	34.8
Sweden [4]	63.3	1.1	35.6
United Kingdom [4]	51.7	12.6	35.7
Denmark [4]	48.6	10.3	41.1
Australia	48.8	9.7	41.5
Norway [4]	53.5	3.0	43.5
Belgium	52.8	1.5	45.7
Italy	49.3	3.0	47.7
France	45.2	5.1	49.7

[1] Includes personal and corporate income taxes and compulsory contributions by employers and employees for social insurance and similar programs.
[2] Includes property taxes and estate, inheritance and gift taxes.
[3] Includes all taxes other than taxes on income and capital.
[4] Fiscal year ending 1959.
[5] Breakdown between taxes on income and taxes on capital not available.

NOTE.—Details may not add to 100 percent because of rounding.

The CHAIRMAN. Thank you very much, sir. Any questions? Thank you.

Mr. GILBERT. Thank you, Senator.

The CHAIRMAN. The next witness is Robert H. Tucker of the Minnesota Mining & Manufacturing Co. Mr. Tucker, take a seat, sir.

STATEMENT OF ROBERT H. TUCKER, VICE PRESIDENT AND SECRETARY, MINNESOTA MINING & MANUFACTURING CO., ACCOMPANIED BY RICHARD BRUST, MANAGER, TAX DEPARTMENT

Mr. TUCKER. Mr. Chairman and distinguished members of the committee, my name is Robert H. Tucker. I reside in St. Paul, Minn., and I am vice president and secretary of Minnesota Mining & Manufacturing Co.

My colleague with me is Mr. Richard Brust, the manager of our tax department.

My comments today will be confined to section 201 of the House bill which proposes to reduce the credit for dividends received by individuals from 4 to 2 percent for 1964 and to repeal the credit altogether for subsequent years.

We submit the proposal is a backward step in American income taxation, is uneconomic, is a serious depressant to the availability of equity capital, and is retrogressive in its philosophy.

We have incorporated in the appendix attached the history of the special treatment of dividends since the adoption of the 16th amendment to the Constitution. A summary of this history will suffice for this presentation.

The initial Revenue Act of October 3, 1913, provided for a deduction of dividends received in computing income for normal tax purposes on individual returns. In this initial act the normal tax was fixed at a

flat rate and an "additional tax" at graduated rates for incomes over certain amounts. The normal tax was applied to corporations, and dividends were not again subjected to normal tax in the hands of individual shareholders.

The act of September 8, 1916 again imposed the normal tax upon corporations, and it reduced the income of an individual by the amount of any dividends, for purpose of the normal tax.

Dividends received by individuals continued to be exempt from normal tax as late as the Revenue Act of 1932, although the corporate rate in that act and several preceding acts was no longer correlated with the individual normal tax rate. The purpose, as expressed in the report of this committee, was "to prevent a second imposition of the basic normal tax" at the time of "distribution to stockholders."

The Revenue Act of 1934 continued the exemption on a reduced basis.

Not until the Revenue Act of 1936 was the "dividend credit" eliminated, and that was thought to be a necessary corollary of the short-lived undistributed profits tax. The continuation of that situation with respect to dividends was on doubt connected with the need for revenue during the depression and the war and postwar periods.

During the ensuing years, as normal and surtax rates climbed to unprecedented levels, the inequitable tax treatment of corporate income was further aggravated.

In the 1954 code, special treatment of dividend income was restored, in a different form but for the same reasons as in the early acts; namely, that the income from which the dividends were paid had already been taxed at the corporate level.

The British tax system has its own method of preventing inequitable taxation of dividends. That system was described by the U.S. Supreme Court in *Biddle* v. *Commissioner* (302 U.S. 573 (1938)), as follows (at pp. 579-580):

> * * * The scheme of the British legislation is to impose on corporate earnings only one standard tax, at the source, and to avoid the "double" taxation of the corporate income as it passes to the hands of its stockholders, except as they are subject to surtax which the corporation does not pay.
>
> * * * * * * *
>
> The stockholders' surtax is computed upon the gross dividend, the dividend which he actually receives plus the tax deducted. If the stockholder's income is exempt or less than the minimum amount subject to the tax, refund is made to him of the proportionate share of the tax paid by the corporation.

The Canadian method was used as a model in our 1954 code. This committee so stated in its report (at p. 7):

> The method of relief from double taxation selected is a modification of the dividends-received credit adopted in Canada in 1949. However, the present Canadian credit is 20 percent * * *. Moreover, limiting the credit to the amount of taxable income, when it is less than the amount of dividends, is a restriction not imposed under the Canadian system. On the other hand, the dividend exclusion provided is more liberal than the Canadian method for persons receiving small amounts of dividend income.

My company is happy to associate itself with the statement on this subject made to this committee on October 30, 1963, by Mr. Andrew B. Young on behalf of the American Bar Association:

> Far from coming to grips with the problem of "ameliorating or eliminating the double taxation of corporation income"—which is basic in restoring tax

neutrality as between incorporated and unincorporated business competitors—the proposed legislation is an unmistakable step in the opposite direction.

Mr. G. Keith Funston, president of the New York Stock Exchange treated this subject in depth in his presentation before this committee on October 25, 1963. We are certain full consideration will be given to the arguments advanced by Mr. Funston.

America should never forget the impelling force of the private enterprise system. It is the availability of venture capital that can and will be used to finance new undertakings, to pump new blood into ailing enterprises, and to expand established industries.

If we are really concerned about providing investmentfor growth or providing facilities for increased consumption which will aid economic growth, we should not scuttle the sound thinking which resulted in the dividend relief provisions enacted in the 1954 code.

Let us look to a simple example of what the investor has left out of $1 of corporate earnings. Under the revised individual and corporate rates suggested in the present bill (after 1965), a corporation having $1 of income before taxes, pays a Federal corporation tax of 48 cents. Of the 52 cents left, and assuming the corporation retains one-half to keep its business going for reinvestment in research, plant, and equipment, this leaves 26 cents available for payment to the shareholder as a dividend.

The shareholder at the top bracket, without benefit of the dividend credit, would pay an individual Federal income tax of 18 cents on the 26 cents received, leaving him 8 cents of the original $1 earned by the company.

If this 8 cents is subjected ultimately to the Federal and State estate taxes, the heirs of the shareholder would be left less than 3 cents.

It would seem apparent that the reward left after taxes for success in sponsoring new businesses is so minimal, that the surplus funds otherwise available for risk capital are being invested in tax-exempt bonds or common stocks of well-established proven businesses.

The point is well stated by the Committee on Federal Tax Policy in its September 1963 publication "Financing America's Future":

> Investment and the whole direction of business depends upon initiative and the willingness of men to try new things at great risk.

While we apologize for advancing arguments on this point, which I am sure by now fall under the cliche of "old hat," we feel it is important that we add our views to those resisting the elimination of the credit.

It is respectfully submitted that the dividend credit in the 1954 code, at most, is a modest amelioration of the inequitable taxation of corporate income, is a small step toward the strengthening of our basic economy; and instead of eliminating the credit, consideration should be given to increasing the same.

Thank you.

(The attachment referred to follows:)

APPENDIX

HISTORY OF SPECIAL TREATMENT OF DIVIDENDS TO ELIMINATE OR AMELIORATE DOUBLE TAXATION

In current discussions, it is often assumed that special treatment of dividends was an invention of the Internal Revenue Code of 1954, sections 34 and 116. That assumption is groundless, as the following historical review will demonstrate.

The most striking examples of special treatment are in the earliest income tax laws after the adoption of the 16th amendment.

1. Act of October 3, 1913: There was a normal tax at a flat rate and an "additional tax" at graduated rates for incomes over certain amounts, section IIA. In section IIB, dividends were deductible in computing income for normal tax of individuals if the corporation was taxable on its net earnings. In section IIG(a) the normal tax at the same rate was imposed upon corporations. Thus double taxation was avoided, at least in the lower brackets.

2. Likewise, in the act of September 8, 1916, the normal tax was also imposed upon corporations, in part II, section 10, but in part I, section 5(b), "for purposes of the normal tax only," the income of an individual "shall be credited with the amount received as dividends" of taxable corporations.

The justice of that special treatment of dividends was considered so obvious that no comment was made in the committee reports on either act.

However, the rationale of such treatment was spelled out in the House committee report on the Revenue Act of 1932 (C.B. 1939-1 (pt. 2) 467):

"Dividends of a domestic corporation received by an individual are allowed as a credit against net income in computing the normal tax on the theory that the normal tax has already been paid by the corporation. Where, however, such corporation is one which is exempt from tax there is no reason why the dividends should not be subjected to normal tax when received by the stockholders. The law is changed to accomplish this purpose."

The same statement appears in the Senate report (id., 510).

An even stronger additional statement was made in the introductory part of that report (id., 503):

"Under all the revenue acts since 1913, dividends received by individuals have been exempt from normal tax. The purpose of the exemption is to prevent a second imposition of the basic normal tax upon the earnings and profits of corporations at the time of their distribution to stockholders. The House bill proposed to remove this exemption. Your committee believes that even the exigencies of the present situation do not justify double taxation of this nature and recommends that the exemption under the existing law be continued."

The House receded on that point (id., 543). However, the corporate rate in that act and several preceding acts was no longer correlated with the individual normal tax rate.

A further departure from the original treatment is explained in the House report on the Revenue Act of 1934 (id., 557-558):

"Our first revenue acts provided for one normal rate and graduated surtax rates. There appears to be no good reason for having both a graduated normal tax and a graduated surtax, since the principle of ability to pay can be adequately taken care of by the graduated surtax alone. Certainly, it is much simpler to have one normal rate of tax. Through adjustment of surtax rates, this change can be made without appreciably decreasing the revenue.

"It is believed that dividends may be properly subjected to a somewhat greater income tax. Under the Revenue Act of 1932 a single man with a net income from dividends of $50,000 pays a tax of $4,960, while a single man with a net income from salary of $50,000 pays a tax of $8,720. In such a case the man with dividend income, under the recommendation of your committee, will pay a tax of $7,170. In other words, instead of paying $3,760 less tax than the salaried man, he will pay only $1,928 less tax. This is due to the fact that dividends are now subject to an 8-percent exemption from income tax, while under the proposal they will only be subject to a 4-percent exemption. It is the opinion of your committee that this increased tax on dividends can well be borne."

The temporary demise of special treatment of dividends came in the Revenue Act of 1936, under the influence of the short-lived undistributed profits tax, as explained in the House committee report (id., 672):

"It is, of course, important to note that a corporation which pays out all its adjusted net income in dividends will pay no tax, while under existing law it is taxed from 12½ to 15 percent on its entire net income. In order to treat the dividend consistently, it is, of course, necessary to subject the stockholder to both normal and surtax on these dividends. This is the most important change in the new plan in respect to individuals since they are now subject only to surtax in case of dividends received from domestic corporations. This change is brought about by omitting the dividend credit allowed by section 25(a) of the Revenue Act of 1934, as amended."

When special treatment of dividends was restored in a different form in the Internal Revenue Code of 1954, the previous history was referred to as follows (H. Rept. 7):

"In this country, prior to the middle 1930's, dividends were exempt from the normal individual income tax, which was generally the first bracket rate. This gave recognition to the fact that the income from which they were paid had already been taxed at the corporate level."

Thus, recognition of the double taxation involved in income taxation of the corporation and the stockholders has a venerable history starting immediately after the adoption of the 16th amendment. The remedies have been more or less complete, but they have always been at the stockholder level. The elimination of any remedy was connected with the short-lived undistributed tax, and probably also with the desperate need for more revenue in depression, war, and postwar years. The equitable need for a remedy has never been denied, and remedies of various kinds have been a part of our income tax law for almost two-thirds of the post-16th amendment period.

The CHAIRMAN. Thank you very much, Mr. Tucker.

Any questions, Senator Gore?

Senator GORE. Is it your company that has these loud billboards all over the country?

Mr. TUCKER. It is. I do not know if you call them loud. We have National Advertising Co., a subsidiary; yes.

Senator GORE. Is that the one that says "three M's" or something like that?

Mr. TUCKER. Right, that is correct, Senator.

Senator GORE. I just want to register my objection to the blaring loud quality of this cluttering of our highways.

Mr. TUCKER. I am sorry to hear that. We feel that it is a good legitimate business. There are those who——

Senator GORE. I do not question the legitimacy of the business, but I am questioning the taste, the quality of the advertising.

Mr. TUCKER. Senator, I would like to say that we have the signs that exhibit the products of the company and the words "research is the key to tomorrow." Are those the signs that you refer to? These are the Scotchlite signs.

Senator GORE. I have tried not to read what is on them, but it is inescapable. [Laughter.]

Senator MCCARTHY. Mr. Chairman, I think I ought to come to the defense of Minnesota Mining.

Mr. TUCKER. Good.

Senator MCCARTHY. I think their own signs are quite modest. It may be that some of the signs that use the reflecting tape may be on the loud side, but 3M, their own billboards, are really quite restrained. I do not think we should hold them responsible for what other companies do with their products.

Mr. TUCKER. We are attempting actually, Senator, to improve the signs that are on the highway. We are dedicated to that naturally. We basically manufacture Scotchlite which is the reflective material that goes on certain of the outdoor advertising signs.

Senator GORE. Come to think of it, I think I had better withdraw that point because I may have some signs next year that some people will find even more offensive.

Mr. TUCKER. Thank you. They are very effective, incidentally.

Senator GORE. Really? I do not think so. Really I do not. I speak only for myself as an individual. I react adversely to them, but I am sure a lot of people will react adversely to mine next year.

Mr. TUCKER. Advertisers feel they are one of the most effective means of advertising. Now, perhaps, to individuals they are, in certain cases, objectionable, and I agree with you.

Senator GORE. Most of the ones I have seen advertise no products. It just seems to try to popularize a name, 3M. What does 3M stand for?

Senator MCCARTHY. It stands for a lot in Minnesota.

Senator GORE. Well, a 3M sign does not mean much to most people in Tennessee.

Mr. TUCKER. Let me say as secretary of our company I hear from many, many stockholders.

Senator GORE. I realize you are trying to sell your stock and promote your products through advertising.

Mr. TUCKER. This has nothing to do with selling stock. They like when they get away from home and they are scattered and not cluttered by any means. I do not think there are more than probably 12 or 15 in any one State. But the letters that I get are very friendly in nature—they are very thankful they remind them back home of Minnesota or they see them as they go down the highway from State to State. I am sure we get 10 in favor to every 1 that is opposed, and we certainly are doing everything within our power to do away with the objectionable features there are in outdoor advertising.

Senator GORE. You seem to have selected some good locations in my State, so I may want to go and rent them for a period of about 3 months next year.

Mr. TUCKER. I am sure we could arrange that.

Senator GORE. I am surprised really that an enlightened company such as you represent would still be using the canard of double taxation. It comes as a surprise.

I know that your interest would be served, but I doubt if you do your case any good by this continued repetition of the canard of double taxation. What about treble taxation? What about quadruple taxation? This exists throughout our economy.

A corporation, it is true, is a fictitious person, but under the law it is a taxpayer. I just disagree with your arguments.

Mr. TUCKER. I think that what we refer to commonly is the feeling of those who feel that corporate income is taxed twice when the same income is taxed at the corporate level and at the stockholder level. Now, technically, they are two distinct taxpayers, and I think even those who oppose it recognize they are two distinct entities as far as taxpayers are concerned. But I think that basically it refers to the taxation of the same income twice.

Senator GORE. If I should buy General Motors stock, on the one hand and, on the other, invest the same amount in the construction of a building in my hometown, do you seriously contend that if I received the same income from each investment that discrimination

should be practiced against the investment in my own hometown facility?

Mr. TUCKER. I would think not, no.

Senator GORE. Well, this is just what you have said to the committee.

Mr. TUCKER. No, I do not believe so.

Senator GORE. Yes. You said there ought to be a credit given, there ought to be favorable tax treatment of income from corporate stock, but you have just said to me now that there should not be favorable treatment.

Mr. TUCKER. Well, we feel that at the present time there is a discrimination against the owner of the corporate stock, because the income that he receives has once been taxed at the corporate level.

Senator GORE. Maybe you did not understand the example I put to you.

Mr. TUCKER. Are you talking about unincorporated business I take it?

Senator GORE. Yes.

Mr. TUCKER. You pay only the one tax on your unincorporated business, whereas the income——

Senator GORE. I pay only the one tax on the income I get from General Motors stock, too.

Mr. TUCKER. You do, yes.

Senator GORE. That is right.

Mr. TUCKER. But General Motors has paid a tax.

Senator GORE. I am Albert Gore, citizen of Carthage, Tenn. Let us say—just as a hypothetical case—that I have substantial sums of money to invest, and I invest $100,000 in the construction of an office building or an apartment building, in Carthage, Tenn.

I invest another $100,000 in General Motors stock. I have the same income from each investment. Do you think that the tax laws should discriminate against investment in one's own home community?

Mr. TUCKER. Certainly, I must say I do not. However——

Senator GORE. If you give a tax credit against the income that I receive from the General Motors stock, and not for the income I have from the building or the business in my own hometown, then you discriminate against the building or the business in my own hometown.

Mr. TUCKER. If we revert back to the source of the income it would seem that the General Motors income produced by the General Motors company was greater than the income produced at the level in your situation.

Senator GORE. You are leaving the field of the discussion now. I have nothing to do with the management of General Motors. I buy their stock as an investment, and I buy it solely on the basis of the return I am going to receive from the stock I have purchased. I have no part in the management whatsoever. I invest in a business in my own hometown on the same basis, an unincorporated one, and yet you say to this committee that we ought to give more favorable treatment to the income that I receive from my General Motors stock than the income I receive from an invesment in an unincorporated business in my hometown. I just doubt if you really mean to say that.

Mr. TUCKER. I think it is—well, your illustration, I think, to some extent begs the question that this dividend that General Motors has

paid to you had already been, or the income had been, taxed at the corporate level. It is going to be again taxed at your level, whereas your income in your building, in your hometown, will only be taxed once at whatever rate your individual rate calls for.

Senator GORE. Well, do you really want to stand on your statement that the tax on the income from an investment in a business in my own hometown should be greater than the tax on the income from an investment that I make in General Motors stock? Do you really want to say that for the Minnesota Mining?

Mr. TUCKER. No, I certainly do not want to say that.

Senator GORE. Thank you, Mr. Chairman.

Senator BENNETT. Mr. Chairman, may I ask a question?

The CHAIRMAN. Senator Bennett.

Senator BENNETT. I would like to pursue this subject, but I would like to change the example a little. There are two competitors side by side in Senator Gore's hometown. One is incorporated and, let us say, he is the sole stockholder for the purpose of simplification, and the other is not incorporated.

Assuming that each business makes the same profit, does each individual come out the same as a taxpayer?

Mr. TUCKER. No, they would not, under those circumstances. If you are taking the income at the corporate level and the income at the unincorporated——

Senator BENNETT. Isn't this an example of——

Mr. TUCKER. This is what we are trying to submit and establish.

Senator BENNETT. Yes.

Mr. TUCKER. That comparing an incorporated against an unincorporated entity, assuming everything else being equal, the owner of the incorporated business on the income produced by his corporation will have less in his pocket at the end of the time when he declares a dividend than if he had an unincorporated, depending to some extent, I think, upon the bracket in which the other income might be available to him.

Senator BENENTT. You are an officer in what might be called a public corporation; the stock is available to the public.

Mr. TUCKER. That is correct.

Senator BENNETT. There are many corporations in this country that are—whether we call them closely held or not—whose stock is not available to the public.

Mr. TUCKER. Yes.

Senator BENNETT. Men or women who have stock in such corporations more obviously pay double tax because they make the investment; well, they are all the way in the investment, they are involved in the management, they are involved in the responsibility; and it seems to me that you can approach this with two assumptions. Senator Gore approaches it with the assumption that you make an investment as a stockholder with no responsibility for management. But when you look at the whole package and compare two related or two businesses that are competitive, you can see that the stockholder has to, first, assume his share of the 52-percent tax, and then he has to pay a personal income tax on any dividend that he may receive.

Mr. TUCKER. Thank you. That is correct.

Senator BENNETT. So this puts quite a premium on the use of the corporate form.

Mr. TUCKER. Yes.

Senator BENNETT. That is all, Mr. Chairman.

Senator GORE. Will the Senator yield?

Senator BENNETT. Yes; sure.

Senator GORE. I know of an individual who, in fact, does have businesses in adjoining buildings. One is a corporation and the other is a partnership. There are tax advantages both ways, not only tax advantages but other economic advantages.

The business that is incorporated is incorporated because of the many advantages of incorporation. The risks are limited, continuity of ownership is made possible, diversity of ownership is made possible. I cannot offhand state all of the economic advantages of incorporation, but there are many, and whether a business is incorporated or not incorporated is generally determined by the existence or the absence of those advantages.

Now, if incorporated under the law, a company becomes a separate entity under the law, and it should be taxed as a separate entity; and income from shares of stock, in my opinion, should likewise be taxed as ordinary income to the stockholder.

I just do not understand the idea that one should have it both ways. If he accepts the responsibility and the advantage of incorporation, then he must pay the price. The corporation is a separate entity in our tax laws and in our whole statutory code.

Senator BENNETT. When the theory of corporations was set up, of course, we had no income tax, and it is hard for me to feel that these advantages, which also carry with them certain responsibilities before the law, should be further weighted with a tax disadvantage.

But you and I have an obviously different point of view on that, and we could continue the discussion indefinitely.

Just one other comment: My memory is that when the first corporate tax was put on it was applied to—it was 4 percent and it was justified on the ground that this was the surtax applied—it was equal to the surtax on individual incomes, and the basic tax on incomes did not apply; is that right?

Mr. Stam reminds me that the corporation had an exemption of $20,000 before the surtax started. So now we have taken away the exemption and raised the rate from 4 to 52 percent, and eliminated any logical relationship between the corporate tax and the individual tax.

This did not occur, Mr. Stam reminds me, until after the income tax had been in existence for more than 20 years. It was 1936 that this tax was applied. But I think we have taken, already, as much time of the committee as we should.

Senator McCARTHY. I would like to go into two points. The basic issue is not really whether we have double taxation, Mr. Tucker, but the amount of tax which is paid really.

Mr. TUCKER. That is basic.

Senator McCARTHY. We could offer you the alternative, if your preferred, let us say, to have the income taxation on corporations removed altogether, and then raise the necessary revenue to finance the Federal Government through necessarily increased rates imposed on individuals, and we might tax the individual stockholder for his share of the corporate earnings which had not been distributed to him.

We could eliminate the corporate income tax altogether, and then we would not have double taxation, but we would have higher taxation

of the individual on all of his income or at least a larger share of his income.

Mr. TUCKER. I would think that would not be politically savory to the people. It is a method of developing the necessary revenue to operate the Government.

Senator McCARTHY. It would eliminate double taxation.

Mr. TUCKER. Yes, but I am afraid you are tearing down the house to kill the mouse.

Senator McCARTHY. There was a time when, as Senator Bennett says, we did not have the corporate income tax, and he sounded as though he thought that was a happy time. I do not know whether it was.

Senator BENNETT. Well, at the same time, the individual income tax rates also were very low.

Senator McCARTHY. You would be against all taxes then?

Senator BENNETT. No. I just yearn for the good old days when they were low enough so that we could pay them without pain.

Senator McCARTHY. This is the point. It is not a question of double taxation, but it is a question of how much is paid in the way of taxes, and of who pays the tax.

Senator GORE. I think our friend from Utah wants to pay some tax but not much. [Laughter.]

Senator BENNETT. In what way, am I different from the Senator from Tennessee?

Senator GORE. I am afraid we have very similar feelings. [Laughter.]

Mr. TUCKER. That is human nature.

Senator McCARTHY. This is the problem before this committee. If you were on the Appropriations Committee, you would find that people are opposed to appropriations in general, but they are all in favor of every specific appropriation.

We have a case in Minnesota. I am thinking of the upper lock and dam on the Mississippi River which even the chamber of commerce was prepared to defend against the attack in Life magazine. But when you move over to taxation you find most everybody saying that we ought to raise enough revenue to pay our bills. The chairman says that regularly. But when you begin to talk about specific taxes, then people are inclined to take the position of the Senator from Utah saying there really is not any one good specific tax. If we did not have to impose specific taxes this would be a rather easy committee on which to serve, but the trouble is that somebody has to pay them.

I do not think the issue of double taxation is particularly a serious one. The fact is that most people are willing to support the corporate income tax now because it has become essentially a manufacturer's excise tax, a kind of camouflaged sales tax, in fact.

Senator BENNETT. I would agree with that.

Senator McCARTHY. So the manufacturers are here testifying on the individual income tax rates, for individuals who get the special benefit of dividend credit and dividend deductions, I do not mind your making a fight on that issue, but it should not be made really on the ground that there is something immoral cloaked under the name of double taxation. The question is one of what objective we are seeking and of how we seek it. We could eliminate double tax-

ation, if it is so bad, and move entirely to the individual income, which has been transferred to him and that which is retained in the corporation and, at that point, I think Mr. Tucker would say let us have a little more double taxation or, at least, let us have it for a while.

Senator BENNETT. Will the Senator yield?

Senator McCARTHY. Yes.

Senator BENNETT. There is an alternative to these other two which has been suggested by one or two witnesses here in which the Senator from Utah is greatly interested, and that is what is called the value-added tax.

Senator GORE. There is another alternative, and that is a progressive income tax, a graduated income tax, on corporations.

Senator BENNETT. We have that now. It is only two steps, and we have widened the steps in this bill, reduced the tax for the $25,000 corporation from 30 to 22 percent.

Senator GORE. There is a threat of bigness in our country, so there is some merit in considering a more steeply graduated corporation tax, and this would be one of the ways to eliminate so-called double taxation.

Senator McCARTHY. We could accept the Communist approach. In Russia they have eliminated the income tax and have nothing but a manufacturing excise tax. I don't think we would want that. We would rather have double taxation.

Mr. TUCKER. We would take double taxation.

Senator McCARTHY. I would like to ask you one or two questions about the tax bill apart from this particular issue, Mr. Tucker. In the tax bill that we approved last year the investment credit provision was included. Could you tell me—if this is in your field of Minnesota Minning—was the investment credit of any particular help to Minnesota Minning?

Mr. TUCKER. May I ask Mr. Brust to answer that? He handles our taxes.

Mr. BRUST. I cannot recall the exact figure, but I think, in relation to other companies, it was of considerably less benefit.

Senator McCARTHY. Probably too small because you do not use a great deal of heavy equipment.

Mr. BRUST. Right.

Senator McCARTHY. A corporate tax cut such as we are talking about in this bill would probably be of more benefit to you than——

Mr. TUCKER. Than investment credit.

Senator McCARTHY. The invesment credit approach.

In the expansion of Minnesota Mining what has been your principal source of capital? Has it been retained earnings or have you borrowed from the banks primarily? Have you used the device of issuing bonds, or capital stock, in the last 10 or 15 years?

Mr. TUCKER. Primarily I would say it has been equity financing. We have had a number of employee stock option plans over the last 10 years. Originally, of course, it was all equity financing. We never had any long-term debt to speak of.

Right after World War II, we did have, a preferred stock issue and a bond issue, but those have been wiped out. The preferred stock has been retired and the bonds are being liquidated. I think it is through in about 1965 or 1966.

Senator McCARTHY. Most of the equity capital has been through the employee stock option purchases?

Mr. TUCKER. Well, recently. We have had no general stock issuance on an equity basis other than through stock options to employees. We have 35,000 employees, and about 20-some thousand of them are stockholders.

Senator McCARTHY. I have no other questions.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Tucker, just this: For many years this committee and the Congress have been privileged to have the benefit of the views of the Minnesota Mining Co. in regard to tax matters. I appreciate your statement this morning in regard to the historical background of corporate taxes, together with your views, and it brings back memories of another very outstanding tax attorney who has appeared before us many times, Mr. John Connolly.

Mr. TUCKER. Thank you.

Senator CARLSON. I would say you did as well as he did, but I would not say any better.

Mr. TUCKER. Thank you very much.

Senator CARLSON. That is all.

Mr. TUCKER. Thank you very much.

The CHAIRMAN. Thank you very much, Mr. Tucker.

The next witness is Mr. Walter A. Slowinski, of Baker, McKenzie & Hightower.

Mr. Slowinski, take your seat. I want to say that I recall the testimony that you gave before this committee on behalf of the U.S. Chamber of Commerce last year, and you were very highly complimented, I believe, at that time.

STATEMENT OF WALTER A. SLOWINSKI, ATTORNEY; ACCOMPANIED BY JOHN OUTLAND, PRESIDENT, CLUB MANAGERS' ASSOCIATION; AND WILLIAM AMLONG, EXECUTIVE DIRECTOR, NATIONAL CLUB ASSOCIATION

Mr. SLOWINSKI. Thank you very much, Mr. Chairman.

Mr. Chairman and members of the committee, my name is Walter A. Slowinski, and I am a partner in the law firm of Baker, McKenzie & Hightower of Washington, D.C. I am appearing before your committee today as general counsel of the National Club Association to present the views of this national organization of private membership clubs on matters of tax reform.

Senator GORE. May I inquire if the Quorum Club is a member of your organization?

Mr. SLOWINSKI. No, sir; I am pleased to say. Ours are private membership clubs which have grown over the years.

The chairman, for example, has an old and venerable club in Richmond called the Commonwealth Club, the professional manager of which is a member of the Club Managers' Association of America.

The Farmington Country Club, for example, would be another in the same category.

I am accompanied today by Mr. John Outland of Dallas, Tex., who is the national president of the Club Managers' Association; and also by Mr. William Amlong, on my right, who is the executive director of the National Club Association.

Our views today are firmly shared by the Club Managers' Association, an organization of 2,000 professional managers of bona fide private country and town clubs across the Nation.

A brief description of the size and character of the club industry will help put these comments in proper perspective. Our segment of the economy grosses $1.9 billion annually, and there are 3,700,000 members of bona fide private membership clubs. These pay approximately $214 million in taxes each year, and employ 310,000 people, with a payroll of $750 million annually. In club dues taxes alone the clubs pay $70 million per year.

Historically our clubs of the United States have existed as self-help institutions, built and maintained at no cost to the taxpayer. Contrary to the view of some, the majority of the clubs are not luxuries but represent the independent effort of many average Americans to provide a wholesome setting in which families and communities can engage in athletic, social, and similar activities contributing to the general welfare. One of the very significant contributions of our clubs to the development of our national image during this era of cold war competition with the Communist countries is the great number of stellar athletes which they have produced. Many of our greatest Olympic swimmers are the direct product of our club training and competition. The same holds true for our great track stars, gymnasts, golfers, tennis players, and many other athletes.

The significant thing about all this in the context of my remarks today is that clubs are private facilities which have cost the Government nothing. On the contrary, their existence has relieved public treasuries, Federal, State, and local, from the substantial burden of providing such facilities, including athletic facilities.

This public function of clubs is in a very real sense analogous to the justification underlying section 170 of the Internal Revenue Code which permits deductions for contributions to educational organizations on the theory that such contributions should be encouraged because in the absence of these organizations the Government would have to perform many of the functions which they carry out.

Of course, no tax deduction is allowed for payments made for the support and upkeep of clubs; on the contrary, an excessively high excise tax of 20 percent is exacted upon club dues.

I am here on behalf of our membership today first to urge a reduction in expenditures by the U.S. Government so that income tax rates can prudently be reduced and so that this discriminatory excise tax rate can be lowered. True tax reform requires an examination of the cumulative burden placed upon taxpayers by the various taxes they are required to pay, not alone the income tax. This is why we raise the issue of this 20-percent-excise tax today. It is manifestly unfair to derive such a disproportionate share ($70 million annually) of the huge amount of Federal spending from a relatively small segment of the economy which already—by its very nature—is helping the Government discharge some of its functions.

As you know, prior to World War II the tax on club dues and initiation fees was 10 percent. Then, because of the exigencies of World War II, the rate was increased gradually to 11 percent and then in 1943 it reached its present high rate of 20 percent. It is indeed interesting to observe at this point in history (20 years later) that the 10-percent increase during World War II was to be a "war tax rate"

which was to have been eliminated immediately upon the termination of hostilities.

During the war the excise tax on furs, jewelry, toilet preparations, for example, was also raised to 20 percent. By 1954, the rate on all of these so-called luxury items had been reduced to 10 percent. By 1956, the only 20 percent excise tax rates remaining were those on cabarets, club dues, and admissions to racetracks.

At that time a special subcommittee of the House Committee on Ways and Means, established to consider excise tax problems, the Forand subcommittee, reported that this 20-percent rate on only these three items represented a "substantial inequality" and that it felt the "Ways and Means Committee may want to review these taxes and take action to reduce the rates to 10 percent * * *."

In 1960, the cabaret tax was reduced from 20 to 10 percent. The Senate Finance Committee gave the following two principal reasons for that rate reduction:

> First, the present 20-percent rate is discriminatory in that the rates of almost all of the other ad valorem excise taxes do not exceed 10 percent; second, the present high rate of this tax is believed to have been a substantial deterrent to the employment of musicians and other entertainers.

Thus, as the picture stands today, only two things are subjected to a Federal excise tax of 20 percent—racetracks and social clubs. Certainly the element of discrimination described by this committee in the statement I have just read has not diminished. Indeed, by the reduction of the rate of the cabaret tax the degree of discrimination has been accentuated.

Moreover, the import of the 1960 cabaret tax reduction is that cabarets fall into a more desirable category whereas clubs fall into an inferior class whose only other occupant is racetracks. It seems obvious that the civic, family, and other beneficial purposes fostered by clubs make it most inappropriate to group the club industry with racetracks—and indeed indicate that clubs should be treated at least as well as cabarets. In the same vein, why should community clubs be treated more harshly than diamond necklaces, mink coats, and expensive sports cars, all of which are taxed at rates of 10 percent or less?

The second reason advanced by this committee for reducing the cabaret tax (namely, increased employment) also applies with respect to a reduction in the tax on club dues. Such reduction would in very many instances redound directly to the benefit of the large number of club employees because it would provide the clubs with an additional source of revenue for salary increases and new jobs.

We respectfully submit that a reduction in this 20-percent rate on club dues is long overdue and that a tax reform measure such as H.R. 8363 provides an excellent vehicle for effecting this type of equitable action.

Our second recommendation is that this committee include in H.R. 8363 the provisions of S. 2068, a bill designed to ease the impact of the travel and entertainment expense provisions of the 1962 act, which was introduced by Senator Long, as well as 19 other Senators, including Senators Carlson, Curtis, McCarthy, and Ribicoff.

Briefly, S. 2068 would substantially modify the harsh and restrictive character of the new entertainment expense rules by permitting the deduction of the cost of bona fide business entertainment. The club industry, along with many others, has suffered from the severe and

unreasonable restrictions which the 1962 legislation placed on legitimate business entertainment. This committee is well familiar with that aspect of the matter and I will not dwell upon it further at this point. However, there is another and more far-reaching objection to these new rules, the long-range significance of which cannot be overemphasized.

An inordinate amount of difficulty arises from the extreme complexity of these new entertainment expense rules. In addition to lengthy and complicated regulations, the Internal Revenue Service policy officials have issued press releases, made speeches, conducted educational programs, and published voluminous questions and answers in an effort to explain these rules.

It is interesting to note that despite the complicated nature of many of the code's provisions, the Internal Revenue Service has very rarely found it necessary to publish interpretational aids such as these questions and answers.

In addition, only last month the Service, a year after the enactment of these rules, found it necessary to initiate a new special training program for its 14,000 revenue agents in an effort to educate them as to what the new law means.

Nevertheless, despite all the explanations offered, the rules are still most difficult to understand; in fact, many businessmen, because of the uncertainty surrounding the deductibility of these expenditures, refrain from taking them at all.

We feel that our already complex tax statutes have reached the breaking point of taxpayers confidence when they defy interpretation in connection with such a simple and everyday business act as entertaining a customer. The real danger here is the threat which such legislation presents to the self-assessment character of our income tax system—universally recognized as the cornerstone on which the success of our income tax is founded. When laws become this complex, taxpayers begin to distrust them, and, if they don't understand and consequently mistrust the law, they may not obey it.

And if they do not obey it, then, of course, our basic principle of self-assessment is undermined. We cannot afford to let this downward process continue.

The solution would be to wipe the slate essentially clean and incorporate the provisions of S. 2068 into H.R. 8363. This would in essence restore the law to the relatively understandable status in which it stood for many years prior to 1962, while at the same time requiring sufficient recordkeeping and imposing other requirements adequate to protect the revenues.

Our final recommendation is that this committee provide in H.R. 8363 an exemption from the 20-percent excise tax on club dues for those payments made to a club by its members for the purpose of establishing a pension plan for the club's employees.

Under present law a large number of employees of the social, athletic and sporting clubs of the United States are not receiving retirement protection from their employers primarily because of the particularly oppressive impact of the 20-percent excise tax on club dues.

The harsh manner in which the present statute operates discourages club members from making contributions for the establishment of retirement plans for club employees, who must then rely almost

entirely on social security. In other words, unlike the normal employer who gets a tax deduction for the contributions he makes to an employee penison trust, the club member not only gets no deduction but must pay an additional 20-percent excise tax on the contribution to that pension trust. He is thus penalized for making a payment to be used solely for the benefit of the club's employees.

It is most inequitable that the retirement needs of such a large segment of the working population as that represented by the employees of the club industry (310,000) are being neglected whereas persons performing identical work for employers who obtain a tax deduction are being afforded protection.

In 1962, Congress enacted the Self-Employed Individuals Tax Retirement Act in an effort to alleviate a similar unfairness which existed between employees and self-employed persons. Enactment of our recommendation, we feel, would be a real step toward providing more equitable treatment among groups of similarly situated employees.

Thus, in summary, Mr. Chairman, four points:

1. Government expenditures should be reduced; individual income tax rates should be reduced.

2. The wartime 20-percent excise tax on club dues should be reduced to 10 percent.

3. S. 2068 should be enacted.

4. The 20-percent club dues tax should not apply to contributions to employee pension plans.

Thank you, sir.

The CHAIRMAN. Thank you very much, Mr. Slowinski.

Any questions, Senator Gore?

Senator Carlson?

Thank you very much indeed, sir.

Mr. SLOWINSKI. Thank you.

The CHAIRMAN. The committee will adjourn until 10 o'clock tomorrow morning.

(Whereupon, at 11:30 a.m., the committee was recessed, to reconvene at 10 a.m., Friday, November 15, 1963.)

REVENUE ACT OF 1963

FRIDAY, NOVEMBER 15, 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), Smathers, Gore, Talmadge, Hartke, McCarthy, Ribicoff, Williams, Carlson, Bennett, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The Chair places in the record a letter dated November 8, 1963, from the Secretary of the Treasury Douglas Dillon commenting on a question raised by Senator Gore during the course of Mr. Leon Keyserling's testimony (p. 650 of pt. II of printed hearings) as to the amount of the tax reduction which would find its way initially into increased consumer demand; and a letter dated November 12, 1963, from Mr. Leon Keyserling, responding thereto.

(The letters referred to follow:)

THE SECRETARY OF THE TREASURY,
Washington, November 8, 1963.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: During the course of Mr. Leon Keyserling's testimony on H.R. 8363, Senator Gore raised a question as to the amount of the tax reduction in that bill which would find its way initially into increased consumer demand. This question may have been prompted by Mr. Keyserling's statement that $2.8 of the $8.9 billion personal tax cut would be saved. This conclusion appears to be based in large part on the estimate that $4 billion of the personal tax cut would accrue to taxpayers with incomes of $10,000 and over.

The estimate that $4 billion of the tax cut would accrue to those with $10,000 or more annual income is excessive. The Treasury estimates it to be $3.6 billion. Of this $3.6 billion, $2.09 billion will accrue to taxpayers in the $10,000–$20,000 tax bracket who, like those below $10,000 consume a large proportion of their income. Also, $5.3 of the $8.9 billion tax cut would accrue to those with income below $10,000.

For these reasons, we feel that a very large proportion of the tax cut will be spent on consumption. Indeed, we expect the amount so spent would be over $8 billion.

It is not clear to us how the estimate of $2.8 billion savings was derived. But it was probably based on the assumption that much higher proportions of additional income would be saved in both the low- and high-income categories. These higher proportions applied to the erroneous overestimate of the tax cut that high-income individuals would receive, led to the $2.8 billion savings estimate. The errors compounded each other to lead to an estimate perhaps three times greater than we feel is correct.

I would appreciate your including this letter in the record of the hearings, and I am also sending copies to Senator Gore and Mr. Keyserling.

Sincerely yours,

DOUGLAS DILLON.

24-532—63—pt. 4——18

LEON H. KEYSERLING,
CONSULTING ECONOMIST AND ATTORNEY AT LAW,
Washington, D.C., November 12, 1963.

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

DEAR SENATOR BYRD: I am writing this letter to you to supplement my testimony of October 22 on the tax bill (H.R. 8363), and respectfully request that this letter be inserted in the printed hearings, preferably immediately following the letter of the Secretary of the Treasury to you dated November 8. My letter is necessitated by the fact that Secretary Dillon's letter of November 8 to you deals entirely with criticisms of some important aspects of my testimony. My letter also contains some information of me by Senators Douglas and Carlson during the course of my testimony, which I promised to supply.

RESPONSE TO CRITICISMS OF MY TESTIMONY BY SECRETARY DILLON

In his letter of November 8 to you, of which he furnished me a copy with his customary courtesy and thoughtfulness, Secretary Dillon points out that I estimated that $4 billion of the proposed personal tax cut would accrue to taxpayers with incomes of $10,000 and over (see my chart 27 on p. 664 of the printed hearings). The Secretary says that the Treasury estimates this figure at $3.6 billion rather than $4 billion. My estimate was based upon data available to me at the time, and I deemed it to be entirely accurate. The Treasury has made revisions of its data from time to time, and I am not prepared to challenge its $3.6 billion estimate.

However, this difference has no significant bearing upon the substance of my argument. As only about 12½ percent of all taxpayers have incomes of $10,000 and over, it seems to me entirely inappropriate that they should receive either the approximately 45 percent of the total proposed personal tax cuts which $4 billion would represent or the approximately 40 percent of the total personal tax cuts which $3.6 billion would represent. I feel it highly inequitable, viewing the needs on social grounds of the about 87½ percent of all taxpayers whose incomes are below $10,000, that they should receive only such portion of the total personal tax cuts as the bill in its present form would provide. Indeed, for reasons which I developed fully in my testimony, there would be much better ways, both economically and socially, of using the amount of money involved in the tax cuts for the highest income 12½ percent of taxpayers than in the way proposed by the bill.

Secretary Dillon's second criticism of my testimony questions my estimate that about $2.8 billion of the proposed personal tax cuts would be saved for investment purposes rather than spent for immediate consumption (see my chart 27 on p. 664 of the printed hearings). This estimate of mine relates to the tax cuts going to taxpayers with incomes of $10,000 and over. To be sure, the estimate would be slightly lower if $3.6 billion rather than $4 billion of the total personal tax cut goes to these taxpayers. But it is evident that the main reason why Secretary Dillon challenges my $2.8 billion estimate is his feeling that taxpayers with incomes of $10,000 and over would save much less for investment purposes and spend much more for immediate consumption than I estimate. Unfortunately, neither in the Government nor elsewhere are there satisfactory estimates of the propensity to save as against the propensity to consume, broken down by income classifications. This is a great deficiency in the available data, and I feel that those in the Government who are proposing policies as consequential as the tax bill should have done more than they done to analyze this problem in depth.

Nonetheless, if my estimate of the propensity to save among taxpayers at $10,000 and above is too high with respect to the marginal increment in their incomes which the tax cut would provide, this would not affect my basic policy position in the slightest. For if Secretary Dillon is more right than I in his estimate relating to this matter, it would simply mean that taxpayers with incomes of $10,000 and above would devote to the immediate augmentation of their consumption an even larger share of the total personal tax cut than they would devote under my estimate, and an even more excessive share in my judgment. Viewing the totality of our competing economic and social needs, I can see no justification for augmenting the immediate consumption of the highest 12½ percent of taxpayers by even as much as would result from my estimates, and a fortiori I can see even less justification for augmenting this consumption as much as would result from Secretary Dillon's estimates. In short, Secretary

Dillon's criticism at this point would seem to misinterpret the whole nature of my position. He would seem to think that I am for tax cuts to stimulate consumption, no matter whose consumption is stimulated. I am for tax cuts to stimulate consumption, but with a high regard for the distribution of this stimulation, so that it will do more for those lower down in the income scale and less for those high in the income scale.

Indeed, my original testimony made the foregoing point very clear. Specifically, I said (see p. 650 of the printed record):

"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 derived 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 or 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."

I should point out also, in this connection, that the current viewpoint of the Treasury seems to reverse its earlier course. For a number of years, the Treasury and others have been arguing that the higher income people need tax cuts in order to stimulate the saving and investment which it is said current tax rates dissuade; until recently, very few had the timerity to suggest that tax cuts just now for the higher income people are needed to lift their immediate standards of living (consumption) as against competing national purposes. Now, however, the Treasury seems to be less confident of the investment argument, and turning to the consumption argument in an effort to answer my emphasis upon consumption. But in doing so, instead of looking at whose consumption most needs stimulation, the Treasury is adhering to the same pattern of tax cuts which earlier were advocated by those who were talking only about the immense need to stimulate investment and even to repress consumption. Earlier hearings before your committee, especially from 1957 forward, will bear out fully what I have just said.

I think it proper at this stage for me to add one point to those presented in my testimony, with respect to the wastefulness of the corporate tax cuts now proposed, piled on top of those made in 1962, and added to whatever portion of the personal tax cuts (whether Secretary Dillon's estimate or mine) will be used for saving and investment, in view of the prolixity of funds now available for investment purposes, as set forth so fully in my testimony. On page 677 of the printed testimony, I estimate that the current tax proposal in its present form would give a stimulative lift to GNP only in the neighborhood of $14½ billion during the calendar year 1964; and I say that this stimulative value is extremely low in view of the size of the current GNP gap, and that the low stimulative value results from the wasteful nature of much of the proposed tax reduction.

This $14½ billion estimate of mine has been corroborated by a great deal of expert judgment since the date of my testimony. In Business Week of November 9, 1963, page 28, there is set forth the judgment of business economists who gathered a week earlier at the University of Michigan's 11th Annual Conference on the Business Outlook, to the effect that GNP in 1964 would be only about $12 billion higher if the tax bill in its present form is passed by February 1964 than if the tax bill were delayed or defeated. On the same page of Business Week, it is indicated that the McGraw-Hill Department of Economics forecasts a 1964 GNP only $10 billion higher with tax reduction than without tax reduction. All of these expert estimates are even lower than my conservative estimate, and add impressive weight to my conclusion that the official proponents of the tax measure are greatly overestimating its stimulative effects in its present form.

With further reference to the Treasury position, I received under date of November 5 a letter from Mr. Stanley S. Surrey, Assistant Secretary, purporting to be written in behalf of Secretary Dillion. Mr. Surrey advances the point that I have not allowed for the fact that some of the corporate tax relief might be paid out in dividends and thus (presumably) add to immediate consumption. Viewing the well-known distribution of corporate securities among the U.S. population by income groups, if the purpose of the corporate tax reduction is in

sizable degree to enlarge the personal incomes of high income individuals even more than they will be enlarged by the personal tax cuts, this to my mind powerfully reinforces all of the criticisms which I have made of the tax bill in its current form.

Finally, with respect to the Treasury position, I find it necessary to comment upon a table inserted on page 709 of the printed testimony by Senator Gore, such table being furnished by the Treasury. This Treasury table contains estimates of the effect of the proposed personal tax cuts upon after-tax or disposable income, and these estimates seem very different from my estimates as shown by my chart 28 on page 667 of the printed testimony. The Treasury estimates might seem to cast doubt upon my stated objections to the extremely large and disproportionately higher percentage increases in the disposable incomes of those in the highest ranges of the income scale, which would result from the tax bill in its current form.

The reasons for the differences between my estimates on this score and the Treasury estimates are plain, and very revealing. My estimates take account of typical itemized deductions, but do not attempt to estimate the consequences of such items as capital gains. In the first place, I had no way of estimating what percentage of the incomes of taxpayers at various income levels are in the form of capital gains. In the second place, I thought it more relevant to compare actual and proposed tax rates as these bear upon taxpayers whose taxes are not distorted by the treatment of capital gains and by other loopholes. In contrast, the Treasury estimate attempts to take account of the special treatmen of capital gains and, to a degree, of dividend income, and this alters the impact of the tax rates because these rates do not apply in the normal ways to these special types of income. But the main significance of the Treasury table on page 709 is a terrific revelation of the fact that, according to the Treasury's own estimates, the hue and cry about the need for big tax reduction for high income people on the ground that their current tax liabilities are repressive or even "confiscatory" has no merit whatsoever, when one looks at the actual taxes which they pay as against their actual incomes.

The table which I set forth below is derived from the Treasury's table on page 709 of the printed testimony. My derived table contains in column 4 the assumed before-tax income (assumed by the Treasury), i.e., the sum of the tax imposed and the after-tax income, which assumed income is higher than the adjusted gross income which excludes a large part of the capital gains income. The main purpose of my table is to show taxes actually paid, as portrayed by the Treasury, as a percentage of actual before-tax income, as apparently assumed by the Treasury.

PRESENT LAW

Adjusted gross income (1)	Tax (2)	After-tax income (3)	Assumed before-tax income (sum of (2) and (3)) (4)	Tax (2) as percent of assumed before-tax income (4) (5)
$5,000	$290	$4,827	$5,126	5.8
$10,000	1,193	8,993	10,186	11.7
$15,000	2,196	13,189	15,385	14.3
$25,000	4,755	21,271	26,026	18.3
$50,000	14,254	38,947	53,201	26.8
$75,000	23,799	57,421	81,220	29.3
$100,000	33,965	79,247	113,212	30.0
$200,000	63,318	184,262	247,580	25.6
$500,000	154,249	567,116	721,365	21.4
$1,000,000	261,929	1,239,659	1,501,588	17.4

HOUSE BILL

Adjusted gross income (1)	Tax (2)	After-tax income (3)	Assumed before-tax income (sum of (2) and (3)) (4)	Tax (2) as percent of assumed before-tax income (4) (5)
$5,000	$219	$4,907	$5,126	4.3
$10,000	972	9,214	10,186	9.5
$15,000	1,830	13,555	15,385	11.9
$25,000	3,983	22,043	26,026	15.3
$50,000	12,127	40,984	53,201	23.0
$75,000	20,672	60,548	81,220	25.5
$100,000	29,670	83,542	113,212	26.2
$200,000	56,675	190,905	247,580	22.9
$500,000	138,216	583,149	721,365	19.2
$1,000,000	238,037	1,263,551	1,501,588	15.9

The results of the above table seem to me amazing. The table shows that, under the present law, the $1 million income taxpayer (adjusted gross income), who really has an assumed before-tax income of more than $1,500,000, pays only 17.4 percent of the latter in taxes, which is lower than the 18.3 percent paid by the $25,000 income taxpayer (adjusted gross income), and enormously lower than the 26.8 percent paid by the $50 000 income taxpayer (adjusted gross income). The Treasury portrayal of what would happen under the House bill is equally startling. It shows that the $1 million income taxpayer (adjusted gross income) would pay in taxes 15.9 percent of his assumed before-tax income, or hardly more than 15.3 percent paid by the $25,000 income taxpayer, and contrasted with 23 percent paid by the $50,000 income taxpayer, 25.5 percent by the $75,000 income taxpayer, etc.

I regard the foregoing demonstration by the Treasury as the most significant portrayal I have ever seen in support of my proposition that even our current tax structure is extremely regressive at many points, when one takes account of the impact of capital gains and other loopholes upon taxes actually paid in relation to actual income. How, then, can one justify the currently proposed schedules of tax reductions on the ground that they are needed to rescue the very high income taxpayer from exorbitant taxation?

RESPONSE TO REQUEST OF SENATOR DOUGLAS FOR DATA RELATING TO CASH FLOW

On pages 721, 722 of the printed hearings, Senator Douglas asked me to reinforce my position, with respect to the very favorable current profit position of corporations, by an examination of cash flow. Without getting into too much technicality, cash flow is the difference between corporate profits as usually reported, and corporate profits plus depreciation which approximate cash flow. It is increasingly acknowledged by economists and other analysts that cash flow has an extremely important bearing upon the availability of funds to corporations for investment purposes.

I set forth below a table derived from tabulations appearing on page 10 of the October 1963 issue of the Survey of Current Business put out by the U.S. Department of Commerce. These data include corporate inventory valuation adjustment, and exclude corporate profit originating in the rest of the world.

[Billions of dollars]

	1955	1956	1957	1958	1959	1960	1961	1962
Before taxes:								
Corporate profits, national income version	41.6	40.2	39.7	35.4	45.4	42.6	41.4	44.4
Corporate profits plus depreciation, national income version	57.5	57.7	59.0	56.0	67.3	65.8	65.8	72.7
After taxes:								
Corporate profits, national income version	19.7	19.0	18.8	16.7	22.2	20.3	19.4	22.3
Corporate profits plus depreciation, national income version	35.7	36.5	38.1	37.4	44.1	43.5	43.8	50.5

There is a table of similar import on page 7 of the September 1963 issue of Economic Indicators, prepared for the Joint Economic Committee by the Council of Economic Advisers. The source of this table is given as the Department of Commerce, and the reason for the difference between the data set forth just above and the data set forth below appears to be that the latter data do not exclude the rest of the world and, therefore, are somewhat higher. Capital consumption allowances are, roughly speaking, comparable to depreciation, and, therefore, corporate profits plus capital consumption allowances are roughly equivalent to cash flow.

[Billions of dollars; quarterly data at seasonally adjusted annual rates]

	1955	1956	1957	1958	1959	1960	1961	1962	1963, 1st quarter	1963, 2d quarter
After taxes:										
Corporate profits	23.0	23.5	22.3	18.8	24.5	22.0	21.8	24.6	25.4	26.8
Corporate profits plus capital consumption allowance	41.4	43.5	44.1	41.4	48.7	47.6	48.6	55.4	57.1	58.9

On page 26 of Business Week of November 9, 1963, this statement appears:
"The eight largest steel producers, for example, showed a 9-month cash flow this year that almost matched their total for all of 1962— and was $115 million greater than in the whole of 1961."

RESPONSE TO REQUEST OF SENATOR CARLSON FOR DATA ON COMPARATIVE RATES OF ECONOMIC GROWTH

On page 686 of the printed hearings, Senator Carlson asked me to furnish information about the economic growth rates of some European countries.

For the period of 1950–60 the annual rate of growth in total output at constant prices is estimated by OECD to have averaged 7.5 percent in Germany, 5.9 percent in Italy, and 4.3 percent in France. For Western Europe as a whole, the average annual rate of growth in real GNP, 1953–60, is estimated at 4.7 percent a year. According to the Bank of International Settlements, the rate of growth in real GNP in 11 countries of Western Europe (Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Sweden, and Switzerland) averaged 6.5 percent in 1960, 6.5 percent in 1961, and 5.7 percent in 1962.

The average annual rate in the Soviet Union, until the most recent 3 years, was variously estimated between 6 and 9 percent. The average since then may have been closer to about 5 percent.

Our U.S. economic growth rates are set forth in my charts on pages 633–634 of the printed hearings.

As stated at the outset, I respectfully request that this letter be inserted in the printed hearings on the tax bill (H.R. 8363).

Very sincerely yours,

LEON H. KEYSERLING.

The CHAIRMAN. We are honored today to have a very distinguished Senator, John Sparkman, of Alabama, and the Chair recognizes him. You may proceed.

STATEMENT OF HON. JOHN SPARKMAN, A U.S. SENATOR FROM THE STATE OF ALABAMA

Senator SPARKMAN. Thank you, Mr. Chairman.

I am accompanied by Mr. Robert R. Locklin, associate general counsel of the Small Business Committee, and by Mr. Daniel T. Coughlin, who is the minority chief representative on our staff.

Senator Saltonstall wanted to be here, but he could not be here in person, so Mr. Coughlin came along. Senator Saltonstall has also given me a letter that, a little later, I should like to read into the record. It is addressed to the chairman. He gave it to me to deliver to the chairman and to the committee.

Mr. Chairman and gentlemen of the committee, I appear this morning as chairman of the Select Committee on Small Business, to express the views of that committee upon certain provisions of H.R. 8363 which have an especial significance for the 4.5 million small business firms in America.

These firms represent approximately 95 percent of all business firms in the country. They account for 46 percent of total business activity, and, in terms of employment, small firms in 1962 were responsible for approximately one-half of total paid employment.

The impact of any legislation upon the business community must be measured largely in terms of its effect upon small business. In these days when our free enterprise, competitive economy is engaged in an international struggle of ideologies, we must not forget that it is largely the small business firm in America which supplies the element of competition upon which the life of our system depends. It

is only when small firms prosper that our system works with maximum efficiency. We all oppose undue interference by Government in the affairs of business. Yet, we know that only when the vital element of effective competition is present does the need for Government action disappear. Those of us who work from day to day with the problems of small business are constantly reminded of their dependence upon large business. It is well to remember, from time to time, that without small businesses and the competitive force they exert, our economic system as we know it today could not endure.

The Small Business Committee has often expressed the view that small business firms need a reduction in tax liabilities to enable them to survive in our rapidly changing economy. We were encouraged by the recognition given this fact by the President in his message to the Congress of January 24, 1963, when he stated that small firms, and I quote his words:

which have less ready access to the capital markets, must depend more heavily for capital on internally generated funds and are generally at a financial and competitive disadvantage.

This brief statement by the President, with its recognition of the general plight of small business and with its special emphasis upon the capital shortage endured by small firms, is an accurate description of the problems faced today by 95 percent of the businesses in America—a problem which the bill now before this committee will go far toward solving.

I might add here that there is another bill pending before your committee, Mr. Chairman, which is directed specifically toward the problem of access to capital markets for small business. I have reference to S. 297, which will correct some tax inequities affecting the small business investment companies, which, as you know, supply equity capital to small firms. Certainly, I do not want to discuss S. 297 at this time, except to say that it does go hand in hand with the bill now being considered by the committee in trying to alleviate the shortage of expansion capital presently facing small business.

Several of the provisions of H.R. 8363 were carefully reviewed at hearings held by the Subcommittee on Taxes of the Small Business Committee in April of this year. At that time, of course, we were dealing only with the recommendations contained in the President's message of January 24. Our purpose was to determine the impact of these recommendations upon small businesses. The findings and conclusions of the subcommittee were published in a report of the full Small Business Committee filed on August 15, 1963 (S. Rept. 397). A copy of that report is attached to my statement, and I offer the report for the consideration of this committee.

The CHAIRMAN. Yes.

Senator SPARKMAN. It is not my purpose this morning to repeat what is contained in the Small Business Committee's report. Rather, I would like to discuss some of the strengths and weaknesses of H.R. 8363 as revealed by the findings and conclusions of our report.

First, the corporate tax reduction:

Back in November of last year, at the time that the administration was putting together its tax program for this year, Senator Bible, who is chairman of our Subcommittee on Taxation of our Small Business Committee, Senator Saltonstall, the ranking minority member of the

committee, and Senator Cooper, joined with me in recommending to the President for inclusion in the tax program a reversal of the corporate normal and surtax rates and an increase in the surtax exemption from $25,000 to $50,000. I am happy to say that the proposal to reverse the corporate rates was included in the administration's program, and, as you know, is a part of H.R. 8363. This measure will provide meaningful relief for small corporate businesses, and is strongly endorsed by the Small Business Committee. With regard to increasing the amount of the surtax exemption, I am sure that this committee will agree that many truly small businesses have annual incomes of more than $25,000. This is especially true of small manufacturing corporations. Such a firm, having income, for example, of $50,000 or $100,000 per year, suffers from the same lack of access to outside capital and the same inability to retain capital from earnings as does a company earning $25,000. The relative impact of these problems may be greater upon those firms toward the bottom of the small business size scale, but they remain very real and very burdensome for all small businesses. I would urge this committee to give serious consideration to the question of whether some increase in the surtax exemption is in order.

Next, multiple surtax exemptions:

The Small Business Committee devoted much study and consideration to the administration's proposal to eliminate multiple surtax exemptions. The surtax exemption was provided by the Congress out of recognition of the fact that the financial burden of the surtax does not fall with equal weight upon both large and small businesses. The exemption was designed for the purpose of equalizing this burden. What was intended as a relief measure for small businesses, however, has become, in practice, a tax benefit for large businesses. This result has been accomplished through multicorporate organizations of large concerns. In his testimony before this committee Secretary Dillon presented a number of examples illustrating the tax benefits derived from multiple incorporation by essentially large enterprises consisting of a number of separately incorporated outlets.

These examples provide strong support for the Small Business Committee's conclusion that the present availability of multiple exemptions has added to the competitive advantage which large businesses have over their small competitors. This additional advantage is one which small business can ill afford. In trying to meet the situation, many small firms have utilized multicorporate organization—to a much lesser degree, of course, than large firms. The evidence presented to our committee revealed that approximately 20 percent of the corporations falling within the Small Business Administration's definition of "small business" are organized into two or more corporations, and approximately 10 percent of these claim multiple exemptions. Our committee recognized that the full benefit of the surtax exemption would be denied to these small firms if the administration's proposal to eliminate multiple exemptions entirely were enacted. These small firms have utilized multicorporate organization because the nature of their business required that they do so. (This is in accordance with the law, which denies multiple exemptions if there are not sound business reasons for the existence of separate corporate entities within the business structure.) They must compete with large businesses, which, for the same or similar sound business reasons, have utilized multi-

corporate organization. As between two such multicorporate business organizations—one small and one large—the tax burden is not equalized by limiting both to a single surtax exemption. The larger firm retains the advantages of financial strength and access to external sources of capital. It was for these reasons that our committee recommended that surtax exemptions be limited to a number which would more realistically reflect the pattern of organization within the small business community. The number of available exemptions should be sufficiently large to permit full utilization by small business, and yet, sufficiently small to avoid as nearly as possible any unfair advantage for large firms.

The provisions of H.R. 8363 which treat the subject of multiple surtax exemptions were not, of course, available to the Small Business Committee at the time of its consideration of this matter. However, according to the report of the Committee on Ways and Means of the House of Representatives, it is the purpose of H.R. 8363, as it relates to multiple surtax exemptions for groups of controlled corporations, to leave such groups in approximately the same relative position they are in under present law. In my opinion, and for the reasons stated in the report of the Small Business Committee, this falls far short of what is needed in this area of our tax laws. As the Senator from Louisiana, Mr. Long, pointed out in his speech to the Senate on October 16, the availability of multiple surtax exemptions has been the subject of severe criticism by students of our tax system. If the recommendation of the Senate Small Business Committee is adopted, meaningful reform will be accomplished and small business will be restored to its rightful place as the beneficiary of the surtax exemption. With regard to the revenue effect of this reform, I do not have any exact figures. However, I dare say that the additional revenue to be derived from placing a small business limitation upon the number of available surtax exemptions might well be sufficient to justify a significant increase in the amount of the surtax exemption.

Whatever action is taken with regard to multiple surtax exemptions, I would urge that the definition of a controlled group of corporations be made to provide specifically that a small business will not be considered a member of any such group solely on the basis that it has received financing from a small business investment company. An SBIC may provide financing to a number of small corporations, and, under very exceptional circumstances, may obtain a controlling interest in one or more of these firms. Such a situation arises only when it is necesasry for the SBIC to assume control in order to protect its investment, and the transaction is accomplished pursuant to strict regulation by the Small Business Administration. SBA regulations require that the transaction provide for the eventual relinquishment of control by the SBIC. I do not believe that these small businesses should be denied the surtax exemptions to which they are otherwise entitled during the period that they may be under control the control of an SBIC. For this reason, I would propose that specific language be included in the bill to make it clear that such businesses are not to be considered as members of a controlled group.

Next, I should like to discuss taxing accrued gain on assets transferred by gift or at death.

H.R. 8363 does not include any provision dealing with the nontaxation of accrued gains on capital assets transferred by gift or at death. Because of this, I understand that the Treasury is now opposed to the lower tax rates upon capital gains. One of the arguments made by the Treasury in favor of taxing accrued gain on assets transferred at death is that this will solve the so-called "lock-up" problem. I am sure that there is a considerable amount of capital which is held in the form of capital assets, until death, in order to avoid taxation of the gain on these assets; and I am sure that much of this capital would be released if the law were changed as the Treasury suggests. I also feel that much of this capital would become available for investment in small firms. Because of this, and because of the further fact that the lower rates on capital gains would encourage investment and risk-taking, the Small Business Committee did not oppose entirely the Treasury's proposal to solve the "lock-in" problem. To be sure, we recognized and illuminated the very serious problems which would result for small business if an additional tax liability should be placed upon inherited interests in small, closely held businesses.

It was a matter of major concern to my committee that our high rates of income and estate taxation are providing positive inducements to the sale or merger of small business firms. The relief provided by section 303 of the Internal Revenue Code allowing redemption of stock in closely held corporations without ordinary income tax consequences, and by sections 6161 and 6166, which provide for extensions of time for payment of estate taxes under certain circumstances, have been helpful in many instances, of course, but these relief measures have not been effective in counteracting the inducements to sell or merge.

A recent study by Dr. Chelcie C. Bosland, professor of political economy at Brown University, which, incidentally, was made possible by a research grant from the Small Business Administration under Public Law 699 of the 85th Congress, indicates clearly that our tax laws provide strong inducements for small firms to sell out or merge. This is found to be true for two reasons. First, it is extremely difficult for a small firm to maintain a sufficiently liquid position to meet the obligations imposed by the estate tax. This liquidity problem is aggravated by, and in many instances directly caused by, our high rates of income taxation. The second factor—and one explored more fully by Dr. Bosland—is the fact that a great deal of uncertainty faces the owner of a small business as to just what value the Internal Revenue Service will place upon his business interest. Dr. Bosland confirmed that this uncertainty, itself, induces sales and mergers.

Obviously, the tax which was originally proposed to the Congress this year would worsen the liquidity and the evaluation aspects of this problem. On the other hand, the Small Business Committee recognized, as I have said, the benefits which might flow to small business from releasing locked-in capital and from encouraging risk-taking through lowering capital gains rates. Our consideration of these factors led us to recommend an exemption from the proposed tax for interests owned in small, closely held businesses. I realize that it is unlikely that the proposal to tax accrued gain on these assets will be revived. In the event an effort is made to do this, however, I would urge you to adopt the Small Business Committee's recom-

mendation. Further, I hope that this committee will not find it necessary to reject the lower tax rates on capital gains provided in H.R. 8363.

Now, a word about estate taxes.

Without regard to any action that may be taken on the proposal to tax accrued gain on inherited capital assets, the President's original proposal to liberalize section 6161 of the code should be added to the bill by this committee. As I said earlier, small businesses find it very difficult to have sufficient liquid assets available for the payment of estate taxes upon the death of the owner. Section 6161 provides for payment of estate taxes in installments for up to 10 years—I may say that was liberalized a few years ago upon the recommendation of the Small Business Committee and, as I recall, the action was initiated by this committee—in cases of undue hardships, and this has served to alleviate to some extent this liquidity problem. It has enabled many small firms to preserve their independence following the death of a principal owner rather than sell out or merge with another firm.

The administration recognized, however, that there was a need to liberalize this section of the code, and it was proposed that section 6161 of the code be amended to provide that circumstances involving a forced sale of a family business to outsiders, or a forced sale on a depressed market, be considered to be an undue hardship, and thereby regarded as sufficient reason for granting an extension of time for the payment of the estate tax.

I realize that this proposal was made as a part of the recommendation to impose a tax on accrued gain on inherited capital assets. However, the administration specifically recommended that section 6161 be liberalized in its application to the existing estate tax, and I should not think the Treasury would object to the enactment of this amendment. It will be helpful to small family-owned businesses and I hope that this committee will see fit to add such an amendment to H.R. 8363.

Mr. Chairman, the report which I have submitted to your committee speaks for itself, and I do not wish to discuss at length those other provisions of H.R. 8363 which were endorsed by the Select Committee on Small Business. I do want to say, however, that small business has a tremendous stake in the bill before your committee. I am hopeful that this committee will amend the bill as I have suggested and report it favorably at an early date.

That is the conclusion of my statement and, if I may, Mr. Chairman, I will read the letter of Senator Saltonstall which he has submitted. It is addressed to you as chairman of the committee.

The CHAIRMAN. It will be inserted in the record.

Senator SPARKMAN. It is dated November 14, 1963, and it is addressed to you, Mr. Chairman, and it is as follows:

DEAR MR. CHAIRMAN: I am most appreciative for Senator Sparkman's courtesy in introducing this letter in the record of your committee. As ranking minority member of the Select Committee on Small Business, I wish to add my support for the tax recommendations contained in the report of this committee on the impact of the President's tax proposals on small business, filed on August 15, 1963 (S. Rept. 397).

The purpose of the President's tax proposals has been to offer a stimulus to corporate investment and consumer consumption. I am in agreement with this for such a stimulus can serve to improve the economy of our Nation. Problems arise, however, in trying to determine how best to achieve this result.

We are all aware of the complexity of our economy. Different segments of the economy are confronted with problems peculiar to each and a common approach to all segments is neither practicable nor equitable. This fact is apparent, I believe, when one considers the small business segment of our economy. While the essential nature and basic interests of small business are alined with those of larger business, small business faces many problems which vary and thereby require an approach different from those involved with a larger business. It is my belief that this factor necessitates certain approaches under our tax structure to benefit small business which will permit it to compete as a positive force in our economy.

I believe that the position expressed by the Small Business Committee in its report best assures proper tax consideration to protect the legitimate interests of the small business community. I feel that the findings and conclusions of this report are worthy of consideration by your committee during its consideration of the President's tax proposals.

I am concerned with some variance which exists between H.R. 8363 and the recommendations contained in the report of the Small Business Committee. I mention, particularly, the area of corporate tax reduction. Prior to the submission of the tax proposals of the President, Senators Sparkman, Bible, Cooper, and I submitted a letter to the President which recommended a reversal in the normal and surtax rates and an increase in the surtax exemption from $25,000 to $50,000. This recommendation was based upon a realization that such an exemption was necessary for small business in order to provide more capital to businesses which face greater problems in obtaining capital and investment credits.

It was gratifying to see that H.R. 8363 does incorporate provision for reversal of the normal and surtax rates, which was recommended by the President. However, I believe the merits of an increase in the surtax exemption to $50,000 warrant consideration by your committee.

I believe that the recommendations of the Small Business Committee in its report which are consistent with those of the President for liberalization of section 6161 of the Internal Revenue Code should be added to H.R. 8363. This would extend to a family business the right to extend the time for payment of estate taxes when a business has been sold to outsiders or on a depressed market, for such would be regarded as an undue hardship.

I concur fully with the lower tax rates on capital gains provided for in H.R. 8363. It is hoped they will be retained by your committee.

I urge that the committee not revive the proposal to tax accrued gain on assets transferred by gift or at death. It is already a substantial problem to a small business to reserve sufficient funds for the payment of income and estate taxes. This, in itself, has served as a deterrent to liquidity and hampered economic growth of a small business. Such a further tax would accelerate the trend toward concentration and the reduction of competition in our economy. If your committee should revive the proposal to tax accrued gain on assets transferred by gift or at death, I submit that the proposal in the report of the Small Business Committee to exempt interests owned in small, closely held businesses be adopted.

I am pleased that H.R. 8363 has recognized areas under our tax structure which require particular attention under the proper needs of small business. I hope that your committee will consider the matters briefly outlined in this letter, but dealt with in considerable detail in the report of the Small Business Committee, as it considers the complicated problems presented by the President's tax proposals.

I am most appreciative for your consideration.

Sincerely,

LEVERETT SALTONSTALL.

The CHAIRMAN. Senator Sparkman, we thank you very much for your valuable suggestions. You have been before the committee quite a few times with respect to the taxation of small business.

Senator SPARKMAN. Almost every time you have a bill, Mr. Chairman.

The CHAIRMAN. You have always made a very concise and, I think, in the main, sound suggestions, and we certainly thank you for this contribution.

Senator SPARKMAN. Thank you very much.

The CHAIRMAN. The next witness is Mr. George J. Burger, appearing in behalf of the National Federation of Independent Business.

STATEMENT OF GEORGE J. BURGER, VICE PRESIDENT, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, D.C.

Mr. BURGER. I am George J. Burger, vice president, legislative activities, National Federation of Independent Business. We are a national organization composed solely of smaller, independent business and professional people. As of October 11, 1963, our membership consisted of 193,921 individual, directly supporting and participating independents. This figure continues to grow. Our members are distributed throughout almost all of the Nation's 435 congressional districts. They are a true cross section of all the vocations at all levels of America's smaller, independent enterprise community.

The stand of the federation is determined by direct vote of the entire membership, with each member having one and only one vote, which he registers on a signed ballot which is sent to his Congressman. The federation conducts these polls through its the Mandate, regularly throughout each year.

Additionally, the federation conducts special business conditions surveys among its members each year. These do not determine federation policy. But they do serve to give a greater view in depth into the problems and thinking of our members.

Due to the workload facing your committee, and due to the fact that tax reductions are needed at the earliest possible date, we will be brief. In order to help out we will make only this brief oral statement, and ask that you file our full testimony in the record of your hearings. Copies of this brief statement and of our full testimony are already in your hands.

Briefly, Mandate polls of our membership and the results of special polls to date show the following trend of thinking on tax reductions generally, and the issues involved in same:

1. By a margin of 2 to 1 our members indicate firm belief that Congress should make tax reduction its No. 1 order of business for 1963.
2. By a margin of a little over 2 to 1 our members favor the President's proposal to reduce taxes in three stages.
3. By a margin of almost 3 to 1 our members favor the general outline of the President's approach to tax reductions for individuals and unincorporated businesses.
4. By a margin of 5 to 4 our members favor the President's approach to corporation tax reductions, however, at the same time our members show greater preference for the proposal advanced by the chairman and minority leader of the Senate Small Business Committee, to cut the corporate tax rate to 22 percent on the first $50,000 taxable income, leaving the rate at 52 percent on all income above that figure.
5. Our members urge strongly that tax cuts be accompanied by reductions in Government spending. They are heartened by predictions by Representative Clarence Cannon that Congress may cut up to $3.5 billion from requested appropriations. They call on all in Congress to be firm in this area.

6. As to reductions in Government spending, reductions in foreign aid are most favored, followed in order by: reductions in Government employment payrolls, and reductions in "social welfare" programs. There is support for recovering revenues lost through tax cuts by the closing of so-called tax loopholes, but this support is smaller than that given to any of the foregoing issues regarding reduction in Government spending.

We urge your committee to pay particular attention to the foregoing conclusions, as well as to the detailed explanations of their bases in the statement we have filed with you, because these survey findings truly represent the thought-through judgment of small, independent business and professional people who are part of the backbone of our free enterprise system, and whose continued opportunities are vital to the preservation of our individual liberties themselves.

One final note: We have examined the rate reduction provisions of the tax bill as passed by the House, and find them right in line with the sense of our membership as expressed in surveys and polls. True, they might be changed for the better. But they are a long forward step in the right direction. Sensing the urgency of the need for tax cuts, we would not urge that time be lost in further debate on them.

Mr. Chairman, and members of the committee, we thank you for your attention, and for myself and our members wish you the very best of success in your most important studies and decisions. If we can be of further assistance to you at any time, please feel free to call on us.

(The supplemental statement of Mr. Burger follows:)

SUPPLEMENTAL STATEMENT SUBMITTED BY GEORGE J. BURGER, VICE PRESIDENT, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, D.C.

I am George J. Burger, vice president, legislative activities, National Federation of Independent Business. We are a national organization composed solely of smaller, independent business and independent professional people. Our home office is San Mateo, Calif. I am in charge of the Washington, D.C., office.

Presently we have over 193,000 individual, directly supporting and participating members throughout all 50 States. This number is increasing every week. From the standpoint of number of directly supporting and participating members, we are the largest business-professional organization in the country.

Our main function is one of encouraging these independent enterprisers—who are the admitted backbone of our free enterprise system, and who are one of the strong pillars supporting our very liberties—to take a continuing, active, informed interest in Government affairs—State and national—and of providing them with programs to do so in an intelligent, effective manner.

I will not describe our method of operation. Most, if not all, the members of this committee have become familiar with the federation over the 20 years of our Washington activities. I will say only that in the federation, members speak directly for themselves—in their statements, officers voice only the opinion of the membership. Through our the Mandate polls (regular reports on which have been furnished to you) we determine the majority position of the membership. This sets the federation's course. Through our special factfindings surveys ("How's Business With You?"—1962; "Let's Take Care of Our Business—Government"—1963) we make it possible for members to tell us, and through us all in Government, the factual basis behind the many problems which are attacked by bills presented for vote in various issues of the Mandate.

First, we would like to say that the rate-reduction and income-averaging provisions of the tax bill as passed by the House under the leadership of the Honorable Wilbur Mills are right in line with the sense of our membership as expressed in surveys and polls. As we will point out later, it could be changed for the better in some respects. Still, it is a solid step in the right direction.

Second, we want to congratulate your committee on these hearings. Reading reports and listening to information as we do, we had feared that there might be delay. We are happy to see the signs are otherwise. The fact is, as we will point out later, that the smaller, independent business and professional people of this country regard action for lower tax rates as one of critical importance to their futures. We are able to make this broad a statement because comparison of our survey and poll results with those made by Congressmen of their constituents in all walks of life show a startling identity in percentages.

Now, in our December 1962 Mandate No. 280 (app. A), 62 percent of our members insisted that Congress make consideration of tax reductions its first order of business in 1963. Further, in our special fact-finding 1962 "How's Business With You?" survey (sample copy and year-end tabular report on file with your committee), to which we received 56,486 signed responses, we questioned members of the desirability of tax reductions, action against unfair competition, imports, etc. By far the largest number of respondents, some 41,445, checked tax reduction as their most pressing need.

Interestingly, in the tax area we asked members what they thought was most needed: Lower tax rates, faster depreciations, plowback allowances, or self-employed retirement plans. We found the following:

1. 20,679 respondents checked "Self-employed retirement plans";
2. 18,208 respondents checked "Lower rates";
3. 16,216 respondents checked "Plowback allowances"; and
4. 11,496 respondents checked "Faster depreciation."

As you know, Congress in 1962 moved a great distance to meet the No. 1 need expressed by our members by enactment of H.R. 10, S. 59, the private retirement program bills. Furthermore, Congress and the administration moved a great distance toward meeting the Nos. 3 and 4 needs in the enactment of H.R. 10650 (which provides an additional 7-percent tax credit to assist in the replacement of equipment and machinery) and in announcemnt of a $1.5-billion increase in depreciation allowances.

This, of course, leaves the No. 2 "Lower rates," need still up in the air.

Now, how do our members, who are a bona fide cross section of all smaller, independent business and professional people in our country (incidentally, the largest such cross section in any single business organization in the land), feel about action toward lower rates?

To put it bluntly, our members stand four-square that tax rates must be reduced, with due consideration to the needs in small, independent business and independently operated professional vocations. They strongly prefer that these reductions be accompanied by matching reductions in Government spending. However, just how they would choose if they were faced with making the hard choice of accepting a tax reduction without matching spending cuts is a question that no one can answer.

Let's look at the record:

First, as to the administration's tax proposals, in our February 1963 Mandate No. 281 (app. B), we found that 66 percent of our members favored the proposal for a three-stage tax cut, 70 percent of our members favored the administration's proposals for reduction of personal income tax rates, and 53 percent of our members favored the administration's proposals to reduce corporate income tax rates.

In any case, as to the question of tailoring these bills to those in smaller, independent business and the professions in the Mandate No. 281, we also asked our members to express themselves on the Senate Small Business Committee's November-December recommendation on corporato tax reduction. We found that 59 percent favored this recommendation, against 53 percent who favored the administration's corporate tax revision plan.

We have made almost the same finding in our 1963 "Let's Take Care of Our Business—Government" special, fact-finding survey (sample copy and first 2-month tabular report attached). In the first 8 months of this particular survey (which will require a full year for entire membership coverage), on the basis of 42,417 signed responses received from members throughout the entire 50 States, we have found a 7 to 1 preference (22,845 "Yes" to 3,882 "No") expressed for the Senate Small Business Committee's November-December corporate tax reduction recommendation to the administration, against an approximate 10 to 8 rejection (8,422 "Yes" to 10,132 "No") of an alternative proposition that corporation tax rates be reduced by 5 percentage points all along the line, regardless of size of corporate income. Interestingly, support for the SSBC plan has grown with the passing of time.

As to the preference expressed for the Senate Small Business Committee corporate tax reduction plan, as you know, all businessmen aspire to grow. This is part of the very nature of our freedom of opportunity and competitive economy system. Historically, the most severe growing pains are experienced in the transition between small and large business. A number of our members are in this stage. Our membership is limited to independently operated and owned firms which are not dominant in their lines. They are experiencing the difficulties in the early surtax area. Others hoping to grow behind them anticipate this difficulty. Therefore, clearly they would prefer a plan that would reverse the tax rates and expand the 22-percent levy to a $50,000 cutoff, to a plan that would reverse the normal tax rates, keep the present $25,000 cutoff, and effectively increase the present surtax by 3 percentage points.

Further, we are asking members in this same special survey whether they prefer to have individual income taxes reduced evenly all along the line regardless of size of income, or to have the larger reductions made in the lower income brackets. To date the margins are running 2 to 1 (18,340 "Yes" to 8,965 "No") in favor of the former, but 3 to 1 in favor of the latter (18,900 "Yes" to 6,884 "No"). These particular tax rates apply equally, of course, to unincorporated business and professional operations the same as to individuals. Interestingly, these ratios have held steady throughout 1963 to date.

We have told you that we do not know how our members would feel about the question of having taxes cut without offsetting Federal spending reductions.

We might have answered this question, "Yes" during 1962. In a bluntly worded poll in our July 1962 mandate No. 277 (app. O attached) we asked members: "Should Congress cut personal and corporate tax rates across the board this year? (Some business and labor groups suggest this to strengthen the economy, even if it results in an increased national debt)." The result, a vote of 50 percent "For," 47 percent "Against," and 3 percent "No opinion." Additionally, in our 1962 special survey we asked: "Do you think Congress should make tax reductions now?" Our 56,486 responses broke down as follows: 73 percent (41,445) "For," 18 percent (10,079) "Against," and 9 percent (4,962) "No opinion."

Today, however, the mood seems one of much uncertainty, if not of opposition to tax cuts without matching spending cuts. In our February 1963 mandate No. 281 we asked: "Do you believe that Congress should match tax cuts by Federal spending cuts on a dollar-for-dollar basis, before finally enacting tax reductions?" The result, a vote of 83 percent "For," 14 percent "Against," and 3 percent "No opinion." This would seem clear enough, except for one consideration, our findings to date in the 1963 special survey. One of our questions is: "Should Congress cut taxes this year?" Of the 42,417 replies to date, 48 percent (20,378) favor such cuts, 20 percent (8,694) oppose the cuts, and 32 percent (13,345) express no opinion.

Why this switch to uncertainty? We believe that three factors are responsible. First, the poll was taken and the survey is being taken during a period of exceptionally intense, sometimes quite bitter, and widely publicized debate over the question whether taxes should be reduced if such reduction contributes to a greater deficit. This it seems, might well encourage a negative reaction. (As a matter of fact, when congressional debate heated up once more over the deficit-creating potential in the tax bill just before House action on same, we observed, in our survey, a reduction of 6 percentage points in support for cutting taxes this year; it is interesting to note, however, only two of these percentage points shifted to the "I'm against tax cuts in 1963" category, and that four of these percentage points shifted to the "I don't know" or "I do not care to express an opinion," the undecided category). Second, and on the other hand, there would seem no question that people generally realize that any increase of the deficit under these circumstances would be different from many others in past years, in that this time the increase would be caused by the transfer of the income involved from the hands of Uncle Sam at Washington to those of individuals and private enterprise. This, it seems, might encourage a favorable reaction. Third, our studies and membership contacts convince us that many people are unaware of the provisions of the legislation. For instance, some are still under the impression that the measure would eliminate entirely deductions for such items as interest on mortgages and charitable contributions, provisions that are about as far from being in the tax bill as the sun is from being in the earth.

Second, as is well known, small business sales and profits tend to be much

more volatile than those of their big business competitors. For instance, as Mr. John Horne, former Administrator of the Small Business Administration, pointed out, earnings of small manufacturers increased by 44 percent as between the first three quarters of 1961 and the first three quarters of 1962, while the earnings of large manufacturers increased by 22 percent. Also, the Treasury Department points out, under the 1963 proposals small corporations will achieve reductions of about 27 percent compared with 4-percent reductions for their giant competitors. To the extent that smaller corporations are able to retain more of their earnings during periods of profit increases than are their larger competitors, it is clear that their position is nothing but strengthened.

While on this subject, we would like to point out that we have polled our members in various mandates, over a long period of years, on the question of income averaging such as is proposed in the administration's tax revision proposals. In each and every case we have received a favorable response.

Frankly, we are much intrigued by the thought that to the extent that these tax reductions might very well make it possible for the Small Business Administration to do a far more comprehensive job in its financial assistance operations. To the extent that reductions improve the financial position of small units, to that very extent this agency, which has been and is doing an excellent job, will be able to get more mileage, so to speak, out of each and every one of its lending assistance dollars. That can be nothing other than a further step in the right direction.

It is most important for Congress to act in this tax area. The more than 4.5 million small firms in the United States comprise about 95 percent of all business in the Nation. They employ 30 million persons (almost 50 percent of our entire work force) and account for 40 percent of all business activity. As a matter of fact, reports by your own committee some years ago indicated that in some lines of trade, particularly retailing, small firms account for as much as 80 percent of business activity, and employ as much as 70 percent of all the gainfully employed.

In any case, as to the polls and surveys, two factors stand out: First, the change in vote between mandate No. 277 and mandate No. 281—from 47 percent opposition to tax cuts that might increase deficits, to 86 percent opposition to enacting tax cuts without offsetting tax reductions. Second, the change in response between the 1962 and 1963 special surveys, which is not appreciable in the category of opposition to tax cuts, but which is heavily in the "I don't know," or "I don't care to express an opinion" category.

For this reason, we do hope it will be possible for the administration and the Congress to effect the maximum reasonable economies in spending programs, because smaller independent business and professional people do need, and can very much use, tax reductions this year. We are indeed encouraged by House action which, according to Representative Clarence Cannon, indicates a possibility that Congress may effect upward of $3.5 billion reduction in spending requests this year.

As to the question how such reductions would affect small firms there can be one answer only: The reductions, while perhaps not the most desirable, would be helpful. For instance, Treasury estimates they would effect a tax savings of $233 million a year for corporations earning under $25,000. This saving, when added to savings made possible under the 1958 $260 million Small Business First Step Tax Revision Act, the 1962 depreciation revisions, and the 1962 7-percent tax incentive, can do nothing but further strengthen the financial position of smaller business units—proprietorships, partnerships, as well as corporations. All of this is an addition to the fact that basically small and growing businesses are the units which emphasize the competitive aspects of our economy, and by their very act of being and succeeding are concrete evidence that the basic freedom of opportunity in our country, which is so vital a part of the mix that goes into bulwarking our individual freedoms.

In short, small business is vital to our Nation, both from the standpoint of the part played economically and from the standpoint of social significance. The level of taxation is a most important factor influencing its chances for success. We appreciate the opportunity to appear before you and discuss this subject today, and hope that in the months ahead, you will continue the good work done in past years, in pressing for enactment of further needed and justified tax relief for this segment of our economy.

(The attachments referred to follow:)

Page 1

ATTACHMENTS TO TESTIMONY BY NATIONAL FEDERATION OF INDEPENDENT BUSINESS, BEFORE THE SENATE SELECT COMMITTEE ON SMALL BUSINESS, APRIL 29, 1963, ON SUBJECT OF SMALL BUSINESS TAX REDUCTIONS

APPENDIX "A" (From Mandate No. 280 - Membership base: 185,445 individual independents)

5. **SHOULD CONGRESS MAKE TAX CUTS** for individuals and corporations its No. 1 order of business in 1963?

☐ FOR ☐ AGAINST

5. **Argument for cutting taxes in 1963:** Taxes must be cut as soon as possible after Congress meets in 1963. Individuals must be left with more money in their pockets for increased purchases, sales, profits, and employment. Corporations must be left with more money for expansions, modernization, and possible lower costs. Both things are needed for growth, which is the only type of economy in which small business can prosper. Expanded business activity could generate additional tax income, thereby reduce any deficit that might be caused.

5. **Argument against cutting taxes in 1963:** It's not reasonable to talk of cutting taxes at a time like this. First, little or no thought is being given to reduction of Federal spending. Second, any cut in individual and corporation rates might require offsetting increases in closing so-called "loopholes" which benefit various segments of our nation. Third, our country is faced with a situation which could easily demand greater outlays for defense. Reduction of tax rates under these circumstances isn't the road to greater strength and prosperity.

Results of foregoing vote as published in Mandate No. 281:

5. Congress make tax cuts No. 1 order of business for 1963	62%	33%	5%

APPENDIX "B" (From Mandate No. 281 - Membership base: 187,576 individual independents)

ARE YOU IN FAVOR of the President's proposal to reduce personal and corporation income taxes in three stages (first part to come in 1963, second in 1964, and final in 1965)?

The President pledged to cut total spending except for defense, space, and interest. This would mean cuts in Gov't employment, welfare programs, other non-defense projects.

☐ FOR ☐ AGAINST

ARE YOU IN FAVOR of the President's proposal to reduce personal income tax rates (this involves 28% cuts on taxable incomes to $5,000, 23%-25% cuts on $10,000-$50,000 incomes, and 15% cuts on all larger incomes)?

Personal income tax rates apply to all unincorporated business and professional operations.

☐ FOR ☐ AGAINST

ARE YOU IN FAVOR of the President's proposal to reduce corporation tax rates to 22% on the first $25,000 taxable income, and to 47% on all above that figure?

Corporations now pay 30% on the first $25,000 taxable income, and 52% on all above that figure.

☐ FOR ☐ AGAINST

OR

ARE YOU IN FAVOR of the plan urged by the Chairman and Ranking Minority Member of the Senate Small Business Committee to cut the corporate tax rate to 22% on the first $50,000 taxable income, leaving the rate at 52% on all above that figure?

☐ FOR ☐ AGAINST

5. **DO YOU BELIEVE** that Congress should match tax cuts by Federal spending cuts on a dollar-for-dollar basis, before finally enacting tax reductions?

☐ FOR ☐ AGAINST

Page 2

ATTACHMENTS TO TESTIMONY BY NATIONAL FEDERATION OF INDEPENDENT BUSINESS BEFORE SENATE SELECT COMMITTEE ON SMALL BUSINESS, APRIL 29, 1963 (continued)

2, 3 **Argument for:** Our present tax system exerts too heavy a drag on private purchasing power, profits, and employment. Designed to check inflation, it now checks growth, flow of dollar purchasing power, invites recession, depresses Federal revenues, and causes chronic deficits. We must bring it up to date now, when the inflationary pressures of war and post-war years no longer threaten. The cuts proposed ($11 billion for individuals including unincorporated businesses, and $2.5 billion for corporations) will increase the purchasing power of American families and businesses in every tax bracket. They will also encourage the initiative and business risk on which free enterprise depends, induce more investment, production and industrial capacity use, and help provide the 2 million new jobs we need each year. The reductions follow the sound principle that each additional penny put into the channels of free enterprise, revolves several times each year, picking up profits and producing jobs. The need for restraint in Gov't spending is recognized. Cuts in non-defense programs are promised. However, we are still in a dangerous world, and must spend the money needed for national defense. This means that the Federal deficit may increase temporarily—while the economy, absorbing the incentives of tax cuts, gears to greater production, profits, wages, and tax production. Thus, the program is spaced over three years, to assist in orderly adjustment of our finances.

Argument for SSBC plan: Most corporations, those with greatest growth promise, earn $50,000 taxable income or less. This plan is specifically for them. It would save $2,000 for firms earning $25,000, and $9,500 for those earning $50,000. No greater savings could be made by any firm. In the President's plan, savings would be $2,000 at $25,000, $3,250 at $50,000 and $5 million at $100 million. Firms earning over $25,000 wouldn't get full tax cut benefits until the 3rd year. The SSBC plan would cause a smaller tax revenue loss.

5. **Argument for dollar-for-dollar cuts:** A soundly managed family or business must keep spending in line with income or go bankrupt. This principle is as old and sound as the world itself. It applies with equal force to Gov't. It cannot go constantly deeper into debt without a day of reckoning, if not for us then for our children. That day could involve complete financial ruin of all, and of the nation itself. Now, the Administration wants to take a risk that tax cuts without equal spending cuts will accelerate business to the point where taxes once more will equal spending. Maybe it's right. But tax revision to date hasn't done this. The only safe course is to match tax cuts with spending cuts.

2, 3. **Argument against:** The tax cut proposals are fine sounding and sincere. However, as matters stand there are areas subject to searching examination. Those in favor state that tax cuts will increase consumer spending which would stimulate production, make funds available for investment, and relieve unemployment. As to the need for doing something drastic to increase employment, we must remember that the statistics on which percentage figures show those out of work reflect in part workers in seasonal industries, housewives and students who are in and out of the labor force, and some people who, for one reason or another, do not want to work at any given time. There is question just how much tax cuts could go to increase employment in these areas. As to the need for funds for investment and purchasing, statistics show that today our reserve of savings and earnings is at an alltime high. Perhaps consumers are not spending their money because of a lack of desire for new or additional possessions, also possibly because of a feeling of insecurity as to what the future holds. Perhaps funds are not being used for plant investment and expansion because, in part at least, in many basic industries production is considerably below present capacity, and for one good reason: that demand is simply not there, even though as stated above, the consumer dollars are available. Therefore, tax reductions would not seem the answer.

Argument against SSBC plan: Small corporations are vital to our economy. But the President's plan is sound. It provides tax reductions for both small and large units, in relation to their needs. Let's face it. This is a country of big and little businesses. Each have their own part to play, their own contribution to make to production, distribution, and employment. Furthermore, there is a definite interdependency between them. The health of one affects the health of the other. Thus, when tax revisions are proposed, each must receive its needed and rightful share of benefits.

Argument against dollar-for-dollar cuts: Businessmen daily go into debt on programs aimed at bigger volume and profits. Risk-taking is part of their lives. But Gov't is the biggest "business" in our country. It too must take risks in building for the future. The facts are that our tax system is dangerously out of date, that changes must be made, that economy must be a watchword at Washington, but that we can't cut defense spending, and that dollar-for-dollar cuts on the civilian side would cut the heart out of vital services. The Administration offers its program as a calculated risk in tax revision that will promote a sounder country. Many successful businessmen agree with its judgment. So, also, should we.

Results of foregoing vote as published in Mandate No. 282

	FOR	AGAINST	NO VOTE
President's proposal for three-stage tax cut	66%	29%	5%
President's proposal to reduce personal income taxes	70%	26%	[illegible]%
President's proposal to reduce corporate income taxes	53%	40%	7%
Senate Small Business Committee plan to cut corporate taxes	59%	34%	7%
Congress match tax cuts by spending cuts	83%	14%	3%

Page 3

ATTACHMENTS TO TESTIMONY BY NATIONAL FEDERATION OF INDEPENDENT BUSINESS BEFORE SENATE SELECT COMMITTEE ON SMALL BUSINESS, APRIL 29, 1963 (continued)

APPENDIX "C" (From Mandate No. 277 - Membership base: 181,078 individual independents)

SHOULD CONGRESS CUT PERSONAL AND CORPORATE tax rates across-the-board this year?

Some business and labor groups support this to strengthen the economy, even if it results in an increased national debt.

☐ FOR ☐ AGAINST

1. Argument for the cuts: Tax cuts are vital to get our economy moving. Reduced personal income tax rates are needed to increase purchasing, sales, profits, and employment. Reduced corporate taxes are needed to promote business expansion. Both are needed for growth, which is the only type economy in which small business can prosper. By putting more money in the trade channels, the cuts should increase tax collections and balance off any loss to Gov't. Even if they don't, and even if they add another $5 to $7 billion to the national debt, this would still be a far lower cost than the price of another depression.

1. Argument against the cuts: Question isn't whether tax cuts are desirable, but whether the Gov't can afford them. The U. S. Gov't is now almost $300 billion in debt. Congress has just raised the debt limit to $308 billion. Gov't may end its fiscal year with an additional deficit of $4 to $8 billion. Sound business judgment dictates Gov't first reduce its spending (which it isn't doing) before cutting its income. Any other way is the road to bankruptcy, which isn't good for anyone, least of all small business. Argument the cuts will generate increased taxes is like an argument to prove perpetual motion. There's no such animal.

Results of foregoing vote as published in Mandate No. 278:

	FOR	AGAINST	NO VOTE
1. Congress cut taxes now	50%	47%	3%

APPENDIX "D" (From Mandate No. 263 - Membership base: 162,853 individual independents)

4. H.R. 2-S. 2. BUSINESS REINVESTMENT DEDUCTIONS . . . Allow businessmen to deduct from taxes up to 20% of all earnings ($30,000 ceiling) which they reinvest in expansions of plant, inventories, and accounts receivable (Rep. Ikard, Tex.-Sen. Sparkman, Ala.).

☐ FOR ☐ AGAINST

4. Argument for H.R. 2-S. 2: This bill would help independents who finish any year with increased funds tied up in accounts receivable, inventories, and new equipment. The 20% allowance ($30,000 ceiling) would apply to these increases. For instance, end a year with $5,000 additional inventory on the shelves, $2,000 additional accounts receivable on the ledgers, an extra $3,000 tied up in a new truck, and the bill would give you a $2,000 tax deduction (apart from other deductions) to help you carry the load. The bill aims to help smaller businesses especially.

4. Argument against H.R. 2-S. 2: This doesn't do anything more than add another gimmick to our jerry-built tax laws, which are nothing more than the happy hunting grounds for lawyers and tax accountants. There's reason to believe it would be of more help to larger firms rather than small businesses. Instead of spending time on this type of legislation, Congress should make a thorough review of all tax laws, close loopholes which permit tax evasion, bring in more revenue, then act to hammer down rates all along the line.

Results of foregoing vote as published in Mandate No. 264:

4. H.R. 2-S. 2. Business reinvestment deduction	86%	11%	3%

For Period 1/19/63 to 3/30/63

Based on 12,099 Survey Responses (This Period)

"LET'S TAKE CARE OF OUR BUSINESS" SURVEY

SUBMITTED BY NATIONAL FEDERATION OF INDEPENDENT BUSINESS — 150 WEST 20TH AVE. — SAN MATEO, CALIFORNIA

HOW'S BUSINESS WITH YOU?

Continued Next Page

*** FIRST QUARTER ***

	Total Ballots Received (Per State)	1. TAX CUTS: Individual Income Taxes — Same percentage cut regardless of income		Bigger cuts in lower income brackets		Corporation Income Taxes — Senate Small Business Committee Plan		Reduce taxes regardless of size		Should Congress cut taxes in 1963?		2. UNFAIR PRICE COMPETITION: Action needed to curb unfair competition — Stronger use of present antitrust laws		Firm retail price proposal		Firm manufacturers' price proposal		Proposal to curb "loss leaders"		
		YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	
ALABAMA	320	107	130	162	71	181	77	50	138	176	51	123	63	119	76	63	123	172	20	ALABAMA
ALASKA	1		1	1		1			1	1		1			1	1		1		ALASKA
ARIZONA	132	46	48	68	23	86	16	26	33	81	25	98	10	35	73	82	33	76	33	ARIZONA
ARKANSAS	107	50	15	58	12	69	5	20	23	29	22	53	7	22	32	59	14	66	16	ARKANSAS
CALIFORNIA	985	544	187	276	194	459	139	239	161	478	199	607	91	392	265	380	229	547	261	CALIFORNIA
COLORADO	183	96	48	77	32	66	16	40	35	68	46	113	34	56	75	110	29	109	28	COLORADO
CONNECTICUT	120	47	21	31	34	55	6	19	14	32	10	37	6	61	20	33	16	57	6	CONNECTICUT
DELAWARE	121	35	46	46	25	21	17	27	54	20	15	93	6	66	37	92	17	92	14	DELAWARE
FLORIDA	303	133	67	108	73	114	29	63	55	171	66	150	39	60	122	133	66	137	63	FLORIDA
GEORGIA	125	36	10	80	7	37	2	12	10	58	5	99	7	79	22	92	5	99	4	GEORGIA
HAWAII	35	21	11	10	15	19	5	7	8	27		25	6	7	22	17	12	23	5	HAWAII
IDAHO	10	3	1	6		6		1	1	6		4	1	5	2	3	2	7		IDAHO
ILLINOIS	480	196	100	211	68	269	55	99	117	156	89	218	31	167	160	206	66	267	59	ILLINOIS
INDIANA	384	159	69	194	39	243	19	56	68	127	53	156	16	99	81	169	67	210	22	INDIANA
IOWA	92	36	29	46	24	51	20	26	32	27	32	67	5	17	61	50	16	70	6	IOWA
KANSAS	220	78	33	126	19	96	7	39	41	100	34	164	10	67	68	91	37	155	16	KANSAS
KENTUCKY	76	50	6	26	10	35	3	18	7	25	14	31	6	15	17	25	11	29	8	KENTUCKY
LOUISIANA	406	153	153	208	88	219	83	126	128	230	85	171	68	115	131	131	93	196	75	LOUISIANA
MAINE	3	1	1	2		1	1	1		2		2			1	1	1	1		MAINE
MARYLAND	125	65	11	55	9	50	7	25	18	74	10	66	13	51	37	75	20	77	14	MARYLAND
MASSACHUSETTS	272	107	51	114	56	185	24	66	71	168	46	120	17	75	60	126	26	188	10	MASSACHUSETTS
MICHIGAN	556	267	122	213	84	310	41	111	134	274	68	302	66	205	166	261	101	336	48	MICHIGAN
MINNESOTA	345	147	63	128	26	158	23	70	59	176	76	192	12	98	91	187	43	164	35	MINNESOTA
MISSISSIPPI	241	82	9	135	6	128	3	56	17	95	64	88	11	51	37	82	19	70	32	MISSISSIPPI
MISSOURI	288	116	60	139	67	129	29	67	73	121	68	173	21	85	97	123	64	172	39	MISSOURI
MONTANA	166	77	20	76	20	79	22	22	27	76	40	85	15	35	70	72	36	93	15	MONTANA
NEBRASKA	368	133	66	199	53	215	38	75	66	137	100	238	25	117	160	189	73	230	61	NEBRASKA
NEVADA	67	39	14	24	16	45	6	20	28	45	3	36	2	25	28	28	19	66	5	NEVADA
NEW HAMPSHIRE	36	11	2	14		13		4	2	13	1	26		4	2	4		11		NEW HAMPSHIRE
NEW JERSEY	215	47	19	106	14	85	6	7	19	93	28	113	10	92	27	101	20	122	7	NEW JERSEY
NEW MEXICO	19	11	3	6	3	7	2	3	3	5	2	11	2	3	8	10	6	8	5	NEW MEXICO
NEW YORK	1152	668	328	635	173	607	95	276	389	584	262	634	129	629	310	530	191	727	152	NEW YORK
NORTH CAROLINA	216	76	53	108	26	139	14	36	61	118	37	123	23	86	36	126	30	168	16	NORTH CAROLINA
NORTH DAKOTA	53	20	12	23	3	26	4	11	23	19	12	22	6	26	10	26	6	31	3	NORTH DAKOTA
OHIO	669	266	166	300	95	421	46	200	173	306	176	353	70	237	183	292	122	382	79	OHIO
OKLAHOMA	92	50	26	38	2	51	6	20	22	28	26	60	2	36	61	60	9	60	9	OKLAHOMA
OREGON	150	66	27	65	28	100	11	27	33	68	37	96	10	56	66	83	19	98	13	OREGON
PENNSYLVANIA	693	362	199	378	117	631	108	159	291	366	193	666	66	266	203	380	121	668	60	PENNSYLVANIA
RHODE ISLAND	35	13	6	12	6	16	2	6	7	16	6	11		16	7	10	3	13		RHODE ISLAND
SOUTH CAROLINA	106	42	33	42	29	54	26	26	39	41	32	65	12	25	47	49	25	59	19	SOUTH CAROLINA
SOUTH DAKOTA	10	5		5	1	5		2	2	7	2	5		5	1	3	1	8		SOUTH DAKOTA
TENNESSEE	175	74	62	92	34	109	19	45	66	85	65	110	8	29	65	65	37	87	23	TENNESSEE
TEXAS	615	401	97	158	184	345	110	198	166	289	136	207	97	165	292	255	130	296	120	TEXAS
UTAH	32	18	5	12	3	21		8	4	16	2	18	3	4	15	11	2	19	2	UTAH
VERMONT																				VERMONT
VIRGINIA	466	151	122	193	100	200	47	98	86	236	130	238	17	163	110	171	63	257	32	VIRGINIA
WASHINGTON	487	199	96	220	68	232	44	98	123	181	89	269	53	141	150	228	72	295	65	WASHINGTON
WASHINGTON, D.C.	29	10	3	9	4	18	1	6	4	20	9	20	2	16	8	20	3	21	4	WASHINGTON, D.C.
WEST VIRGINIA	11	2	2	3		8		2	2	3	3	8	1	4	4	4	2	8	1	WEST VIRGINIA
WISCONSIN	300	176	57	151	44	169	25	78	68	150	60	184	26	137	81	176	40	203	20	WISCONSIN
WYOMING	4	3		2		2		2			3	2			1	1	1	2		WYOMING
TOTAL FOR ISSUES	12,099	5,211	2,604	5,411	1,963	6,412	1,209	2,580	2,996	5,662	2,481	6,531	1,123	3,981	3,637	5,466	2,101	6,965	1,461	TOTAL FOR ISSUES

For Period 1/19/63 to 3/30/63

Based on 12,099 Survey Responses (This Period)

"LET'S TAKE CARE OF OUR BUSINESS" SURVEY

SUBMITTED BY NATIONAL FEDERATION OF INDEPENDENT BUSINESS — 150 WEST 20TH AVE. — SAN MATEO, CALIFORNIA

HOW'S BUSINESS WITH YOU?

*** FIRST QUARTER ***

	Total Ballots Received (Per State)	3. LABOR REGULATION:				4. TAX REFORM-GOVERNMENT SPENDING: SECURE FUNDS FOR TAX CUT BY.												5. IMPORTS-EXPORTS: HAS THE 1962 TRADE LAW:						
		Proposals for 35-hour week		Apply antitrust law to labor unions the same as to business		Closing so-called "tax loopholes"		Reduction of Gov't spending		Cut "foreign aid"		Cut Federal payrolls-employment		Reduce public works		Cut "social welfare" programs		Helped your business operations?		Harmed your business operations?		As an importer or exporter, have you used SBA, Commerce, State Dep't aids?		
		YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO	
ALABAMA	320	10	295	304	2	145	128	294	6	299	7	271	25	86	182	229	59	2	62	27	36		22	ALABAMA
ALASKA	1		1	1		1		1		1		1			1		1		1		1			ALASKA
ARIZONA	132	4	127	129	2	52	63	119	2	116	4	102	27	30	86	73	68	8	80	32	57		19	ARIZONA
ARKANSAS	107	3	96	103	2	61	36	94	2	93	4	80	9	19	69	63	26	5	65	21	28	2	11	ARKANSAS
CALIFORNIA	985	59	880	907	42	538	266	821	42	756	73	772	101	340	458	650	192	53	402	178	333	44	139	CALIFORNIA
COLORADO	193	11	174	184	3	137	25	161	8	153	16	126	47	52	97	143	16	3	86	17	55	3	49	COLORADO
CONNECTICUT	120	3	110	117	1	62	24	92	1	86	16	90	11	32	56	60	21	8	70	18	62	2	61	CONNECTICUT
DELAWARE	121	6	109	121		87	10	99	2	91	12	84	16	28	70	64	24	6	37	16	28			DELAWARE
FLORIDA	303	11	275	281	3	162	127	265	26	252	21	264	29	105	156	211	55	30	149	35	162	10	36	FLORIDA
GEORGIA	125	3	122	125	1	83	18	116	2	116	2	117	5	85	30	109	5	6	82	52	40		2	GEORGIA
HAWAII	35	1	34	33	2	16	16	29	5	20	9	23	10	8	24	26	9	2	13	1	15		11	HAWAII
IDAHO	10		8	10		5	3	10		10		8		2	5	7	1		3	4	1	2	1	IDAHO
ILLINOIS	480	10	434	456	4	190	166	408	11	375	40	407	39	173	218	367	66	11	170	53	130	2	32	ILLINOIS
INDIANA	386	5	355	375	1	233	62	332	5	336	10	329	14	69	235	261	73	8	153	59	100		25	INDIANA
IOWA	92	4	85	85	3	59	17	79	7	75	5	73	14	31	50	51	26	2	25	11	18		16	IOWA
KANSAS	220	6	209	210	2	100	79	197	1	186	11	185	8	85	108	109	57	1	56	27	48		30	KANSAS
KENTUCKY	76	4	68	71	3	44	10	68		53	6	51	3	17	26	36	15	2	27	5	23	1	8	KENTUCKY
LOUISIANA	406	23	374	378	13	173	111	331	19	335	26	260	83	91	225	261	106	14	118	22	77	4	28	LOUISIANA
MAINE	3		3	2			1	3		2		2		1		2		1	1		1	1		MAINE
MARYLAND	125	6	119	119	2	73	27	100	8	104	3	85	20	26	86	66	23	11	33	13	40	2	8	MARYLAND
MASSACHUSETTS	272	4	264	266	4	199	37	234	17	203	36	198	28	92	122	107	117	16	155	38	100	8	37	MASSACHUSETTS
MICHIGAN	558	10	524	539	3	321	155	455	44	393	39	417	67	164	264	223	130	21	235	52	201	2	103	MICHIGAN
MINNESOTA	345	4	339	339	2	188	69	286	7	239	26	255	15	81	154	162	65	22	123	23	108		26	MINNESOTA
MISSISSIPPI	241	8	226	232	5	66	25	182		209	4	114	10	20	53	95	9	22	86	64	93		7	MISSISSIPPI
MISSOURI	288	12	259	265	6	142	89	251	15	218	26	224	20	91	126	174	58	11	74	39	66		26	MISSOURI
MONTANA	166	11	153	157	6	64	63	150	4	150	5	136	10	74	65	96	42	2	83	15	76		27	MONTANA
NEBRASKA	364	8	351	361	1	163	113	305	6	284	13	276	8	80	168	181	97	15	96	33	84	1	25	NEBRASKA
NEVADA	67		67	65	1	13	35	64	2	58	5	50	7	9	63	61	18	3	21	9	19		6	NEVADA
NEW HAMPSHIRE	36		36	36		10	2	31	1	23		29		8	23	6	26	2	5	1	5	1	3	NEW HAMPSHIRE
NEW JERSEY	213	5	206	233	3	160	44	196	4	175	22	183	15	72	118	102	73	7	55	28	31	2	3	NEW JERSEY
NEW MEXICO	19		17	17		11	3	16		18		15	2	6	6	16			11	2	9		2	NEW MEXICO
NEW YORK	1152	37	1083	1099	14	608	326	935	106	860	158	827	144	268	670	584	279	66	490	153	379	13	81	NEW YORK
NORTH CAROLINA	214	2	210	210	1	126	47	183	7	164	29	165	14	69	101	148	44	9	70	32	58	2	32	NORTH CAROLINA
NORTH DAKOTA	53	3	49	50	2	25	10	42	2	40	5	42	3	10	30	30	12		19	10	9	2	6	NORTH DAKOTA
OHIO	669	15	637	658	2	295	193	597	18	553	39	514	59	206	330	365	155	20	297	67	282	2	76	OHIO
OKLAHOMA	97	2	93	95		44	25	82	2	80	7	80	2	35	42	74	6	4	30	11	32		5	OKLAHOMA
OREGON	150		150	150		84	35	134	4	120	18	115	8	50	74	108	19	2	49	30	37		8	OREGON
PENNSYLVANIA	693	17	668	682	3	370	121	611	24	562	66	559	62	220	311	406	143	18	348	88	238	2	99	PENNSYLVANIA
RHODE ISLAND	35	2	33	35		11	13	29	4	22	5	27	4	11	19	23	6		23	3	20		14	RHODE ISLAND
SOUTH CAROLINA	106	3	100	102		48	41	97	3	93	3	87	3	46	46	86	8	2	47	12	34		14	SOUTH CAROLINA
SOUTH DAKOTA	10		9	7	1	6		7		8		8		3	2	4	1		4		4			SOUTH DAKOTA
TENNESSEE	175	2	164	168	1	90	51	163		153	5	152	4	66	88	138	13	6	49	16	65		31	TENNESSEE
TEXAS	615	8	599	612		285	209	527	24	577	9	546	41	293	246	402	95	13	281	51	211		72	TEXAS
UTAH	32	2	30	30	1	17	5	29		24	2	25	1	3	18	20	5	1	11	3	6	1	3	UTAH
VERMONT																								VERMONT
VIRGINIA	446	11	418	429	2	199	126	411	10	372	23	336	51	136	259	320	59	19	145	70	118	2	35	VIRGINIA
WASHINGTON	487	14	462	480	2	161	133	401	13	358	32	320	67	95	288	294	103	22	170	65	139	2	36	WASHINGTON
WASHINGTON, D.C.	39		36	37	1	16	16	30	2	26	7	28	5	10	23	26	7	4	8	1	10	1	2	WASHINGTON, D.C.
WEST VIRGINIA	11		10	11		6	2	9		7		5	2	1	5	4	1		6	3	1			WEST VIRGINIA
WISCONSIN	300	5	286	296	2	187	63	257	12	236	34	254	14	99	168	165	91	8	158	36	122	2	34	WISCONSIN
WYOMING	4	1	3	4		3	1	3		3		3		2	2	2							1	WYOMING
TOTAL FOR ISSUES	12,099	355	11,359	11,642	156	6,092	3,291	10,336	478	9,668	877	9,300	1,109	3,598	6,000	7,254	2,477	493	4,747	1,595	3,600	123	1,310	TOTAL FOR ISSUES

Declaration of Independence

"We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable rights, that among these are Life, Liberty, and the Pursuit of Happiness—That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed." ——

Your Response To This Survey Is An Expression Of Consent Of The Governed

PROTECT THESE BASIC RIGHTS BY ADVISING YOUR LAWMAKERS, STATE AND NATIONAL, OF THE NEEDS OF SMALL BUSINESS, VITAL TO OUR COUNTRY.

Dear Federation Member:

Our Nation is in critical times. The question before us is plain survival in a world that becomes more dangerous and more fiercely competitive with each passing hour.

Our ability to meet the tests ahead will depend greatly on our internal strength. This, in great measure, means the strength of an ever-growing free enterprise system in providing jobs and producing goods for military and civilian use in great enough volume, at reasonable costs, and profitable prices.

This, in turn, means that all in Government—State as well as Federal—must pay closer attention than ever to strengthening our business system—small units as well as large. That is why it's vital for YOU to counsel with all in Government—exercising your rights laid down in the Declaration of Independence—to help them reach the right kind of decisions on laws which will ACTUALLY WORK at the local level.

You can do this through the programs of your Federation. Its practical accomplishments* show that strength in numbers really counts when independents present a solid, strong front in expressing the consent or dissent "of the governed."

This is the third yearly Special Survey by your Federation. It presents issues which you have told us are most important to the welfare of our Country. These Surveys have been of great value in helping to guide your Federation, and in assisting lawmakers. You will see some good examples below.

Your ACTION NOW in responding to this Survey will speed up the opinion flow that can, and will, contribute to the further corrections vitally needed in our economy.

Sincerely,

C. WILSON HARDER President

*LET'S TAKE A QUICK LOOK AT WHAT SMALL BUSINESS HELPED TO ACCOMPLISH DURING THE 87th CONGRESS IN LINE WITH FEDERATION ACTION WITH GOVERNMENT

- $1.5 billion in faster tax recoveries on spending for modernization of operations.
- Increase in Government contracts awarded to Small Business under SBA set-asides:

Year	Contracts	Value of Orders
1962	56,944	$1.8 Billion
1961	34,272	1.2 Billion
1960	24,152	878 Million

- Private earnings limit on social security retirement increased to $1,700.
- 100% increase in Justice Dep't activity against monopoly mergers.
- Protections written into free trade bill, to safeguard interests of U.S. smaller firms.
- Substantial Government activity to curb unfair price competition.
- 30% increase in enforcement of laws to assure fairness in advertising.
- Independent business representation continued at Cabinet level by White House Committee on Small Business.
- Increased payments to help relocation of firms forced to move by highway programs.
- Increase in SBA Regular Business Loans to Credit-worthy Independents:

Year	Loans	Value of Loans
1962	6,203	$360.7 Million
1961	4,989	250.4 Million
1960	3,670	168.4 Million

- Enactment of bill that would close tax gap between independents and cooperatives by $30 million annually.
- Passage of bill to permit self-employed business-professional people tax deductions for private retirement plans.

1 TAX CUTS. There's much talk about reducing taxes in 1963. If they are made, which of the following should be done to further strengthen the position of independents in business and the professions:

ON INDIVIDUAL INCOME TAXES
(which apply to all unincorporated business and professional operations)

A. Reduce individual income taxes evenly all along the line regardless of size of incomes involved .... YES ☐ NO ☐

— OR —

B. Reduce individual income taxes to afford greater savings to firms and people with incomes of $8,000 or less .... YES ☐ NO ☐

ON CORPORATION INCOME TAXES

A. Reduce corporation taxes as suggested by Senate Small Business Committee, to make greatest percentage reductions for firms earning under $50,000* .... YES ☐ NO ☐

— OR —

B. Reduce corporation taxes by 5 percentage points all along the line, regardless of size of corporate income .... YES ☐ NO ☐

SHOULD CONGRESS CUT TAXES THIS YEAR? .... YES ☐ NO ☐

Comments ____

____

____

*SSEC SUGGESTION: Corporations now pay 30% tax on first $25,000 of taxable income, and 52% in tax on earnings above that figure. The Committee proposes to substitute for this a 22% tax on the first $50,000 in taxable income, followed by a 52% tax on all earnings in excess of $50,000.

TEAR ALONG THIS LINE

2 UNFAIR PRICE COMPETITION. If you feel you are being injured by unfair price, unfair advertising allowance, unfair advertising, or other unfair competition (including secret rebates, etc.) at manufacturer, wholesale, or retail level, what do you think is most needed for corrections?

A. **CURRENT LAWS.** Stronger enforcement of present laws that prohibit unfair competition at the manufacturer, wholesale, and retail levels .... YES ☐ NO ☐

B. **NEW FIRM RETAIL PRICE PROPOSAL.** Manufacturers establish the retail prices at which all who handle their goods must sell them (no one permitted to sell for less; no one permitted to sell for more) .... YES ☐ NO ☐

C. **NEW FIRM MANUFACTURER PRICE PROPOSAL.** Require manufacturers to publish price schedules covering sales to all classes of customers (retailers, wholesalers, chains, discount houses, etc.). Require them to sell only at these published prices (no secret deals, rebates, or allowances). This leaves wholesalers and retailers still free to set their own selling prices .... YES ☐ NO ☐

D. **NEW LOSS LEADER PROPOSAL.** Prohibit all businesses from selling goods below their purchase costs with intent to injure competitors (this proposal would not govern prices on close-outs, etc.) .... YES ☐ NO ☐

Comments (please name source of your unfair price competition—viz. discount houses, chains, co-ops, factory owned stores, etc.)

____

____

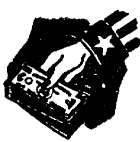
____

3 IN THE FIELD OF LABOR UNIONS AND THEIR ACTIVITIES.

A. Do you favor the proposed 35-hour work-week? .... YES ☐ NO ☐
B. Should unions be required to operate under the antitrust laws the same as businesses? (Unions are now exempt from these laws) .... YES ☐ NO ☐

Comments ____________________

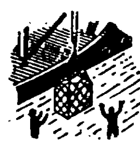
4 TAX REFORM-GOV'T SPENDING. Congress is being urged to reform taxes (close "loopholes" such as deductions for interest, contributions, etc., also tighten up on capital gains, depletion allowances, etc.) to compensate for revenue losses due to tax cuts. Check below to indicate your thinking on this and possible alternatives:



A. Believe revenue losses should be recovered by tax reform ("loophole" closing) YES ☐ NO ☐
B. Believe losses should be recovered by reduction in Government spending .... YES ☐ NO ☐
C. Cut foreign aid .... YES ☐ NO ☐
D. Cut federal payrolls-employment .... YES ☐ NO ☐
E. Cut public works (dams, highways, buildings) .... YES ☐ NO ☐
F. Cut social welfare programs .... YES ☐ NO ☐

Comments ____________________

5 IMPORTS-EXPORTS. Has the 1962 Trade Law (aimed to promote greater sales of American goods abroad and greater sales by foreign factories into our country, by reducing tariffs):



A. Helped your business operations .... YES ☐ NO ☐
B. Harmed your business operations .... YES ☐ NO ☐
C. If you are in imports or exports, have you used the helps offered by Small Business Admn., Commerce Dep't., and/or State Dep't .... YES ☐ NO ☐

Comments (including your view on proposals regarding United States joining up with European Common Market)

____

SIGNATURE ____________ BUSINESS NAME (PLEASE PRINT) ____________

STREET & NUMBER ____________ CITY OR TOWN ____________ ZONE ______ STATE ______

TYPE OF BUSINESS: PROFESSIONAL ☐ RETAIL ☐ WHOLESALE ☐ MANUFACTURING ☐ SERVICE ☐

Senator HARTKE. Mr. Chairman, I seek recognition to present a motion to the chairman. I realize we are not in executive session. The motion is to terminate these hearings, oral testimony in these hearings.

I should like to make a short statement in connection therewith as to why I would like to do that, if I may.

The CHAIRMAN. You may proceed.

Senator HARTKE. There seems to be little question, Mr. Chairman, but that some kind of tax reduction will pass at some time in the reasonably near future. There also seems to be little question but that this reduction in rates will become effective on January 1, 1964, even if final passage comes after that date.

I believe that it is important that businesses be accorded the right to plan in orderly fashion their fiscal affairs for 1964. For businesses to do so, the tax schedules for the businesses themselves, as well as their employees, should be known in advance of the effective date. A retroactive reduction creates problems in itself, as well as confusion.

This confusion may be even more common among individual wage earners subject to withholding than it is to employers themselves.

There is, moreover, a strong feeling throughout the country that Congress is, and has been, dilatory. Regardless of how we may feel individually about the justification for this feeling, it is a fact that such does exist.

Specifically, the people of the country know that a tax reduction program has been pending before Congress almost from the day the session was convened last January. While most of the 10½ months that have intervened have been spent by debate and committee study in the House, 5 weeks also have been spent by our own committee.

During those weeks, we have heard 72 witnesses, 32 of whom previously appeared before the House Ways and Means Committee. I have carefully checked the testimony of each of these to determine whether or not all facets of the bill have been aired. It can be stated conclusively that every section of H.R. 8363 has been covered. Suggestions have been made pro and con. I have prepared a table, which is attached to this memorandum, which I ask to be included in the record, showing the sections covered by each witness already heard by the Senate Finance Committee. Also a part of the table is a listing of 34 witnesses scheduled to be heard by the Finance Committee who already have testified before the House Ways and Means Committee together with a showing of the sections of the bill about which they have testified. In all, the seven volumes of House hearings include testimony of 267 witnesses. Yet the Senate minority leader has predicted that passage will not come before March 15.

All this, I sincerely believe, shows clearly and conclusively that the entire bill's contents have been covered and recovered by witnesses.

In addition, it is worthy of note that many segments of the economy and specific associations have been heard or are scheduled to be heard several times over. For instance, four representatives of chambers of commerce have presented the chamber of commerce viewpoint, and five have represented insurance groups. Twelve individuals representing oil interests are on the announced schedule for future hearings.

The testimony has been, and will continue to be, largely repetitious. The same can be said of the farm bureau, various labor unions, and many other trade associations. As noted earlier, 32 of the 72 witnesses heard in our committee were already on record in the House hearings, while 34 of the 88 listed on the remaining schedule have also testified before the Ways and Means Committee.

In my opinion, Mr. Chairman, no useful purpose can be served by delaying committee action to hear this kind of repetition.

On the other hand, much can be gained by early action on this matter. If we are going to give the economy the kind of boost which can come from a justifiable cut in taxes, timing is important. The President yesterday indicated that, and it was repeated by Dr. Heller here in this hearing. In my opinion, a cut is right; and it is also a wise move from the point of the overall national economy. If we are going to do this, it should be done when the maximum effect can be obtained; otherwise, we dissipate part of our purpose in cutting taxes.

The value of a tax cut may be lost if the economy is given a chance to soften before the reduction becomes effective. In that case, the cut becomes remedial instead of preventative. And, as in medicine, prevention is easier than cure. An ounce of prevention is, indeed, worth a pound of cure in this case.

The First National City Bank of New York said in its November 1963 economic letter:

> It is important to remove uncertainties clouding economic prospects, for both business and Government will soon be facing decisions about budgets and expenditures, the results of which will influence economic activity in the year ahead. Both administration spokesmen and business leaders have recently commented on the need next year for the stimulus of tax reduction.
>
> A group of more than 2,600 business executives—the Business Committee for Tax Reduction in 1963—expressed the view in a letter to Members of the Senate on October 14 that "the economy is now approaching a critical juncture." They warned that "delay and doubts created by failure to enact the tax bill this year could entail serious economic risks."

That is the end of the quotation.

This, I submit, represents conservative business thinking. It does not represent some half-baked idealism or some radical makers of money policy.

In moving to end testimony, I do not wish to interfere with or upset the prerogatives of the chairman, nor do I wish, in any way, to limit or hamper the desires of committee members who may have additional comments or amendments. I believe that any new thoughts on the bill can be submitted in writing. I believe that we can begin within a few days the final ordeal of executive sessions so that a bill may be reported to the Senate next month.

I believe that Members of the Senate want to vote on a tax measure now.

I believe that the country wants and expects us to vote on this matter as soon as possible. I believe the needs of the economy demand an early vote. I believe an early vote would provide the kind of orderly tax cut which would be best for the economy and best for the country.

Therefore, Mr. Chairman, without further discussion, I move that the oral hearings be closed at the earliest possible moment. I realize that we are not in executive session now, but I would respectfully request that my motion be considered in executive session.

(The attachments referred to by Senator Hartke follow:)

IDENTIFICATION OF SECTIONS, H.R. 8363

Rate changes:
- 111. Individual income tax rates.
- 112. Minimum standard deduction.
- 113. Retirement income credit, tax on nonresident aliens.
- 121. Corporate rate reductions.
- 122. Current tax payments by corporations.

Structural changes:
- 201. Dividend credit and exclusion.
- 202. Investment credit.
- 203. Group-term life insurance.
- 204. Reimbursement of medical expenses.
- 205. Sick pay exclusion.
- 206. Elderly gain on residence sale.
- 207. Deductions of State, local, foreign taxes.
- 208. Casualty and theft losses.
- 209a. Charitable contributions and gifts.
- 209b. Five-year charitable contribution carryover for corporations.
- 209c. Limitation on charitable contribution deduction (future gifts, tangible).
- 210. One-percent limitation, medicines and drugs for over 65.
- 211. Care of dependents.
- 212. Moving expenses.
- 213. Interest on loans (insurance and annuity contracts).
- 214. Employee stock options and purchase plans.
- 215a. Interest on certain deferred payments.
- 215c. Carrying charges.
- 216. Personal holding companies.
- 216j. Foreign personal holding company holdings.
- 217. Oil and gas well treatment.
- 218. Iron ore royalties.
- 219. Capital gains and losses.
- 220. Depreciable real estate.
- 221. Income averaging.
- 222. Repeal of 2-percent surtax on consolidated returns.
- 223. Reduction of surtax exemption (controlled corporations).
  - A. General testimony.
  - B. Guidelines depreciation.

PUBLIC WITNESSES BEFORE SENATE FINANCE COMMITTEE ON H.R. 8363

1. William Keel, research director, National Democratic Committee.
*2. Joel Barlow, U.S. Chamber of Commerce.
3. Leon H. Keyserling, consulting economist and attorney.
*4. Richard H. Headlee, U.S. Junior Chamber of Commerce.
5. Mark M. Jones, National Economic Council.
6. Robert A. Gilbert, Intercontinental Research and Analysis Co.
*7. Dan Throop Smith, Harvard Graduate School of Business Administration.
*8. Roswell Magill, Cravath, Swaine & Moore.
9. Angus McDonald, National Farmers Union.
*10. Edward Hollander, Americans for Democratic Action.
*11. Andrew J. Biemiller, AFL-CIO Legislative Department.
*12. Charles B. Shuman, American Farm Bureau Federation.
*13. Johnson McRee, Jr., Manassas, Va.

14. Lester V. Chandler, Department of Economics, Princeton University.
15. William S. Wasserman, New York.
*16. Dr. Charls Walker, American Bankers Association.
*17. Keith Funston, New York Stock Exchange.
*18. John L. Connolly, Council of State Chambers of Commerce.
19. Walter E. Hoadley, Armstrong Cork Co.
*20. Donald C. Slichter, American Life Convention, and Life Insurance Association of America.
*21. Floyd Newton, American Textile Manufacturers Institute.
*22. Charles W. Stewart, Machinery & Allied Products Institute.
*23. Chester W. Edelmann, American Retail Federation.
*24. W. P. Gullander, National Association of Manufacturers.
*25. Arthur T. Roth, Bankers Committee for Tax Equality.
*26. Carroll F. Lewis, Manufacturers Association of the City of Bridgeport, Conn.
27. Edwin J. Rosenbaum, New York.
28. Andrew B. Young, American Bar Association.
29. Bernard H. Little, Ohio Manufacturers Association, Ohio Brass Co.
30. W. T. Hyde, Jr., F. S. Smithers & Co.
31. Ward Ashman, National Conference on Public Employee Retirement Systems.
*32. Carl Bare, National Fraternal Order of Police.
*33. Walter Bouldin, Edison Electric Institute.
34. Steve Stahl, Oklahoma Public Expenditures Council.
35. Howard B. Dean, Association of Stock Exchange Firms.
*36. J. Sinclair Armstrong, U.S. Trust Co. of New York.
37. Moses H. Wilbourne, Cole Supply Co., Inc.
*38. E. S. Hall, Freedom, Inc.
39. Stuart T. Saunders, Business Committee for Tax Reduction in 1963.
*40. Robert J. Casey, Association of American Railroads.
41. Charles Marshall, Nebraska Farm Bureau.
42. Richard Berry, Salem, Virginia Chamber of Commerce.
*43. James B. Wold, Associated Industries of Alabama.
*44. C. R. Strackbein, Nationwide Committee on Import-Export Policy.
45. Edward W. Newton, Meriden, Conn.
46. Dr. Roger Freeman, Hoover Institute, Stanford University.
47. Joseph R. Barnes, Illinois Manufacturers' Association.
*48. Carl Beck, National Small Business Association.
*49. Maurice E. Peloubet, Price, Waterhouse & Co.
50. Stephen T. Dean, Florida Bar Association.
*51. Raymond A. Hoffman, Illinois State Chamber of Commerce.
52. C. Lowell Harriss, Economics Department, Columbia University.
*53. Rolf H. Berg, National Tool Die & Precision Machining Association.
*54. Tyre Taylor, Southern States Industrial Council.
*55. William M. Horne, Jr., Manufacturing Chemists' Association.
56. William Kuhfuss, Illinois Agricultural Association.
*57. Garner M. Lester, National Tax Equality Association, Inc.
58. Roland M. Bixler, Manufacturing Association of New Haven County.
59. H. L. Thompson, Jr., National Wholesale Hardware Association.

NOTE.—An asterisk denotes that witness or his organization previously testified also before the House Ways and Means Committee. These total 32.

SCHEDULED WITNESSES ALREADY IN HOUSE COMMITTEE RECORD

1. Charles A. Siegfriend, American Life Convention, 1848.
*2. W. L. Hearne, Financial Executives Institute, 2571.
3. John K. Dyer, Jr., Towers, Perrin, Forster & Crosby, Inc., 1488.
4. W. Evans Buchanan, National Association of Home Builders, 2139.
5. C. Beverly Briley, National Association of Counties, 1719.
6. John F. Nagle, National Federation of the Blind, 1252.
7. Otis Ellis, National Oil Jobbers Council, 2167.

*8. Adon Smith, Association for Advanced Life Underwriting, 1320.
9. Francis G. Bray, National Association of Life Underwriters, 1217.
10. Arthur M. Arnold, Commerce & Industry Association of New York, Inc., 1919.
11. A Wilfred May, editor, Commercial & Financial Chronicle, 1095.
*12. James B. Carey, AFL-CIO, 1955.
13. E. W. Anderson, Federal-Mogul-Bower Bearings, Inc., 1394.
14. George W. Omacht, American Finance Conference, Inc., 2717.
15. Roy Blough, Columbia University, 2239.
*16. Rolla D. Campbell, National Council of Coal Lessors, Inc., 3623.
17. Kenneth M. Piper, Council of Profit Sharing Industries, 1286.
18. Richard A. Musgrave, Princeton University, 2424.
*19. John C. Williamson, National Association of Real Estate Boards, 879.
20. Henry J. Clay, Realty Committee on Taxation, 907.
*21. J. Golodner, Actors Equity Association, 944.
22. David W. Herrmann, National Association of Shoe Chain Stores, 1894.
23. Harold Decker, president, Independent Petroleum Association, 3685.
24. Scott C. Lambert, Standard Oil Co. of California, 3758.
25. Richard H. Gonzalez, Humble Oil & Refining Co., 3706.
26. Wallace W. Wilson, Continental Illinois Bank & Trust Co. of Chicago, 3751.
27. Ira H. Cram, Continental Oil Co., 3754.
28. W. E. Shrider, Liaison Committee of Cooperating Oil & Gas Associations, 3896.
29. Tom L. Schwinn, Kansas Independent Oil & Gas Association, 3928.
30. Stark Fox, Oil Producers Agency of California, 3960.
*31. Elmer L. Hoehn, Independent Oil Producers & Landowners Association, 3899.
32. Lincoln Arnold, American Mining Congress, 3464.
33. Thomas W. Power, National Restaurant Association, 1696.
34. The Honorable Jack Miller, U.S. Senator from Lowa, 2076.

NOTE.—An asterisk denotes House testimony was from same organization but by another individual. Numbers after name indicate initial page of testimony, Ways and Means hearings.

Areas of witness testimony on H.R. 8363 before Senate Finance Committee

Witness number	Section of bill covered by testimony																																	
	A[1]	111	112	113	121	122	201	202	203	204	205	206	207	208	209a	209b	209c	210	211	212	213	214	215a	215c	216	216j	217	218	219	220	221	222	223	B[2]
1	X																																	
2			X		X	X	X		X		X	X	X	X	X	X	X	X	X			X							X		X			
3	X	X			X			X																										
4	X	X			X																													
5	X																																	
6	X																																	
7							X	X	X		X		X	X			X			X	X	X	X		X		X	X	X	X		X	X	
8	X	X			X		X																						X				X	X
9	X	X			X			X																			X		X					
10	X	X			X		X	X																										
11		X			X			X			X	X	X	X				X		X		X	X						X					
12	X		X				X	X																										
13		X			X		X	X																										
14	X																																	
15	X																																	
16	X						X																											
17	X				X		X																											
18					X	X	X	X	X		X		X	X						X		X					X	X	X			X	X	
19	X	X			X		X	X														X							X					
20	X	X			X																								X					
21	X	X	X		X	X	X	X	X		X		X	X						X		X							X	X	X	X	X	
22	X	X	X		X	X	X	X	X		X									X		X							X			X	X	X
23		X	X		X		X	X	X																							X	X	
24	X	X			X		X																											
25					X																													
26		X			X		X		X		X																							
27		X			X	X																												
28		X			X												X					X			X									
29		X			X	X	X	X						X																				
30		X			X																													
31		X		X			X			X		X																						
32	X																																	
33							X	X																										
34	X						X						X																					
35							X																						X					
36	X	X			X		X		X																				X					
37							X								X														X					
38	X																																	

See footnotes at end of table.

Areas of witness testimony on H.R. 8363 before Senate Finance Committee—Continued

Witness number	Section of bill covered by testimony																																
	A[1]	111	112	113	121	122	201	202	203	204	205	206	207	208	209a	209b	209c	210	211	212	213	214	215a	215c	216	216j	217	218	219	220	221	222	223	B[2]
39	X																																	
40					X	X		X	X							X																		X
41	X																																	
42	X	X			X																													
43					X		X																											
44	X																																	
45	X																																	
46	X	X			X														X															
47						X	X	X	X											X		X							X			X		
48		X			X			X																										
49					X																													
50			X			X	X		X		X	X		X	X		X				X		X		X	X	X		X	X				
51	X	X			X	X	X		X											X		X							X		X		X	X
52		X			X																													
53	X	X			X																													
54	X	X																																
55	X						X	X	X											X		X	X						X	X		X	X	
56	X																																	
57	X				X	X	X																											
58		X			X				X																								X	
59					X	X	X																											

[1] A. Generalized testimony.
[2] B. Depreciation guidelines.

Scheduled witnesses already in House committee record

	A	111	112	113	121	122	201	202	203	204	205	206	207	208	209a	209b	209c	210	211	212	213	214	215a	215c	216	216j	217	218	219	220	221	222	223	B
1									X																									
2						X	X		X						X	X				X		X							X		X	X	X	
3									X																									
4	X	X			X																		X							X			X	
5													X	X	X																			
6																			X															
7	X	X			X																						X		X					
8									X																									
9		X									X										X								X					
10																																	X	

11																						X							X				
12	X	X	X		X		X		X		X	X						X	X	X							X	X	X		X		X
13																						X							X				
14	X				X																												
15	X				X																						X	X	X				
16																													X				
17																													X				
18	X	X			X		X			X	X				X				X	X									X				
19								X																					X	X			X
20																														X			
21																				X											X		
22																																X	X
23																											X		X				
24																											X						
25																											X						
26																											X						
27																											X						
28	X																										X						
29																											X						
30																											X						
31																											X						
32		X			X																						X						
33	X																										X	X	X				
34	X	X					X									X													X		X		

The CHAIRMAN. Senator Gore?

Senator GORE. Mr. Chairman——

Senator HARTKE. I am not asking for any action now, I hope you understand that.

Senator GORE. Mr. Chairman, our distinguished colleague from Indiana, you will recall, offered a motion to rush the bill through without adequate consideration before the public hearings had scarcely gotten started.

Senator HARTKE. Mr. Chairman, for correction in the record, I indicated that I would unless some other senior member of the committee did before I did. I think the senior Senator from Illinois offered that motion. I voted for it. I am referring to Senator Douglas.

Senator GORE. I understood he was offering the Hartke motion.

Senator HARTKE. I think he offered his own. I do not care. I will be willing to associate myself with it.

Senator GORE. All right. This motion received four votes.

Mr. Chairman, our distinguished friend and colleague from Indiana has introduced more amendments to the pending bill than any other Member of the Senate. Now I do not say this to be critical, I do not make this statement in the form of an accusation. But I have before me the official calendar which shows the amendments to the bill which have been printed and which are pending before the committee. There are 21, 8 of which bear the authorship of the distinguished senior Senator from Indiana. Only one of the eight, however, directly bears upon a provision in the pending bill All, however, are important amendments.

I take it that the distinguished Senator from Indiana offered these amendments in all seriousness and sincerity and desired that they be considered. The committee has heard no testimony even from the distinguished author of the amendments with respect to most of them.

I have offered some amendments, not as many as my distinguished colleague, but I assure you I offered them in all seriousness, and expect them to be considered.

The AFL-CIO spokesman came before this committee, requesting to be heard, and recommended some 20 changes in the bill not yet submitted in amendment form, and requested that those changes be considered. As I have said, these amendments have not yet been received. I take it they will be received in a few days.

I would like to point out, Mr. Chairman, that the hearing by this committee is the first opportunity that the American people have had to testify for or against the pending bill. There was no opportunity in the House of Representatives.

The Ways and Means Committee held a hearing on the President's tax message and his recommendations. But the bill before us now bears little resemblance to the proposals which President Kennedy submitted.

As an illustration of how the testimony before the Ways and Means Committee was in the abstract and generalized, I would like to refer to the testimony of Mr. George Meany on page 1956 of the hearings before the Ways and Means Committee. Incidentally, I heard Mr. Meany on television this morning inveighing against automation, and well he may give it serious thought because, as I have pointed out to this committee already, not a single new job, net, has been added in

the last decade to five basic elements of our economy, manufacturing, transportation and utilities, construction, agriculture, and mining. Instead of there being new jobs in these five basic elements of our economy, there are more than 2 million fewer jobs than 10 years ago. Yet this bill provides additional incentives to further and more rapid automation.

I have not reached the conclusion that I would oppose automation, but I think increased automation should be recognized as one of the inevitable consequences of the liberalization of depreciation instituted last year, of the 1954 tax reductions, of the investment credit enacted last year, and of the provisions of the pending bill.

In Mr. Meany's testimony, found on page 1956 of the Ways and Means hearings, he stated:

"The details are important"—but he did not have the details to testify upon. Of course, they are important. The details of the bill go to the question of whether or not this is a "justifiable" tax cut. This is the word Senator Hartke used. He advocated stimulation of the economy that would come from a "justifiable" tax cut.

I submit that the pending bill does not provide for a "justifiable" tax cut. But let me continue to read from Mr. Meany's testimony, in general, not in detail, not with respect to a specific bill:

> The details are important, but I would like to ask you to look beyond them. You are not just considering a tax program. You are not just deciding who ought to get tax relief and how much. You are making the most significant single decision that will be made this year and, perhaps, for many years, about the economic future of the American people. It is not too much to say that your decision will determine whether or not the United States will suffer another major recession this year.

Now, that is testimony in general, on a general proposition, before the Ways and Means Committee in March, before the pending bill had been introduced, indeed before it had even been written.

Now I find on page 1957 of the Ways and Means Committee hearings this further statement by Mr. Meany:

> But the basic reason why the American economy has grown so slowly, why our national output is so far behind our productive capacity, whether you say the gap is $35 billion a year like the President's Council of Economic Advisers said, or $60 billion as our AFL-CIO economists say, the basic reason is the shortage of customers with money to spend.

Mr. Meany had no way of testifying, Mr. Chairman, as to whether the provisions of this tax bill provided proper stimulation of consumer demand.

It was only before this committee, and after the motion to curtail the hearings was first made, that the AFL-CIO had an opportunity to testify as to whether, in its opinion, the terms of the pending bill did, in fact, place sufficient emphasis on consumer demand. What was the testimony of the AFL-CIO in that regard? The answer was, "No," it did not.

Amendments were suggested which this great organization, representing millions of working men and women, asked that the committee consider, which would place more emphasis on consumer demand.

Now, Mr. Chairman, our distinguished friend from Indiana says that this committee has spent 5 weeks on this bill which Mr. Meany says is not only the most important bill this year but the most important in many years.

The House of Representatives spent 8 months. The Treasury Department spent a year in preparing its recommendations. And yet the Senate is asked to give this the rush act.

Among the top accomplishments of the Senate this year has been its refusal to be stampeded into unjustified and unwise action on this bill. Therefore, I shall oppose the motion of my distinguished friend, and I shall accord him the courtesy and consideration which I am sure he will accord me, which is to give consideration to the amendments to the pending bill which he and I have offered. And I expect also to give consideration to the changes which the AFL–CIO has recommended, as well as suggestions made by the American Farm Bureau Federation, the various organizations and respected citizens who have come before this committee.

Senator CARLSON. Will the Senator yield?

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Mr. Chairman, I just wish to state this. I am ready to vote if the chairman wants to call an executive session. But I would call the attention of the committee to the fact that the second largest investment in industry in this Nation is the electric generating industry with $60 billion, and we have had some witnesses from them. The oil industry in this Nation is second with $40 billion, and we have not heard any oil industry witness.

I would certainly hope that this great segment of our economy, which is so important, would at least have an opportunity to present their views not only on this bill but any pending legislation.

Senator GORE. Well, we are awaiting testimony this morning from the Chairman of the Federal Power Commission, who comes here as a consequence of his responsibility and sworn duty to oppose a provision in this bill, a provision of favoritism. I will not further characterize his testimony because I do not know just what he will say. But this illustrates the necessity for giving consideration to this bill which makes 232 changes in the tax law, not more than 2 of which were really covered in the debate in the House of Representatives, and most of which the American people are yet acquainted with.

Yes, this is an important bill. It is a monstrous bill. It should be thoroughly considered and, if reported to the Senate, fundamentally altered.

Senator CARLSON. Will the Senator yield again?

Senator GORE. Yes.

Senator CARLSON. Mr. Chairman, I have just been advised that another great extractive industry in this Nation, the mining industry, has not yet been heard; and, there again, I would protest most vigorously if these people would not be permitted to be heard.

Senator HARTKE. Mr. Chairman, just for the sake of the record, I want this clearly understood. I discussed this with the chairman, and I informed him that I wanted to make the motion today. I was clearly under the impression that no vote was to be taken today, and I think the chairman understood that.

Just for the benefit of my distinguished friend from Kansas, I am in no way asking any witness to be cut off this morning. I just wanted to present it, that is all. I know my distinguished friend from Tennessee opposes this bill, and I respect him for his opposition. I know that he wants to go into the stretchout and slowdown to kill the bill, if possible, and that is all right with me, too.

All I ask is, since I accord him every right, I just do not want to be denied my right to have what little say I can have in my one vote, and if I do that, why, I will be happy.

Senator GORE. Will the Senator yield?

Senator HARTKE. Yes.

Senator GORE. Does the distinguished Senator wish his amendments given consideration?

Senator HARTKE. Well, just for the sake of the record, I did not want to get into a discussion of that. Most of them have been discussed, and if you will look on the chart you will see where I have indicated one of them, the most important on the guideline provision, is on the chart. It has been discussed several times. In fact, I did not even introduce it as an amendment. It was discussed as part of this bill even prior to the time that I had indicated I was going to put it in as an amendment.

Senator GORE. Well, the Senator may have indicated his views, indeed the mere introduction of the amendments indicated his support for them. But what about the American people who might be interested either for or against the amendments?

Senator HARTKE. As I said, there has been testimony. It is indicated—not testimony by me, but testimony by other witnesses.

Senator GORE. Who testified before this committee on these amendments, would the Senator be able to tell?

Senator HARTKE. Under the guidelines provision, if you will look on the chart before you——

Senator GORE. That is only one of the eight.

Senator HARTKE. It is the most controversial one, I suppose.

Senator GORE. I do not know who has testified on that.

Senator HARTKE. Mr. Peloubet was one who testified quite at length. But, be that as it may, I am not asking you to agree with me on anything. If you will look on the last line you will see the numbers which are charted to the numbers of the witnesses. There are four individual witnesses who have testified on the guideline depreciation.

Senator GORE. Well, according to my information, your amendment was introduced only yesterday.

Senator HARTKE. That is right. The amendment was introduced yesterday.

Senator GORE. Therefore, no one has had an opportunity even to read it, let alone testify on it.

Senator HARTKE. Mr. Chairman, I am not interested in getting a dispute on this, but just for clarification, I would like to go ahead with the hearings for today, but for clarification, there was an individual bill introduced. It was discussed by these witnesses as the bill and referred to as a bill number.

Subsequent to that time, I have indicated I would offer it as an amendment to this bill.

Senator GORE. Well, Mr. Chairman, I am not interested in promoting a dispute between my distinguished friend and myself either. But this committee is being pictured as giving improper consideration to the bill. I think it is giving adequate consideration to the bill, consideration which the public interest requires and which the importance of the issue demands and deserves.

Senator HARTKE. Mr. Chairman, I have not pictured this committee as doing anything. I have tried to picture my own views. I have asked no one else in the committee to even adopt them. I hoped they would be sympathetic, but I respect every member's opinion, his views. The only thing I ask is that I be allowed to have my own views and to express them to the committee, and with that I would like to leave the matter and proceed with the hearing.

The CHAIRMAN. I would like to say to the Senator from Indiana that he has raised an issue that casts a cloud more or less on the proceedings of this committee, although the committee voted 12 to 4 to leave to the chairman the procedure as to the witnesses. I want to ask the Senator whether it would be satisfactory to him to have an executive session immediately after the open session today so that the committee can express itself again on this subject?

Senator HARTKE. Well, I understood the Senator from Delaware, the ranking minority member, is not here today, and he asked me that it not be presented today.

The CHAIRMAN. I do not think the ranking minority member would object to it. He can be reached. He knows that those not here can cast their votes. As a matter of fact, the proxy of the ranking minority member has been left with one of his colleagues.

Senator HARTKE. Personally, Mr. Chairman, I have no objection to whatever the chairman would like to do on this.

The CHAIRMAN. I understand that you want to record your own vote.

Senator HARTKE. That is right, sir.

The CHAIRMAN. If the committee will agree, the Chair will call an executive session immediately after this meeting.

Senator SMATHERS. Mr. Chairman, may I just be heard for a second on that? As the chairman knows, I have been in some consultation with him with respect to this matter. I have the highest respect for my friend from Tennessee.

It is my judgment, however, that we can sit here and consider a bill for a month or two, and we still are not going to get a bill that he would vote for, and I do think that there are several of us who would eventually like to have a bill. The question is, When can we have a bill and when can we give it the type and character of consideration which a matter of this importance deserves?

The ranking majority member, Senator Long of Louisiana, is not here, will not be here, would like to be here, on a matter of this character to discuss it and cast a vote, and I had hoped, and I had originally understood, although I had not talked with the chairman exactly about this, that there would be a vote on this matter on Tuesday, and I had hoped that at that time some part of that time might be adjusted so that we could proceed in a fashion where it would give those of us who favored the bill an opportunity, possibly an opportunity at least, to get to a vote of some kind this year. It may be that we could not do it, but I would like to ask the chairman—he asks is there any objection, I do not object—but I would implore the chairman to withhold having an executive session until the Senator from Louisiana could be here.

The CHAIRMAN. I will say to the Senator from Florida that the Senator from Indiana is offering in open session a motion which should

be considered in executive session, and he has given his remarks to the press. I do not think the committee should be left in a position whereby discredit had cast upon it with respect to the method that these hearings are being held. There is a great deal which can be said about it.

He says himself that this bill has been before the Congress 10½ months—5 weeks before the Senate, and some 9 months before the House.

As the Senator from Tennessee so ably pointed out, under House procedure, the Ways and Means Committee hearings were on the presidential message, and the actual bill is not formulated until after the hearings. Therefore, there have been no hearings in the House on this specific provisions in the bill, because the bill was not even put together, until shortly before it was brought to the House floor.

I think that this committee has worked industriously. We have worked mornings and afternoons. We have had good witnesses, and the hearings have been helpful.

I agree with the statement that this is, perhaps, the most important fiscal legislation considered by the committee in 30 years that I have been in the Senate. It involves a tax reduction on borrowed money of $11 billion to be added to the public debt and, at the same time, it contemplates, as Mr. Heller testified, that expenditures will be increased.

Now, that raises the question as to the future policy of this country with regard to deficit spending in order to reduce taxes.

As long as the Senator from Indiana has insisted upon bringing this up in open session, I do think it would be only fair to the rest of the committee to have a vote on it and see whether he is sustained or not sustained. Those who are absent will have an opportunity to cast their votes, and the vote will be announced when they have had an opportunity to do so.

I will ask for an expression of the sense of the committee.

Senator DIRKSEN. Well, Mr. Chairman, I am not insensible of the fact that there is clamor in some quarters for a tax bill, nor am I unaware of the fact that there is a large degree of indifference in the country to this particular tax bill.

I do not know that there has been a tremendous pressure, but it all adds up finally to excoriations of both branches of the Congress, but particularly the Senate, that it is a standstill or a do-nothing body. I have got quite a different name for it. I think it is a stop-look-and-listen body, and I think, in that respect, it has done an exceedingly good job during this session.

I have said, on many occasions, that I subscribe to what Edward Gibbon wrote in his "The Decline and Fall of the Roman Empire" when he said more often than not progress is made not by what goes on the statute book but what is kept off or does not get on the statute book.

But I know these little taunts from the outside finally develop an excessive zeal for expedition, and committees, not merely this committee, but all committees in the House and the Senate, when confronted with a lot of witnesses, think in terms of cutting them short and giving them 5 or 10 minutes.

I had no trouble hearing 440 witnesses some years ago when I was Chairman of the House Agriculture Subcommittee on Appropriations,

and I have no recollection that anybody was caught short, and, with some modesty, I think we did the best job that year that was done in a long time.

So we have got to be thinking about the witnesses who come here, who are delegated by their groups and associations to testify.

Senator HARTKE. Mr. Chairman——

Senator DIRKSEN. Wait just a minute.

We had a witness here last week from the Illinois Chamber of Commerce. I think that chamber has the largest membership and is the largest, most active chamber in the United States. Now he comes from their finance committee, and he becomes the representative of 3,000 or 4,000 dues-paying members who pay substantial dues for the service that he rendered, and when they send him down here, they, as substantial taxpayers of the country, have a right to expect that he get something more than cavalier treatment from a House or Senate committee.

If he has got a statement that takes 30 or 40 minutes, I am willing to hear him. I do not want him to go back to Chicago and have to report that the committee chopped him off and gave him 10 minutes to file his statement, then to interpolate and interpret the general thesis that he was presenting to the committee. These people are entitled to be heard, and I think we ought to curb our rather excessive zeal for expedition, because I know of no better way to ultimately undermine free government, because the shorter you cut it finally the closer you get to an oppressive system where nobody else's views count except those who are sitting in the seats of authority.

So, Mr. Chairman, I share your belief that we just as well resolve the issue immediately, and I am ready to vote.

Senator HARTKE. Mr. Chairman, all I want to say is, I want the chairman to know that I am not attempting to cast any cloud upon the committee. Actually, the President indicated yesterday in his press conference that he hoped we could have a bill this year. In my opinion, I think there is no question that if we proceed to hear the witnesses who are scheduled, in the order in which they are listed, it would be a physical impossibility to report a bill out of this committee in this session, and it may even now be a physical impossibility to do so if the hearings were, as a normal course, terminated at this time.

If I recall correctly, the distinguished minority leader indicated this week that in his opinion there would not be a bill acted upon on the floor of the Senate before approximately March 15.

Senator DIRKSEN. Well, Mr. Chairman, this is a good time to just ventilate a timetable. We are going to take out 2 or 3 or 4 days to take testimony on the debt limit starting Monday, as I recall, and then proceed with the witness calendar.

Now, the Thanksgiving recess is a definite commitment and begins on the 27th of November, and we go over to the 2d of December.

The Christmas recess is a definite commitment made by the majority leader to start on the 20th of December and go to the 2d of January. It is not going to be changed.

Now, you can take the calendar for yourself and just look at the number of working days, exclusive of Saturday and Sunday, and then measure it against the backdrop of conference reports, other legisla-

tion, the unfinished appropriations bills, and see precisely where you are.

I have made it clear, and I have not invoked a rule, but I have said to the chairman, and he understands it fully, that when controversial matters are on the floor of the Senate I propose to invoke the rule. I should have done it, I think, more freely now because there were four or five members of this committee who are also on the Foreign Relations Committee which is sponsoring that highly controversial foreign assistance bill on the floor.

I presume if we were all there in the afternoon we would not have an imbroglio like we had last night that kept us here to all hours and the night before.

I have never felt that anything we do much after 6 o'clock is worth the paper it is written on. [Laughter.] George Marshall, the Chief of Staff, once said that any idea you get after 3 o'clock in the afternoon isn't worth much, and I am beginning to think there is some point in what he had to say.

But now we are going to have to wrestle and hassle and maybe undo some of the things that we do after irritation and fatigue falls upon the members in the dark hours of the night.

But there is your timetable. So you just take the rest of 1963, see how many working days you have got and what we have to do, and so my prognostication that there will be no tax bill this year stands, because mechanically and physically you cannot get a tax bill.

Now, you made one other statement that I think should be corrected. If I heard you correctly, you said everybody knew that the chairman was trying to kill the tax bill.

Senator HARTKE. No, I did not say that.

Senator DIRKSEN. We have got a record——

Senator HARTKE. I will be glad to say so, I want that corrected immediately. I said the Senator——

Senator DIRKSEN. I hope it will be corrected.

Senator HARTKE. I said the Senator from Tennessee has indicated on the floor of the Senate that he was against the tax bill.

Senator DIRKSEN. I thought you used the word "kill."

Senator HARTKE. I did not refer to the chairman. I was referring to the Senator from Tennessee, and I am not sure, but I think he said he wanted to kill the bill.

Senator DIRKSEN. Well, I won't argue the point or even ask the members of the committee to take the oath and testify as to what you said, but I thought from here that I heard you say "k-i-l-l."

Senator HARTKE. I said I think I said "k-i-l-l."

Senator DIRKSEN. You did.

Senator HARTKE. But I referred not to the chairman, and I think the Senator from Tennessee used that exact word on the floor of the Senate, that he was going to do everything he could to kill the bill.

Senator DIRKSEN. Well, I think the record ought to be clear. Who then did you have in mind as trying to kill the tax bill?

Senator HARTKE. I will be glad to have the record read, if you want it read, but I was talking about my distinguished friend from Tennessee, and that is with whom I was in colloquy.

Senator DIRKSEN. I have never heard the chairman ever say in word or deed or in print or by mouth that he wanted to kill the tax bill.

Senator HARTKE. I never said it either.
Senator DIRKSEN. He did say that he thought——
Senator HARTKE. I never said it either.
Senator DIRKSEN. That he ought to have the benefit of the 1965 budget figures before we take action, and that along with it we ought to hear every pertinent witness.

Now, I say frankly to you I want to see a tax bill, but I want to see a good one, a fair one, and there are some holes in this bill, as the distinguished Senator from Tennessee has said, and it is going to take some time to mark up when we get all these green volumes before us. At that time I will take them along and put them around the Christmas tree and then I will begin to go to work on them. But we have got to have a little time to digest the testimony, and you know how it will be when we are sitting here working away in executive session to mark up the bill, and then if, by some strange phenomenon we suddenly have civil rights on the floor of the Senate, then I can say to you, sir, that not only will the rule be invoked at 12 o'clock, but I will insist on its enforcement, because I am not going to see the members of this committee divide their time with an abstruse tax bill, and the intricacies and the challenges in a package civil rights bill. I think then the committee has a duty to be on the floor, and insofar as it is within my feeble endowment to bring it about, I shall try to bring it about.

So that is just another complication to indicate the mechanical problem and the problem of the Gregorian calendar that constantly stares us in the face.

Senator HARTKE. With all due respect to the distinguished minority leader, I made no such reference to the chairman. I want it clearly understood. I think the chairman understands that I made no such reference. I hold him in the highest respect. I was speaking to my distinguished colleague, the Senator from Tennessee about his attitude on the bill. I want it understood that I have advocated a tax cut since January 1961. I have been doing it consistently all the way through. I am not changing my position. I wanted an early date then, and I want an early date now, and I am not asking that anyone be denied any rights or privileges or anything else. All I ask is that I be entitled to have my own say and my own vote.

Senator DIRKSEN. Mr. Chairman, if I affronted my Hoosier neighbor, I apologize.

Senator HARTKE. Let me say, if I have affronted anyone on the committee, I sincerely apologize. I do not think I did, and I certainly did not intend to.

Senator WILLIAMS. Mr. Chairman, I apologize for being late, but I would suggest while these apologies are being extended, that we also apologize to the witnesses who were scheduled this morning, and assure them that there will be a day added to the hearings whereby they will have an opportunity to present their case. We regret the necessity of extending this, but I think they should be assured they will be given their opportunity even though it is after Christmas.

The CHAIRMAN. This issue has been raised in open meeting. The Chair now declares the committee in executive session and suggests that we move into the next room to vote upon the motion of Senator Hartke.

(A short recess was taken.)

The CHAIRMAN. The committee will be reconvened. The Hartke motion was defeated 11 to 1. The absentees will be given an opportunity to vote.

Senator GORE. Mr. Chairman, I regret very much to interrupt the hearing any further, but since reference was made to my statement on the floor of the Senate, I would like to make the record perfectly clear.

Here is the bill which I said I wanted to kill. I still do. I think the American people ought to know that this is a 310-page bill, only about 10 pages of which relate to rate reduction or adjustment. There are 300 other pages that deal with structural provisions, nearly every page of which seeks to feather the nest of some special interest or group.

Yes, I want to kill this bill, but I would be glad to support a tax bill which, in the words of the distinguished Senator from Indiana, was a justified one. Thank you.

Senator HARTKE. Mr. Chairman, just for the sake of the record then, since it was brought up, I was in discussion with the Senator from Tennessee, and I referred to his statement on the floor, and I said that he had indicated on the floor that he wanted to kill the bill, and if the record reads otherwise I wish to be corrected.

Senator GORE. I agree that the Senator was referring to me and he referred to me correctly with respect to the terms of this bill.

Senator HARTKE. Thank you.

Senator GORE. But I have been seeking the enactment of an adequate and fair tax bill for years. I still seek that.

The CHAIRMAN. We will turn to the witnesses.

The next witness is the Honorable Joseph C. Swidler, Chairman of the Federal Power Commission. We are sorry to have delayed you.

STATEMENT OF HON. JOSEPH C. SWIDLER, CHAIRMAN, FEDERAL POWER COMMISSION; ACCOMPANIED BY RUSSELL C. RAINWATER, CHIEF ACCOUNTANT

Mr. SWIDLER. Mr. Chairman and members of the committee, I am happy to be here by invitation of the chairman to testify on the proposed section 202(e) set out in H.R. 8363.

I might say that this section is not a revenue section. It is rather, a section which proposes to prescribe the treatment to be given the investment tax credit for ratemaking purposes by Federal regulatory agencies.

I have a formal statement which I should like to have made a part of the record. But, with your permission, I shall attempt rather than read the statement, to summarize my position and let the statement stand as a more full and exact expression of my views.

This is a rather awkward time for me to testify on an investment tax credit problem because the Federal Power Commission now has pending before it both a rulemaking proceeding with respect to accounting for the investment tax credit, and rate cases involving the treatment of these credits for ratemaking purposes.

Nevertheless, I shall try to be responsive to the committee's invitation and speak with as much fullness and as much clarity as I can.

Section 202(e) would direct all Federal regulatory agencies with

respect to public utilities generally, which are defined to include the electric companies, natural gas distribution companies, and various other utility companies, that the credit should not be flowed through to the consumer except on the basis of the averaging of the allowances over the life of the property involved.

An altogether different scheme is proposed for the tax credit of the natural gas pipeline companies. In the case of these companies which receive a 7-percent credit as compared to the 3-percent credit for the public utilities, the statute would provide that none of the credit might be flowed through to the consumer, but that all of it should be retained by the shareholders and that none could be reflected in any way, directly or indirectly, in a rate case.

In both cases, these provisions are stated in terms of retroactive interpretations of the investment tax credit provision; retroactively both of these different methods of treatment are to be considered as part of the original congressional intent, as I understand section 202(e).

My Commission is not all of one mind with respect to these provisions. I speak for two other members, Commissioners Charles Ross and David Black, as well as myself, of course, in urging that the question of regulatory treatment of the investment credit should be left with the Commission. On any substantive questions, I speak only for myself.

Commissioners O'Connor and Woodward have asked me to state their general concurrence in the principle that the Commission should have discretion in fixing rates and that, in general, the legislative body should not prescribe the rate treatment of specific items of cost. But they think that an exception should be made here because of the controversy which has arisen with respect to the intention of Congress in enacting the investment tax credit provision, and they would therefore see no objection to a departure from that principle under these particular circumstances.

I do not comment here today on the revenue feature. The Commission is not opposing the investment tax credit for the companies it regulates. I comment here today only upon the congressional prescription and direction to the regulatory agencies as to the precise effect to be given to the investment tax credit in a rate case, and I am here on behalf of the majority of the Federal Power Commission to urge that the Congress not set the precedent of legislating the details of the treatment of the items of cost for ratemaking purposes.

As I am sure the members of the committee know, public utility commissions were created in the first place because legislative ratemaking had proved to be infeasible. The State legislatures and the Congress created specialized administrative agencies charged with the responsibility for determining just and reasonable rates, subject always to judicial review and, as you know, there is a great body of law which channels and controls the administrative agencies in carrying out their responsibilities for determining just and reasonable rates.

This system has flexibility. It permits adjusting the delicate balance between the interests of ratepayers and investors in the light of changing circumstances.

It permits changes from time to time in the general rules as the situation may require, and it permits individual differentiation in accordance with differences in the particular circumstances of individual industries or companies.

With respect to the income tax feature in particular, the rule governing administrative agencies was laid down by the U.S. Supreme Court in 1922 in the *Galveston* case (*Galveston Electric Co.* v. *Galveston*, 258 U.S. 388, 399 (1922)). That case held that the income tax related to a just and reasonable level of earnings was an allowable cost, and that earnings must be permitted which would enable a company to pay the income tax which would be due on the basis of just and reasonable rates as a part of its——

Senator GORE. And allow thereafter a fair and reasonable return on investment.

Mr. SWIDLER. That is right, sir.

Senator GORE. But if I understand the pending bill and your description of it, the bill would interject by law an estoppel against the Commission's considering the particular tax features referred to here in a ratemaking case.

Mr. SWIDLER. That is right, Senator Gore. It no longer relates the income tax allowance to the level required to be paid on the basis of a fair and reasonable rate level and earnings level, but prescribes an arbitrary, or at least a flat, additional level of earnings over and above just and reasonable rates.

Senator BENNETT. Mr. Swidler, if I may interject——

Mr. SWIDLER. Yes, Senator Bennett.

Senator BENNETT (continuing). Isn't the requirement also that in order to get the benefit of this particular tax advantage they have to make an increased investment, and isn't the purpose of the program to stimulate investment for the purpose of increasing job opportunities?

Now, if we are going to take all of that incentive away and give it to the consumer by reducing the rate then you have, in effect, negated the purpose of Congress in passing this particular law.

Mr. SWIDLER. The electric industry and, to some extent, the natural gas industry in advocating the extension of the investment tax credit provision to cover their operations made clear the very great inducement to investment that would result from coverage irrespective of whether the benefits were flowed through to the consumer, because there is a reduction in fixed charges, there is, in effect, a reduction in initial cost, and this would make possible investments which would otherwise be marginal.

So far as the purpose of the investment tax credit provision is concerned, no member of our Commission has any quarrel with you, but we do think that there is a serious question whether the purpose of inducing investment would be best realized by providing that the whole benefit must go to the shareholder and might then be fully reflected as dividends or whether it should be reflected as reduced costs.

Senator BENNETT. Well, who supplies the additional investment, the consumer or the shareholder?

Mr. SWIDLER. The shareholder supplies the—well, obviously the growth of the industry is made possible by its growth in earnings, by the money that the consumers pay.

In the utility business, Senator Bennett, which sells only one commodity, which does not have annual changes of style or packaging, which does not have new products for which provision must be made each year, the investment in plant, by and large, is controlled by one

factor—growth. If the industry builds ahead of its projected loads by more than a little, it will very soon slow down and let loads catch up. So that the controlling consideration in determining the investment in the businesses for which the Commission has regulatory responsibility is growth which, in turn, is related to the rate level. When the investment tax credit provisions were before you, and the question was whether to extend its coverage to the regulated companies, some of the industry witnesses made precisely this point: That with the benefit of this tax reduction they could reduce rates, increase use, and thereby require and justify investment in additional plant.

Senator BENNETT. Under the bill those industries that feel they can prosper more by reducing rates would have the right to reduce rates.

Mr. SWIDLER. Yes, sir; and those which feel they would rather pass the money along to their stockholders would have the privilege of doing that.

Senator BENNETT. That is right.

Excuse me, go ahead.

Mr. SWIDLER. It is a point that I wanted to make, and I was glad to be able to make it in response to your question.

One general result, to come back to the question of principle involved, Senator Bennett, of directing the Commission as to a particular allowance to be made in a rate case, if the bill should pass, would be that the Commission could no longer be responsible for determining just and reasonable rates or for defending the equity of the results of the administrative process. It is obvious that the responsibility of the Commission would be diluted.

Senator TALMADGE. Mr. Chairman, may I ask a question at that point, if the witness would yield?

Mr. SWIDLER. Yes, Senator Talmadge.

Senator TALMADGE. How has the Federal Power Commission treated the acceleration depreciation ruling that the Treasury put in effect last year?

Mr. SWIDLER. Are you talking about guideline depreciation, sir?

Senator TALMADGE. Yes, sir. You will recall that last year the Treasury Department, by their regulations, increased the depreciation factor which gave more benefits to all taxpayers or shortened the period thereof. In what way did the Federal Power Commission treat that for ratemaking purposes?

Mr. SWIDLER. Our Commission has not attempted to direct—as yet we have taken no action to direct—the companies under our jurisdiction as to whether they should or should not take advantage of the guideline depreciation rates. Thus far they have been left to make this decision on their own judgment.

Senator TALMADGE. The Commission, of course, has to use some yardstick for depreciation in determining what is a fair return.

Mr. SWIDLER. Yes, sir.

Senator TALMADGE. Have you used the Treasury regulations?

Mr. SWIDLER. We have——

Senator TALMADGE. Or whatever the utility desired to use themselves; which has it been?

Mr. SWIDLER. Thus far we have not interfered with the exercise of judgment by the companies under our jurisdiction in using guideline depreciation rates for tax purposes if they wished. We have not compelled them to.

Senator TALMADGE. Now, the second question: How have you used this investment credit heretofore for ratemaking purposes?

Mr. SWIDLER. That question as well as the liberalized depreciation question is now involved in proceedings before the Commission in which the Commission will, I expect soon announce decisions.

Senator TALMADGE. I take it by your response then that the Commission has not made a determination on that point; is that correct?

Mr. SWIDLER. The Commission prior to the time that any of the present members were appointed, and with respect to liberalized depreciation, developed a rule that it would permit normalization and allow a 1½-percent return upon the amounts held in the fund for normalization.

The Commission more recently, after the current members had been appointed, announced that they proposed to review the treatment of liberalized depreciation, and the Alabama-Tennessee Natural Gas Co. case was used as the vehicle for reviewing that question. Consideration was delayed by litigation in the courts, but it has now been argued, and it is before the Commission for final disposition which, I believe, will not be long delayed.

Senator TALMADGE. Thank you.

Senator GORE. Mr. Chairman, may I ask a question? Had you finished, Mr. Swidler?

Mr. SWIDLER. I had not quite finished summarizing, but it is of no moment.

Senator GORE. I will wait.

The CHAIRMAN. Go ahead.

Mr. SWIDLER. I want to call to the attention of the committee the fact that this would be the first time that Congress had prescribed the details, the specifics, of rate treatment of costs by any utility commission so far as I am aware, and if the Congress should prescribe this one, I presume it will be asked to prescribe more and different ones, and it will be besieged on both sides to allow more or less for this item or that until, I think one can visualize, the decline of the regulatory process progresses to the point where it could no longer produce just and reasonable rates in the current legal sense of that term.

The amounts involved in this particular case are very large, about $60 million for the natural gas companies; about $86 million for the electric companies; and when the tax effect of these amounts is taken into account this could involve as much as $300 million in rate reductions annually.

I need hardly say that if the Congress should pass these provisions, the Commission will faithfully carry them out to the best of its ability, but on behalf of the Commission majority we urge, both with respect to the merits of the provision and with respect to its precedent as destructive of the administrative process, that it not be enacted.

Thank you.

(The prepared statement of Mr. Swidler follows:)

STATEMENT OF JOSEPH C. SWIDLER, CHAIRMAN, FEDERAL POWER COMMISSION

Chairman Byrd and members of the Committee on Finance, I am here in response to your invitation to discuss the treatment of the investment credit by the Federal regulatory agencies proposed by section 202(e) of H.R. 8363, the pending revenue bill.

I should like to say at the outset that this is a difficult time for me to testify because the treatment of the investment credit for regulatory purposes is an

issue in cases now pending before the Commission. I am not in a position to advise you as to how the Commission will decide this substantive question and my own views on the substantive question do not necessarily coincide with the views of all or any of the members of the Federal Power Commission. However, I am not precluded from expressing my views as to the advisability of a congressional prescription of a specific ratemaking formula for treating the investment credit. The members of the Commission have read this prepared statement and I am authorized to state that a majority of the Commission concurs in recommending that the Commission should be permitted to continue to exercise discretion in determining the rate effect of the investment tax credits allowed natural gas pipelines and electric public utilities under FPC jurisdiction. Commissioners O'Connor and Woodward have requested me to note their view that ordinarily the elements of just and reasonable rates should be left to the discretion of the Commission, but that the controversy with respect to congressional intention as applied to the investment tax credit makes it desirable for Congress to eliminate the question of congressional intention by prescribing the rate treatment.

I should like briefly to summarize the status of the investment credit under existing law with respect to the electric power and natural gas industries which the FPC regulates and the changes in the situation if section 202(e) of H.R. 8363 is enacted.

Under the existing investment credit provisions of the Revenue Act of 1962 (Public Law 87–834), there is allowed a credit against the income tax of natural gas pipeline companies, and taxpayers generally, of 7 percent for investment in essentially tangible property, such as machinery and equipment. In the case of electric power companies and others classified as public utilities the credit is fixed at 3 percent.

The credit is applied as a direct reduction of the taxpayer's income tax liability otherwise computed. The credit may entirely offset the first $25,000 of tax liability and may offset one-fourth of the tax liability above $25,000. Any credit which cannot be used in the current year because of these limitations may be carried back for 3 years and then forward for 5 years; and if not then fully exhausted the remaining unused credit may be applied in the sixth year as an ordinary tax deduction.

The House has proposed several changes in the existing law but I should like to confine my attention to the change identified as section 202(e), labeled "Treatment of Investment Credit by Federal Regulatory Agencies."

For convenience I have set forth as an appendix the text of section 202(e) of H.R. 8363 as passed by the House (p. 37).

Section 202(e) of H.R. 8363 directs the Commission in fixing rates for natural gas companies to make an allowance for Federal income taxes in the same amount as would be allowed if the investment credit did not exist, unless the company consents to a different treatment. In effect, it directs the Commission to permit the natural gas companies to claim the investment credit to reduce their income tax bills but forbids the Commission, without the companies' consent, to consider the reduction in taxes in fixing the just and reasonable rates. Section 202(e) has a different provision for the electric power companies. If this provision becomes law we are forbidden, unless the companies concerned give their consent, to reduce the income tax allowance in fixing rates by more than a share of the investment credit prorated over the average useful life of the property.

A discussion of the need for section 202(e) must be in the context of the underlying basis for FPC regulation of the natural gas pipelines and electric power companies. Congress has provided for Federal regulation of these two industries because they are natural monopolies with respect to the customers they serve and regulation is considered a necessary substitute for competition.

Neither the Federal Power Act nor the Natural Gas Act contains a detailed formula to direct the Commission in its task of regulating the wholesale prices of natural gas and electricity. As is also the case in most other regulatory legislation, State and Federal, the standard in both statutes administered by the FPC is a general one—"just and reasonable rates." Congress delegated to the Commission the task of perfecting the detailed standards to implement this broad and general statutory guide. The reason for such a policy is obvious. The Federal Power Commission can be expected to acquire expert knowledge of the problems and needs of the industries it regulates and to apply its informed judgment in developing realistic rules that will keep the industries healthy while affording consumers protection against excessive prices.

In determining just and reasonable rates for the gas pipelines and electric power companies the FPC over the years has developed a workable set of standards. In essence, we allow utilities to charge rates which compensate them for their expenses of doing business plus a reasonable rate of return on their investment in utility operations. Federal income taxes have long been regarded as an operating expense to be covered by the utilities' rates. As early as 1922, the Supreme Court in the case of *Galveston Electric Co.* v. *Galveston*, 258 U.S. 388 (1922) stated that "In calculating whether the 5-cent fare will yield a proper return, it is necessary to deduct from gross revenue the expenses and charges; and all taxes which would be payable if a fair return were earned are appropriate deductions" (p. 399).

Section 202(e) represents a break with past practice. For the first time, Congress would single out a particular facet of the ratemaking process and instruct the FPC how to decide this issue in determining just and reasonable rates. Congress, of course, has the right to take this action and whatever directions Congress may give the Commission will carry out to the best of its ability. However, your invitation to me requires that I comment on the advisability of these provisions. In my opinion, there is no reason with respect to the investment credit to depart from the long-standing congressional policy of leaving to the discretion of the administrative agency the manner in which it will treat the items that go into determining utility rates.

There have been numerous amendments to the Federal income tax law over the years, but to my knowledge, the present proposal if enacted would be the first time that Congress has prescribed the regulatory treatment to be given to tax relief. Several amendments to the income tax law somewhat similar in purpose to the investment credit come to mind. I refer to liberalized depreciation authorized by section 167 of the Internal Revenue Code of 1954 (526 U.S.C. 167), accelerated amortization authorized by section 168 (26 U.S.C. 168), percentage depletion (26 U.S.C. 611–613), and intangible well-drilling costs (26 U.S.C. 263(c)).

In performing its regulatory responsibilities the Commission must carry out the congressional policy of the tax laws, as well as of other relevant laws. Specifically, the rgeulatory treatment of the investment credit must be one that will stimulate investment. In my judgment, that basic difficuly with the proposed legislation is that it binds the Commission to carry out the congressional purpose in a specified manner and, I might add, in a different manner for the electric utilities than for the natural gas companies. The proposed legislation would prevent the Commission from choosing the method which best serves the overall public interest at a given time for a particular regulated industry, or from choosing a variant of the standard formula in individual cases presenting special problems.

We are speaking of the proper regulatory treatment of very large sums of money with respect to the industries subject to the jurisdiction of the FPC. Natural gas pipelines increased their gross utility plant by approximately $5 billion for the 5 years from 1957 through 1961. Assuming a 7-percent investment tax credit in that period and that 85 percent of the additions would be eligible for the credit, the tax savings to the companies in bulk would average approximately $60 million per year. Were all of the credit passed on to the gas consumers, considering the doubling effect of the income tax which now requires approximately $2.08 in rates to net a $1 rate of return to the company, consumers would save about $120 million a year.

On the electric side, in the period 1957, through 1961, privately owned electric power companies increased their gross utility plant by approximately $17 billion. Assuming the existence of an investment tax credit of 3 percent in this period and estimating 85 percent of the additions as eligible for credit, the tax savings to the electric companies in bulk would average about $86 million per year. If there were flow through to consumers, and with the doubling effect of the income tax, they would benefit by an annual average reduction or savings in rates of $172 million if applied to intrastate as well as interstate sales.

In view of the increasing demands for power and gas which will require larger investments in the years ahead, we estimate that these sums will increase at compounded rates of about 5 percent annually for natural gas companies and by about 6 percent a year for electric companies, assuming stable price levels.

One of the reasons for which the FPC was created was to provide expert judgment on specialized questions with respect to the industries placed under FPC jurisdiction. I realize that there is an element of competition which affects the gas and electric utilities, which compete for some of their markets with each

other and with other energy suppliers. However, this is not the same as the competition between companies in the same industry which determines the prices at which most products are sold. Indeed, it was because of the inadequacy of competition that Congress has deemed that regulation of the electric power and natural gas industries is necessary to insure fair prices to consumers. The problem raised by section 202(e) is whether the Commission should be bound to a single formula in carrying out its function as the substitute for the kind of competition that exists in the unregulated industries.

Congress has prescribed no such formula for the industries where the forces of competition are relied upon to produce economic decisions in the public interest and which are therefore not regulated. They are free to reflect the congressional purpose of the investment credit provisions in a variety of ways. In some industries the reduction in income taxes will permit price reductions which create greater consumer demand and stimulate additional investment by requiring greater plant. In other industries where plant obsolescence is the problem the credit may serve as an incentive to replace existing plant in order to place the company on a more favorable basis to meet future competition. In either case competition serves to determine the price effect which a particular company gives to the investment credit to stimulate new investment.

Section 202(e) would allow the regulated industries to escape regulation over how they would reflect the investment credit in their rates even though they are subject to regulation because Congress believed that consumers needed protection against unjustified charges by these industries. In my opinion the Congress should permit the Commission, rather than the regulated utilities, to decide this component of the just and reasonable rate, in the same manner as we decide all of the other items which are the basis for the wholesale price at which gas and electricity are sold.

Although the principal question raised by section 202(e) is whether the Congress should instruct the Commission as to the particulars of allowances for ratemaking purposes, I must add in candor, speaking for myself alone, that there is serious question whether the rule prescribed by the statute is substantively fair and will carry out the congressional purpose of stimulating investment in new facilities. As to this I shall only say that there is much to be said for the position that in the case of public utilities and natural gas pipelines it is the rate of growth in the use of their product or service which controls their investment in new facilities, and that the rate of growth is in turn largely affected by the level of rates which their customers must pay. In this view, utilizing the credit as a basis for reducing rates and increasing consumption might well achieve the objectives of the statute far better than either of the specific formulas it prescribes.

I therefore urge, Mr. Chairman, that this committee and the Congress eliminate section 202(e) from the revenue bill.

APPENDIX

H.R. 8363, section 202:

"(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—

(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

"(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."

Senator BENNETT. May I ask one more question, just to clear up the record? What policy did the Commission adopt with respect to the

changes that were made in the liberalization of depreciation by the 1954 act when companies, corporations, were given the right to use the double declining balance method which was a counterpart of the liberalizations that were created last year? Do you know?

Mr. SWIDLER. I attempted, in response to Senator Talmadge's questions, to say what the past practice has been with respect to liberalized depreciation.

Now, the accelerated amortization, which was the predecessor of liberalized depreciation, was a different matter, but with respect to liberalized depreciation which, I think, first came about in 1954, the Commission did permit normalization, and on the amount held in tax reserves a return of 1½ percent was permitted. As I said, this ruling is now being reviewed.

Senator BENNETT. What confuses me is the word "normalization" which I recognize may be a word of art, but it is not a word that we ordinarily use in this committee.

Mr. SWIDLER. I am sorry, Senator. One gets used to the patter of his own field, so that one hardly recognizes it when he is using it. But "normalization" means while a company might charge for tax purposes twice as much depreciation and thereby reduce taxes substantially, for rate purposes he would charge only the normal amount, and the difference in taxes would be held in a reserve. Normalization is the application for rate purposes of the taxes based on normal depreciation, while charging the liberalized depreciation for tax purposes.

Senator BENNETT. And on that particular asset held in reserve you only allow 1½ percent——

Mr. SWIDLER. Yes, sir.

Senator BENNETT (continuing). Profit, which is roughly what, a quarter of the normal profit that you would allow?

Mr. SWIDLER. Yes, sir.

Senator BENNETT. Thank you.

The CHAIRMAN. Senator Gore?

Senator GORE. Mr. Chairman, lest some of the questions I ask of the witness appear to indicate that I have some knowledge of what he has said or done heretofore, I wish the record to show that I have not talked to Mr. Swidler about this issue in any respect. The only expressions I have heard from him or read from him on the issue are those he has testified to here today.

Was the subject matter under discussion introduced in the Congress in the form of a bill designated H.R. 7111?

Mr. SWIDLER. I do not know the answer to that, Senator. I know that it was a provision, I recall, introduced at the instance of Chairman Mills in the House. But whether it was first introduced as a separate bill, I do not know.

Senator GORE. Well, it is true that a bill introduced by Congressman Wilbur Mills, H.R. 7111, contains the substance of section 202(e) of the pending bill, although there may be a few minor differences.

To your knowledge, was there any public hearing on that bill?

Mr. SWIDLER. No, sir. To my knowledge there was not.

Senator GORE. I am not asking you to say emphatically whether there was or was not, but insofar as you know, no public hearings were held on that bill?

Mr. SWIDLER. So far as I know, and I think I would know, there were no public hearings; yes.

Senator GORE. Did you ask to testify?

Mr. SWIDLER. No, sir; I did not.

Senator GORE. Do you know if anyone asked to testify on this provision?

Mr. SWIDLER. No, sir.

Senator GORE. Did you communicate to the Ways and Means Committee your views on that bill?

Mr. SWIDLER. Yes, sir.

Senator GORE. Was that letter made public?

Mr. SWIDLER. No, sir.

Senator GORE. Would you supply this committee with a copy of that letter?

Mr. SWIDLER. I would be glad to.

Senator GORE. Mr. Chairman, since this letter has not been published, I ask that it be made a part of the record at this point.

The CHAIRMAN. Without objection.

Mr. SWIDLER. May I present it for the record now? I have a copy.

The CHAIRMAN. The insertion will be made.

(The document referred to follows:)

FEDERAL POWER COMMISSION,
Washington, D.C., August 5, 1963.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to the oral request received this morning from a member of the committee staff requesting that the Commission submit any comments it wishes to make to your committee on H.R. 7111 by August 6, 1963.

H.R. 7111 would amend the Internal Revenue Code to direct the manner in which Federal regulatory agencies would treat the investment tax credit established by the Revenue Act of 1962 for ratemaking purposes. Specifically, it would preclude such agencies, including the Federal Power Commission, from reducing any taxpayer's Federal income taxes by the amount of the investment credit, for the purpose of establishing a cost of service and reducing the rates and tariffs to be charged. The bill would also preclude an agency from allowing a lower rate of return on plant investments because the funds were derived from the investment tax credit.

The question how the investment tax credit should be treated by this Agency, both as a matter of accounting and for ratemaking purposes, is presently pending before the Federal Power Commission in contested proceedings, and oral argument has been scheduled before the Commission en banc. Under these circumstances, we do not believe it would be appropriate at this time for the Commission to comment upon the merits of the proposed method of treating the investment tax credit for regulatory purposes.

We recognize, of course, that Congress may wish to prescribe the manner in which its regulatory instrumentalities should reflect tax provisions which Congress has made applicable to businesses whose rates and service are subject to Federal regulation. It is our view, however, that generally it is preferable to leave to the regulatory agency most familiar with the special problems of a particular industry the determination how particular tax and other expense items should be treated for ratemaking purposes within the overall regulatory framework Congress has provided for that industry.

In view of the brief time which has been available to us, since the receipt of the request for comments, it has been impossible to contact Commissioner Woodward who is out of town, nor have we been able to clear this response with the Bureau of the Budget. Commissioner O'Connor has requested me to note his view that regulatory treatment of the investment tax credit depends upon congressional intent, and that the Commission would be aided by a clear expression of intent by the Congress on the issue. Commissioner Morgan's separate views are attached.

Sincerely,

JOSEPH C. SWIDLER, *Chairman.*

STATEMENT OF COMMISSIONER MORGAN CONCERNING H.R. 7111

On January 15, 1963, the Federal Power Commission, in a notice of proposed rulemaking, asked for comments of all interested parties prior to February 19 concerning the proper accounting disposition of investment tax credits in the electric power and natural gas industries. Eighty-three responses advocating various treatments of the tax credit were received. On April 24 the Commission announced it would hear oral argument on the subject on June 11. Subsequently the Commission postponed argument to July 25, then to August 6, and finally on July 26 postponed the oral argument indefinitely. At the present time no date for the argument has been scheduled, and as a consequence of the imminent termination of my service on the Commission I shall not be able to hear and participate either in the argument or in the decision resulting therefrom.

Consequently it is entirely appropriate, since I have reviewed the written comments received, and have also reviewed the history of the basic legislation, for me to comment on H.R. 7111, the purpose of which has been outlined by Chairman Swidler's letter.

H.R. 7111 is contrary and inimical to the interests of the utility ratepayers of the United States. It should not be enacted. If it is enacted, Congress will have sanctioned the practice of charging utility ratepayers for fictitious taxes and will have prevented the regulatory agencies from interfering with that practice. Such a step is a drastic departure from good regulatory procedure. It will be costly for the ratepayer. It cannot be justified on the ground of the purported need to furnish an incentive for utilities to make new investment.

That incentive already exists. Utility regulation already provides an incentive for utilities to make timely and adequate new investments. In the first place, utilities are under legal obligation to make such investments in order adequately to serve the public for which they have assumed utility responsibility. This includes an obligation to serve the growing demands of the public. Second, utilities run practically no risk in making such investments: a fair return on their rate base, including needed additions thereto, is virtually guaranteed to the utilities not only by the Constitution but by statutory law and judicial holdings. Third, utilities have experienced not the slightest difficulty in attracting the capital necessary to make such investments. The guarantees I have already mentioned furnish more than sufficient reassurance to investors, and I repeat that no further incentive to the gathering or the expenditure of capital is necessary.

The comments this Commission has received concerning this matter, as well as the testimony of the Secretary of the Treasury prior to enactment of the investment tax credit law, persuade me that it would be costly, wrong, and unproductive from the point of view of the national welfare for the Congress now to force regulatory agencies to extend to the utilities of this Nation an unneeded windfall in the form of an allowance for fictitious taxes.

H.R. 7111 can only unjustly enrich the utilities at the expense of their captive customers. It can have no other result. It should not be reported to the floor by your committee. If it is reported, it should be defeated by the House.

Senator GORE. Mr. Chairman, this is one illustration of the generalized statement I made earlier today that most of this bill, about 300 pages of it, deals with special provisions that do not relate to tax reduction for the American people. Here is an example of a tax-free subsidy which is proposed to be written into permanent law. The Chairman of the Federal Power Commission comes here opposing it. He submitted a letter to the other body. It was not printed, not made public. This is the first time anyone has had an opportunity to testify upon this important issue.

I would like to put into the record at this point a table, the accuracy of which I cannot substantiate. The table was prepared by the Council of Electric Consumers, and I submit it for the record with that understanding.

It shows that tax-free dividends are already great; that consumers are being required to pay high rates which are not altogether reflected in taxation by the utilities receiving them, and it seems to me that this bill would worsen the situation.

I ask unanimous consent that this table be inserted in the record.

Senator BENNETT. Does the table indicate the sources of other tax-free dividends as you describe it?

The CHAIRMAN. Without objection.

(The table referred to follows:)

Tax-free dividend payments by private power companies

	Tax-free dividends paid, 1954-61 (*)	Tax-free dividends paid in 1962		Tax-free dividends paid, 1954-62
		Dollars tax-free	Percent tax-free	
Arizona Public Service	$2,306,539	$4,156,750	65	$6,463,289
Atlantic City Electric	7,774,952	3,311,814	57	11,086,7[illegible]
Brocton Edison	1,150,776	109,865	9.4	1,260,641
California Electric Power	9,622,376	2,522,478	76.3	12,144,854
California Oregon Power (C) [1]	17,799,341	----------	----------	17,799,341
California Oregon Power (P)	534,583	----------	----------	534,583
Central Hudson Gas & Electric	6,672,855	809,326	22.66	7,482,181
Central Louisiana Electric	6,568,425	656,139	22.7	7,224,564
Central Maine Power	4,652,279	160,213	2.989	4,812,492
Connecticut Light & Power	8,800,497	2,025,554	18	10,826,051
Connecticut Power [2]	1,340,731	----------	----------	1,340,731
Detroit Edison	77,534,088	5,499,762	17	83,033,850
Duquesne Light	3,830,376	4,884,000	29.6	8,714,376
El Paso Electric	2,800,354	158,104	6	2,958,458
Essex County Electric [3]	565,796	----------	----------	565,796
Fall River Electric Light	780,516	131,527	19.6	912,043
Fitchburg Gas & Electric	141,621	94,315	22.11	235,936
Florida Power	760,396	----------	----------	760,396
Florida Public Utilities	171,159	51,565	16	222,724
Gulf State Utilities	8,215,451	320,546	3	8,535,997
Hartford Electric Light	16,612,631	1,777,680	36	18,390,311
Haverhill Electric [4]	176,474	----------	----------	176,474
Idaho Power	8,321,531	1,714,500	27	10,036,031
Illinois Power (C)	3,201,000	----------	----------	3,201,000
Illinois Power (P)	1,877,064	----------	----------	1,877,064
Interstate Power	985,834	203,800	6	1,189,634
Lawrence Electric [4]	466,917	----------	----------	466,917
Lowell Electric Light	522,886	----------	----------	522,886
Maine Public Service	342,451	185,597	28.3	528,048
Merrimack-Essex Electric	2,649,636	----------	----------	2,649,636
Missouri Public Service	339,300	----------	----------	339,300
New England Electric System	21,719,793	6,818,204	45	28,537,997
New England Power (P)	347,568	----------	----------	347,568
Niagara Mohawk Power	65,351,824	7,592,700	30	72,944,524
Oklahoma Gas & Electric	9,454,012	704,291	8	10,161,303
Orange & Rockland Utilities	825,215	194,080	7.48	619,295
Pacific Gas & Electric	21,443,270	17,4 1,393	30.9	38,894,663
Pacific Power & Light (C)	45,886,056	13,512,000	100	59,398,056
Pacific Power & Light (P)	6,242,658	2,546,000	100	8,788,658
Portland General Electric	15,206,607	3,365,076	57.2	18,571,683
Public Service of Indiana	24,318,968	1,021,486	8	25,340,454
Public Service of New Hampshire	7,991,987	2,155,560	55.2	10,147,547
Rockland Light & Power [5]	2,783,439	----------	----------	2,783,439
Southern Berkshire Power & Electric [6]	190,646	----------	----------	190,646
Southwestern Electric Service	1,484,083	160,511	51.635	1,644,594
Southwestern Public Service	7,620,462	1,761,859	18.9	9,382,321
Suburban Electric	1,480,291	----------	----------	1,480,291
Union Electric	44,344,614	10,642,067	5.1	54,986,681
Utah Power & Light	4,671,975	2,636,008	40.8	7,308,063
Virginia Electric & Power	4,062,107	----------	----------	4,062,107
Washington Water Power	28,030,103	2,370,474	41.51	30,400,577
Weymouth Light & Power [6]	435,990	----------	----------	435,990
Worcester County Electric	5,117,085	----------	----------	5,117,085
Total	516,027,588	101,708,324	----------	617,735,912

[1] Merged with Pacific Power & Light, 1961.
[2] Merged with Hartford Electric Light, 1956.
[3] Name changed to Merrimack-Essex, 1957.
[4] Merged with Merrimack-Essex, 1957.
[5] Name changed to Orange & Rockland Utilities, 1958.
[6] Merged with Massachusetts Electric, 1961.

Sources: For percent of dividend payments considered tax-free by companies, various financial publications. For total dividend payments, company reports to FPC. Computations by ECIC. Dividend payments are those made on common stock, except where noted. Where company paid tax-free dividends on both common and preferred, each is identified. (C)—On common stock. (P)—On preferred stock. (*)—Not all companies paid tax-free dividends in all years from 1954 through 1961. For year-by-year breakdown, see Nov. 30, 1961, and Jan. 7, 1963, ECIC Newsletters.

Senator BENNETT. Does the table indicate the features of other tax bills?

Senator GORE. I submit the table to the Senator from Utah.

I have no information about the table except the indexes that are given there, along with the table. It was furnished me by the Electric Consumers Information Committee with headquarters at 2000 Florida Avenue, Washington, D.C. The executive director is Mr. Marvin Zeldin.

If anyone has questions as to the accuracy of the statistics used, we can make further inquiry.

Senator BENNETT. I am just trying to get a definition of the phrase "tax free dividends." Can you help us, Mr. Swidler?

Mr. SWIDLER. I do not purport to be an expert on these things, but I understand that this arises out of passing along to shareholders tax benefits made available by Congress which exceed true costs, where a tax benefit is accorded over and above what is allowed for ratemaking purposes.

We have Mr. Russell Rainwater, the Commission's chief accountant, here, and if you would like a more precise or elaborate explanation I would be glad to call him.

Senator BENNETT. I do not think we need to tie the committee up, but if there are other sources, other types, other tax benefits which, by law, may not be included in the ratemaking process, I would like to know what they are.

Mr. SWIDLER. So far as I know, there is not now any requirement by the Congress that would limit the Federal regulatory agencies in determining costs in a realistic way for ratemaking purposes. This would be the first.

Now, in some of the States—you understand that the electric power companies, in particular, are 90-plus percent in strictly retail operations, and that the major rate impact upon them would be from the State commissions rather than from the Federal Power Commission. The States have varied in their treatment of liberalized depreciation, and some permit full normalization and full return and this, I think, would increase the amount of the so-called tax-free dividends.

Senator McCARTHY. Mr. Chairman, may I ask, are there any forms of income that a public utility might earn that are not considered when you are determining its rate of return on investment?

Mr. SWIDLER. With respect to——

Senator McCARTHY. If the utility had money invested, let us say, in tax-exempt securities, how would you treat the income from those securities? Would they be included for ratemaking purposes or are they entirely exempt?

Mr. SWIDLER. If the amount of the capital were in the rate base, for example, if this were a reserve that was needed in its utility business and upon which the company had made a temporary investment in securities, if we allow the investment as a part of the rate base as a needed reserve, then any earnings would also be included as a part of the jurisdictional return or jurisdictional earnings.

Senator McCARTHY. No matter what the investment was?

Mr. SWIDLER. Assuming that it was reasonable and was included in the rate base.

Senator McCARTHY. Say it was an investment in municipal bonds, which would be tax exempt. It would not make any difference, this is the question?

Mr. SWIDLER. For ratemaking purposes it would not make any difference; no, sir.

Senator McCARTHY. And it would be included as income?

Mr. SWIDLER. Yes, sir.

But in our operations, of course, we must always make segregation between jurisdictional and nonjurisdictional business, both for the natural gas companies and for the electric power companies, because in the case of the natural gas companies, in particular, they carry on many nonjurisdictional activities. They are in petroleum production over which we have no jurisdiction, as such. They are in many other activities related and unrelated to the natural gas business.

With respect to the electric power companies, we must make the segregation between the intrastate and the interstate aspects of the business.

Senator GORE. Mr. Chairman, since this is a very important question and one upon which State regulatory agencies may well wish to make representation to this committee, I would like to hear briefly from Mr. Rainwater on this subject. He is an expert on it, and I would like to know just how this is going to affect the——

Senator BENNETT. Can Mr. Rainwater identify this phrase "tax-free dividends"?

Mr. RAINWATER. I believe I can.

Senator BENNETT. Of course, rainwater is a tax-free dividend [laughter] particularly out in our country.

Senator GORE. Not if it is radioactive. [Laughter.]

Mr. RAINWATER. I believe I can explain very simply what the term "tax-free dividend" means. We have a situation where a company has taxable income of a given amount that rarely, if ever, equals the amount of the book income. As a rule, book income is greater because of the various types of deductions which they may get for tax purposes.

Now, if the taxable income is less than the book income, and the dividends that come out of book income are sufficient to exceed the amount of taxable income, then the amount that exceeds the taxable income becomes tax free in the sense that it is treated for tax purposes as a reduction in the original investment; in other words, a reduction in capital.

Senator GORE. Then it passes through the corporation, the utility, to the stockholder without the incidence of taxes.

Mr. RAINWATER. At that time: yes, sir. But in the event the stockholder at a later date sells his stock, then this tax-free dividend benefit that he gets is deducted from the base; it is affected there at the end when he sells the stock.

Senator BENNETT. Isn't that true of any corporation that if its dividend exceeds its income, this is the balance, the difference, which is regarded as a return of capital?

Mr. RAINWATER. Yes, sir; that would be so; yes, sir; if we are talking about book income.

Senator BENNETT. Yes.

Mr. RAINWATER. Tax free dividend is a special term. It is related only to the difference between taxable income and book income, and

to that extent you might have a dividend that was perfectly proper from a corporate standpoint, and is available from book income, and it is not a return of capital, but for tax purposes it would be a return of capital because there was not enough taxable income to cover it. That is the reason that you get that distinction.

Senator BENNETT. Well, a company operates at a loss but still maintains a dividend pattern, and you could say the same thing. It did not have enough taxable income to cover its dividends, had no taxable income, but it continued to pay a dividend out of its surplus, so this becomes "tax-free income."

Mr. RAINWATER. That would not necessarily be from a tax standpoint. It is necessary to compare your dividends with what dividends have been paid as compared with your reported taxable income.

Senator BENNETT. I do not see any difference.

Mr. RAINWATER. It is a term that relates wholly to the differences between corporate book income and taxable income.

Senator BENNETT. But it creates, in this kind of a statement it creates, the illusion that these electric power companies are escaping taxation on a certain part of their income, and they are not, in fact. They are subject to all their taxable income as determined by the limits of the tax law.

Mr. RAINWATER. That is true; yes, sir.

Senator MCCARTHY. Let me ask you a question. Is it true that in the case of power companies that the amount of tax-free dividends that is paid is generally much higher than in the operation of other forms of business and, if so, why is this the case?

Mr. RAINWATER. I am not aware that it is higher than other forms of business. I have never made any study of that kind, but I do know that there are a substantial number of utilities that are in a fairly high percentage of tax-free dividends, some as high as possibly 80 percent.

Senator MCCARTHY. I think in most cases the corporation pays dividends out of earned income, does it not? As a general rule, dividends are not paid by distribution of capital, not year after year. Why is this not the case with the private utilities? What is the source of the year after year of a tax-free dividend?

Mr. RAINWATER. I am sure to some extent in others than the utilities, would be different, I am sure would be considerably different, and that is the fact that industries generally, other than utilities, will record the same depreciation for book purposes that they do for tax purposes. Many utilities do not.

Your depreciation for tax purposes may be considerably greater than your depreciation for book purposes, which will tend to reduce your taxable income. So if you compare, in that situation, your taxable income with your book income, you have a lower taxable income, and the amount of dividends paid which may be entirely proper from the corporate standpoint, may be partly tax free because it is——

Senator BENNETT. They are not tax free.

Mr. RAINWATER. As that term is used.

Senator BENNETT. Yes.

It seems to me we are developing the fact that this is a term that is, that creates, an unfair connotation. The Internal Revenue Service determines what rate of depreciation is fair for income tax purposes,

and any company whose rates is accepted by the IRS cannot be accused of having a "tax-free situation." If you carry this out to its logical conclusion, the 48 percent that a company maintains, after taxes, is tax free, and to me that is a completely false connotation in that it creates the impression that the company is evading taxes and has a dividend to pay out of a source of income that has escaped taxation.

Actually in the end it can only pay its dividends out of that portion of its gross income which is left after taxes; is that right?

Senator GORE. Maybe I can be of a little assistance to my friend from Utah.

As I understand it, a dividend which is interpreted under the circumstances as a return of capital is tax free to the stockholder when he receives it. Is that correct?

Mr. RAINWATER. At the time he receives it; yes, sir. But when he sells his stock at some later date——

Senator BENNETT. It reduces his base.

Mr. RAINWATER. It reduces his investment base, so that he would have to pay at that time.

Senator GORE. But at that time he would pay a capital gains tax, but meanwhile he has already gotten a reduction in his ordinary tax.

Mr. RAINWATER. That is correct; yes, sir. So maybe that helps it.

Senator BENNETT. If somebody hands you back $10—if you invest $100 in a corporation, and the corporation gives you back $10 of it—it is your money they are giving you back. This is not income on which you owe an income tax.

Senator GORE. You are speaking of a real situation, whereas this is one artificially created by law. Let me read you from a description of this process in Barron's:

> Companies subject to Federal or State regulation often are permitted to figure net income two different ways: once for tax purposes, and once for regulatory purposes. When regulatory income exceeds tax income, the difference, if the company sees fit, may be paid to shareholders as a tax-free return of capital.

As I understand that, that is what you told us in a little different language a few moments ago.

Mr. RAINWATER. Yes, sir; except that there they refer to regulatory income, and I referred to corporate book income.

Senator GORE. Yes. Well, corporate book income is the basis on which——

Senator BENNETT. The tax is collected.

Senator GORE. No, not the basis on which taxes are collected, but on the basis of which rates are made.

Mr. RAINWATER. Yes.

Senator GORE. Now, we come directly to this provision in the bill. This would set up more of the same thing and freeze it into permanent law.

Mr. SWIDLER. Yes, sir.

Senator GORE. And this is why you are coming to testify against it?

Mr. SWIDLER. No, sir. I am not concerned about the effect upon the shareholder, except indirectly. I am concerned about the effect on the ratepayer.

Senator BENNETT. You are concerned about the effect upon your responsibility and your power to fix rates under the law under which you operate.

Mr. SWIDLER. Yes, sir. I am concerned about our ability to fix rates which are just and reasonable—no more, no less—and to do it in an effective, flexible, and fair way.

Senator GORE. Well, I accept the correction. You limit your testimony to the responsibility of the office which you hold.

Mr. SWIDLER. Yes, sir.

Senator GORE. Which is a regulatory office.

Mr. SWIDLER. Yes, sir.

Senator GORE. As a Senator undertaking to represent the public weal, I must look also to the equity of tax-free dividends to the shareholder, as well as the estoppel against consideration by the Commission of these tax favors in ratemaking cases. So I want to ask you one more question, and then I will desist.

Were you asked by anyone in higher authority, in the administration, to testify here or did you come upon your own responsibility under the office which you hold?

Mr. SWIDLER. I came upon invitation, Senator Gore, and I am not sure to what initiative I owe the honor of the invitation.

Senator GORE. You were not asked by anyone in the administration to testify?

Mr. SWIDLER. No, sir. I was not asked by anyone in the administration to testify.

Senator GORE. You are the chairman of an independent regulatory agency?

Mr. SWIDLER. Yes, sir.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Swidler was invited by the chairman at the request of a member of this committee.

Are there any further questions?

Senator CARLSON. I have a number of questions coming from a State, of course, that is greatly concerned about the rate structure, tax structure, and the regulations of your great department.

You mentioned to the Senator from Tennessee that you not only have the tax section but you have the regulatory features of these organizations and corporations, and I think you can help me answer a letter I got yesterday.

I received a letter, yesterday, from one of the officers of the REA co-ops in Kansas, and he wrote and complained of the fact—he said it is a fact—that your agency is assuming regulatory powers over the rural electric cooperative; is that correct?

Mr. SWIDLER. May I answer that——

Senator CARLSON. I will be glad for any help I can get.

Mr. SWIDLER. Yes; I would be glad to try to explain that situation, which is one with which I am quite familiar.

The Federal Power Act applies to all persons owning electric power facilities utilized in interstate commerce except municipalities and other public agencies. Nothing is said about cooperatives, as such, one way or the other.

Now, when the new Commissioners took office we found that the Federal Power Act was more honored in the breach than in the ob-

servance, and that, as a practical matter, insofar as regulation of transactions in interstate commerce was concerned, it was almost a dead letter. We had given effective administration—I speak of my predecessors—to the accounting provisions of the statute. There had been effective administration of the licensing provisions of the statute, but with respect to the regulation of transactions in interstate commerce it was virtually nonexistent. We had not even published a list of the companies subject to our jurisdiction, and I believe we were the only regulatory agency in the world which did not know who we were regulating. The people we were supposedly regulating did not know whether they were under our jurisdiction or not, and no effort had been made to resolve these questions.

We undertook when we took office, to change this, to provide a forum where the buyers and sellers of electricity in interstate commerce could look for resolution of their conflicts and controversies, and where it would be possible to prescribe fair and reasonable terms, as well as just and reasonable rates, for the sale and the interchange of electricity in interstate commerce.

In preparing this list, the first ever published, we were brought squarely to the question, should it or should it not include electric power cooperatives?

The statute did or did not cover them, Senator Carlson. We had to decide the question one way or the other.

We first sought an opinion from Richard Solomon, our General Counsel, a copy of which I have with me, if you are interested, and I offer this for the record.

(The document referred to follows:)

OPINION OF THE GENERAL COUNSEL RE FEDERAL POWER COMMISSION AUTHORITY OVER COOPERATIVE BORROWERS FROM THE RURAL ELECTRIFICATION ADMINISTRATION

This opinion is directed to the question, put to the undersigned, whether the Commission possesses any authority under the Federal Power Act, over the operations of cooperatives established under State laws to provide electrical service to their members, and financed, in whole or in part, by loans from the Rural Electrification Administration (REA). The opinion also considers the nature and extent of any such jurisdiction. For the reasons set forth below it is my view that—

1. The fact that persons engaged in the transportation or sale for resale of power in interstate commerce are organized as cooperatives or secure some or all of their funds from the REA does not act to remove them from the category of public utility, if they otherwise come within the provisions of section 201(e) of the act.
2. The Commission is not authorized to pass upon actions of the REA Administrator in making loans to cooperatives or other borrowers pursuant to his authority under the Rural Electrification Act of 1937, as amended.

In view of the separate considerations leading to these two conclusions, I have divided this memorandum into two parts.

I

DOES THE TERM "PUBLIC UTILITIES," AS USED IN SECTION 201(f) OF THE FEDERAL POWER ACT INCLUDE PERSONS OWNING OR OPERATING FACILITIES FOR THE TRANSMISSION OR SALE FOR RESALE OF ELECTRICAL ENERGY IN INTERSTATE COMMERCE WHO ARE ORGANIZED AS NONPROFIT COOPERATIVES UNDER STATE LAW, OR SECURE ALL OR PART OF THEIR FINANCING FROM REA LOANS?

A. The language of the statute

In answering this question we start with the language of the statute. Part II of the Federal Power Act governing the regulation of electric utility companies

in interstate commerce, applies to the "transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce * * * (sec. 201(b)) and gives the Commission "jurisdiction over all facilities for such transmission or sale of electric energy * * *" (ibid). "Any person who owns or operates facilities subject to the jurisdiction of the Commission under this part" is by definition a "public utility" (sec. 201(e)). The only categories of persons which the statute expressly exempts from the provisions of part II are "the United States, a State or any political subdivision of a State, or any agency, authority, or instrumentality of any one or more of the foregoing, or any corporation which is wholly owned, directly or indirectly, by an one or more of the foregoing, or an officer, agent, or employee of any of the foregoing acting as such in the course of his official duty * * *" (sec. 201(f)).

Such "public utilities" are expressly subject to the interconnection provisions of section 202 (b) and (d); the disposition of property, consolidation, and security acquisition provisions of section 203(a), the security approval provisions of section 204 (sec. 204 does not apply where the public utility is organized and operating in a State which provides for regulation of its security issues); the rates and charges provision of sections 205 and 206 (which, of course, do not include any authority over retail rates), the adequate service provisions of section 207, and the cost of property provisions of section 208. In addition, a "public utility" is subject to the accounting and depreciation requirements of sections 301 and 302, as well as to certain specific procedural provisions of the act (secs. 209(b), 304, and 306).

The definition of a public utility in the Federal Power Act is stated in terms of the types of facilities a person owns or operates, rather than the organizational structure of the "person" owning or operating the facilities, the source of its financing, or the nature of the service, if any, it holds itself out to perform. Congress' intent to focus upon the nature of the facilities owned or operated, rather than the nature of the person owning or operating these facilities, was manifested by the amendments to section 3 of the Federal Water Power Act (adopted simultaneously with parts II and III), to define the term "person" and broaden the existing definition of the word "corporation." Person was defined to mean "an individual or corporation." And "corporation," which previously had been defined as "a corporation organized under the laws of any State of the United States empowered to develop, transmit, distribute, sell, lease, or utilize power * * *" was now defined to refer generally to "any corporation, joint-stock company, partnership, association, business trust, organized group of persons, whether incorporated or not, or a receiver or receivers, trustee or trustees of any of the foregoing." The reason given for this change by the House committee report (H.R. 1318, 74th Cong., 1st sess., p. 22) is significant. It states "[T]he definition of 'corporation' is *broadened*; at present the term relates only to electric companies, but in drafting the new sections it has been more convenient to have it relate to all corporations *and similar forms of business organizations*." [Emphasis added.]

The definition of the parties subject to Commission regulation under part II is to be contrasted with jurisdictional definitions in analogous Federal regulatory statutes which uniformly have defined the regulated class in terms of the type of service they perform for the public.[1] Significantly where the regulatory scheme of such acts differentiates as to type of regulation on the basis of the nature of the holding out of the company performing the service, this is expressly stated in the statutes themselves.[2] Also, where Congress intended to

---

[1] See Interstate Commerce Act, title 1, 49 U.S.C. 1(1)(3) (railroads and pipelines, other than for natural gas); 302–303 (motor carriers) 902, 904 et seq. (water carriers); 1002 (freight forwarders); Federal Aviation Act, 49 U.S.C. 301 (air carriers); Communications Act of 1934, as amended, 47 U.S.C. 153(h) and title II (communications common carriers by wire or radio); Shipping Act of 1916, as amended, 46 U.S.C. 801 (common carriers by water in foreign and interstate commerce); cf., Mineral Leasing Act of 1920, 41 Stat. 449, as amended, 30 U.S.C. 185 (1958), making certain pipelines securing right-of-way permits from the Secretary of the Interior "common carriers."

[2] See title III of the Interstate Commerce Act, 49 U.S.C. 301, et seq., esp.; 304, 306–310, distinguishing between the regulations of motor carriers on the basis of whether they are "common carriers" (49 U.S.C. 303(a)(14) or "contract carriers" (49 U.S.C. 303(a)(15), and prescribing a still different degree of regulation over "private carriers of property" (49 U.S.C. 303(a)(17); title IV of the Interstate Commerce Act, 49 U.S.C. 901, et seq., making similar distinctions between "common" and "contract" carriers by water (cf., 49 U.S.C. 90 2(d)) with 49 U.S.C. 902(e), see e.g., 49 U.S.C. 906, establishing the different standards for common and contract carriers by water with respect to their tariffs and schedules). Cf., the Communications Act of 1934, as amended, 47 U.S.C. 151, et seq., which provides for the licensing of all persons engaged in interstate or foreign radio communications (title III of the act) and superimposes thereon detailed rate and service regulations of radio "common carriers" (title II of the act).

exempt cooperatives from regulatory language otherwise broad enough to include them, it has done so by specific language. See 49 U.S.C. 1002, *United States* v. *Pacific Coast Wholesalers Ass'n.*, 338 U.S. 689. On the other hand, where, as here, a statute contained no such exemption, the courts have held that a cooperative air freight forwarder was an indirect air carrier under the Civil Aeronautics Act of 1938. *Consolidated Flowers Shipments* v. *Civil Aeronautics Board*, 218 F. 2d 814 (CA 9).

The legislative history of section 201(e) fully supports this proposition that the term "public utility" was not intended to import into the statute the concept of a holding out to serve the public generally. From the start, the Commission's jurisdiction under part II of the Federal Power Act was drafted in terms of persons owning or operating jurisdictional facilities rather than any consideration of the manner in which such persons were organized to do business or the nature of their holding out to the public, and the term "public utility" was used merely as a shorthand device to refer in subsequent sections of the act to persons subject to the Commission's jurisdiction. See H.R. 5423, 74th Congress, 1st session, as introduced on February 6, 1935, page 104 [3]; S. 1725, 74th Congress, 1st session, as introduced February 6, 1935, page 105. And in the Senate hearings, Mr. DeVane, the Solicitor of the Commission, who was largely responsible for the original draft of parts II and III, submitted an "analysis" of the bill, stating (hearings before Senate Committee on Interstate Commerce on S. 1725, 74th Cong., 1st sess., p. 246):

"The term 'public utility' is used for convenience to define the operating companies that come under the provisions of the title. In subsequent provisions it is thus unnecessary to make constant reference to the limited jurisdiction of the Commission; use of the term 'public utility' carries with it this essential limitation."

Nowhere in the hearings, reports, or debates was there any suggestion that the plain meaning of section 201(e) was in any way to be limited beyond its terms. Specifically, there was no suggestion that it did not apply to cooperatives or to borrowers from governmental sources.

B. The administrative "history" of Commission jurisdiction over cooperatives

In view of the above, I should conclude that the Commission's jurisdiction over public utilities included jurisdiction over cooperatives owning or operating jurisdictional facilities, even if this jurisdiction had lain totally dormant during the 28 years since part II of the act was enacted. For an agency's failure to utilize statutory authority does not result in waiver or lapse, even where it may in the meantime have taken the position that it does not possess the authority. *Phillips Petroleum Co.* v. *Wisconsin Public Service Commissons*, 347 U.S. 672, 677–678 (1954); *United States* v. *DuPont*, 353 U.S. 586, 590 (1956); *United States* v. *American Union Transport Co.*, 327 U.S. 437, 454–55 (1945); *Union Stockyard Co.* v. *United States*, 308 U.S. 213, 224 (1939). In fact, however, the administrative history is consistent with and supports the position I have reached.

It is argued that the views expressed by the Federal Power Commission when the REA Act was before Congress are inconsistent with its exercise of any jurisdiction over borrowers from that agency. For the Commission, in response to a request for its comments, generally approved the proposed legislation and limited its specific comments to pointing out a possible conflict between its powers to investigate all facets of electric service with the provision which would authorize the REA Administrator to investigate rural electrification. Surely it is argued, if the Commission at the time thought it had any other responsibility with respect to potential REA borrowers it would have said so.

If there were no other contemporaneous statements of Commission views on the subject, this position might be plausible. Absent such statements, it could be argued that the Commission's failure to mention other aspects of its jurisdiction over REA borrowers was merely because it didn't conceive such jurisdiction as conflicting with that to be given the REA.[4] Another reason for the failure of

[3] "Every person who owns or operates facilities subject to the jurisdiction of the Commission under this title and every person who controls, directly or indirectly, any such person, shall be subject to the provisions of this act. (The term 'public utility' when used in this act means any person who owns or operates such facilities."

[4] To the extent that such absence of conflict could not be said to exist if the Commission's jurisdiction over security issues under sec. 204 does not extent to passing upon potential REA loans, this merely conforms to the views expressed in pt. II of this opinion.

the Commission to refer to its own jurisdiction over public utilities may well have been the general lack of prescience as of 1935 that the rural electrification program would expand to include many companies owning or operating jurisdictional facilities.[5]

But we are not left to surmise as to the current views of responsible members of the FPC and REA as to the scope of Commission jurisdiction over REA borrowers. For on January 11, 1936, prior to the passage of the REA Act, the "broad definition" of the newly adopted parts II and III of the Federal Power Act was interpreted by Dr. Jack Levin, Assistant Counsel of the REA (then operating pursuant to Executive Order No. 7037, May 11, 1935) as "includ[ing] besides public utilities, cooperatives and other public bodies the REA makes loans to."[6] Specifically, he stated "the broad definition of corporation, licensee, municipality, project cover all classes of REA borrowers."[7] A copy of this memorandum was sent to the FPC. Thereafter on January 22, 1936, Mr. Levin wrote the FPC Chairman, Frank R. McNinch, asking whether "the contract for an REA loan * * * require[s] * * * the approval of the Federal Power Commission" and whether "the rate given by the [prospective borrower] require[s] * * * approval."[8] The Chairman replied by letter of January 24, 1936, that he believed the note was a security requiring this Commission's authorization provided that the borrower already owned or operated other jurisdictional facilities.[9]

The same question was raised with respect to a hypothetical borrower in a letter from the REA's General Counsel to Mr. Oswald Ryan, then FPC General Counsel. The hypotehtical borrower was clearly outside this Commission's jurisdiction because it was an intrastate distributor, purchasing all its energy intrastate. Mr. Ryan wrote in a letter dated February 8, 1963: "* * * the character of the organization seeking a loan is relatively unimportant, as the status of public utility is conferred upon any person owning or operating facilities subject to the jurisdiction of the Commission under part II of the Federal Power Act. Such public utility status therefor (sic) may attach to cooperatives as well as to corporations engaged in the business of selling electric energy to consumers for a profit" (id. at p. 1).

There does not seem to have been any formal assertion of Commission jurisdiction over REA cooperatives during the following 11 years (or for that matter, any rejection of jurisdiction during this period). Commencing in 1947, however, the Commission has asserted its jurisdiction over REA cooperatives in a series of proceedings. The principal situation in which this has occurred is with respect to proceedings under section 203 where cooperatives have leased or sold their assets to investor-owned public utilities. See, e.g., *Ark-La Electric Co-op, Inc.*, 6 FPC 1037 (1947); *Montana-Dakota Utilities & Dakotas Electric Co-op, Inc.*, 8 FPC 869 (1949); *Frontier Power Co.*, 9 FPC 1298 (1950); *Black Hills Power & Light Co. and Rushmore G. & T. Electric Cooperatives, Inc.*, 10 FPC 864 (1951). It has been contended that in each one of these cases an investor-owned utility was also involved as buyer or seller, and thus the finding that the co-op was a public utility was necesasry dicta. Whether or not this is true, it does not detract from the fact that the Commission since 1947 has uniformly made such findings. Moreover, in at least one case (*Black Hills Power & Light Co., supra*), the Commission's finding was made in the course of rejecting a motion to dismiss for want of jurisdiction.

Similarly the Commission in a number of cases has advised REA co-ops that sell power at wholesale in interstate commerce by participating in power interchanges with investor-owned companies, that they, too, were required to file rate schedules pursuant to section 205. See, e.g., letters to Minnkota Power Co-

[5] As a result of the FPC statement an amendment was offered to what is now sec. 2 of the Rural Electrification Act to require REA investigations of REA's to be made "in cooperation with the Federal Power Commission" (80 Congressional Record 2824). The amendment was objected to by Senator King on the ground that it would imply that the Commission, contrary to his understanding, had authority to investigate rural electrification (ibid.). But nothing in Senator King's statements or Senator Norris' replies thereto can be read as indicating that they believed the Commission had no jurisdiction over REA borrowers. On the contrary, King stated, "I have no objection to the Federal Power Commission proceeding under the authority which they now possess * * *" and proposed only that the section be redrafted to provide that "nothing in this section shall be so construed as to impinge upon or interfere with any of the authority conferred upon the Federal Power Commission" (id. at 2824–2825).

[6] Levin, memorandum to Vincent Nicholsen, REA General Counsel, re: Jurisdiction of the Federal Power Commission over REA, Jan. 11, 1936, p. 1.

[7] Id. at 4.

[8] Letter from Jack Levin to FPC Chairman Frank R. McNinch, Jan. 22, 1936, p. 1.

[9] Letter from FPC Chairman McNinch, Jan. 24, 1936, p. 1.

operative, Inc., November 16, 1950; September 9, 1955; December 3, 1956; February 1, 1957; December 8, 1957; and November 10, 1960; Coos-Curry Electric Cooperative, Inc., December 15, 1950; June 21, 1951; Dairyland Power Cooperative, August 14, 1961. In each case the cooperative responded by filing certificates of concurrence with already filed rates (as permitted by sec. 35.3 of the Commission's regulations). And at least one cooperative Tippah Electric Co-op, filed an original cost statement after being required to do so.[10]

I do not suggest that this sporadic administrative history standing by itself would be too persuasive. But it does demonstrate the invalidity of complaints that the Commission was in any way breaking new ground when it suggested in *Southwestern Power Administration-United States Department of the Interior*, 27 FPC 895, 898, that Associated Electric Co-op, which participated in an interstate interconnection agreement with other purchasers from the Administration, was an electric utility. It also underscores the irrelevance to the present question of the various attempts of Congress, during the very period the Commission was holding that cooperatives could be public utilities, to give the Commission specific new powers to review certain REA loans.

The proposals to give the Commission authority over REA loans were introduced, both in the form of legislative proposals and as riders to REA appropriations bills during 1946 and 1947. The first of these efforts (H.R. 5555, 79th Cong., 2d sess.), was a bill introduced in 1946 which would have precluded any REA loans for generation or transmission facilities unless the borrower had first secured the consent of a "State authority having jurisdiction in the premises, or, if there is no such State authority, unless the consent of the Federal Power Commission is first obtained; and the Federal Power Commission shall not give such consent unless it first determines that the proposed acquisition, construction [* * * etc.] will result in a lower cost of electricity to the rural electrification project * * * to be secured therefrom than could otherwise be obtained." The bill was not reported out of committee. But during the same Congress, a rider was offered to the Urgent Deficiency Appropriations Act of 1946, which would have precluded any REA loans for generating facility construction or acquisition "unless the Federal Power Commission would first certify that there is not sufficient electric current available in the area concerning the responsible rates" (92 Cong. Rec., 1799). There was considerable discussion of this proposal on the floor of the Senate (ibid. at 1799–1817), after which it was defeated by a vote of 52 to 21.

In the 80th Congress a bill was introduced (H.R 2709, 80th Cong., 1st sess., 1947) paralleling H.R. 5555 to which I have already referred. No action was taken on this bill. However, the House Committee on Appropriations, in reporting the 1947 Department of Agriculture appropriations bill, spoke favorably of the pending proposal (see H. Rept. 450, 80th Cong., 1st sess., p. 32). Apparently as a substitute for the proposed bill, the Senate report on the 1947 agricultural appropriations bill contained a paragraph instructing the REA Administrator to report proposed loans for generating plants to the two appropriations committees 30 days in advance of their approval.

All these proposed bills would have gone far beyond any existing authority the Commission may have over REA co-ops. The bills applied to all co-ops, whether or not they owned or operated jurisdictional facilities and were thus public utilities within the meaning of the Federal Power Act. And the standards under which the Commission would have passed upon proposed loans under these bills—that "there is not sufficient electric current available in the area concerned at reasonable rates" or that the proposal "will result in a lower cost of electricity in the rural electrification project * * * to be secured therefrom than would otherwise be obtained," are both more specific and more farreaching than any authority the Commission presently exercises over the security issues of public utilities under section 204 of the act. It was thus not surprising that Congressmen on both sides of the issue asserted that adoption of such a proposal would give the Commission significant authority it did not already possess. There is, however, no statement during the lengthy debates on the proposal that the Commission lacked any jurisdiction over REA co-ops. And while it can be said that a number of the Senator's statements indicated a belief that the Commission had no existing power to disapprove loans made by REA to co-ops, this is a proposition which, as indicated in part II, infra, is not inconsistent with the Commission's having jurisdiction over cooperatives owning or operating jurisdictional facilities, and in which I concur.

[10] These actions were taken by letters from the Secretary and not by formal Commission order. They are for this reason of lesser significance.

C. The contentions that section 201(e) should not be read literally

Since the literal meaning of the critical statutory language and its legislative history clearly supports a positive answer to the question presented, this interpretation, under normal standards of statutory construction must prevail in the absence of strong extrinsic evidence that Congress nevertheless did not intend the language to be so read, or that a literal reading would be inconsistent with other provisions of the act and the basic statutory scheme. See *Walling* v. *Portland Terminal Co.*, 330 U.S. 148 (1947); *Pillsbury* v. *United Engineering Co.*, 342 U.S. 197 (1952); *United States* v. *Shirey*, 359 U.S. 255 (1959). I have carefully examined the various arguments which have been made in support of such contentions and find them all to be unpersuasive.

It is strongly urged, that the definition of public utility must be read in the light of the language of section 201(a) of the Federal Power Act which generally states the need for exercise of the regulatory authority of parts II and III of the act. This section provides:

"It is hereby declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this part and the part next following and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest. such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States."

The argument is that only the business of transmitting and selling electric energy "for ultimate distribution to the public" is declared to be affected with a "public interest" and Federal regulation is declared to be in the public interest only with respect to "such business" or "such energy." Cooperatives, it is urged, sell only to their members and thus are not involved in either the transmission or sale of electrical energy for "ultimate distribution to the public."

Nothing in the legislative history of the Federal Power Act supports the suggestion that the language "for ultimate distribution to the public" was intended to limit the reach of the act to electric companies holding themselves out to provide electrical service to all members of the public (the "common carrier" concept) as contrasted with those who offered to serve only limited portions of the public (the "members" of cooperatives or others with whom they might "contract" to act as "carriers").

The phrase "ultimate distribution to the public" did not appear in the original draft of the Federal Power Act. It came into the body of the act as one of a series of amendments suggested by the National Association of Railroad & Utility Commissioners (NARUC). In explaining the new language, Mr. Benton, general solicitor of NARUC, stated that the intent was "to insert this declaration, which is taken from title III of the bill" and to add to it "a clear declaration by Congress of its intention to grant the power to the Federal body to regulate that which is beyond the jurisdiction of the local Commission" (hearings before the House Committee on Interstate and Foreign Commerce on H.R. 5423, 74th Cong., 1st sess., pt. 3 at p. 1677).

Mr. Benton explained that the only purpose of the amendment he proposed was to make clear where Federal authority left off and State authority began (ibid.). Nowhere in his testimony did he suggest that the amendment was designed to limit the phrase "public utility"—which was included in the original draft—to companies holding themselves out to serve all members of the public.

As Mr. Benton stated, the phrase "ultimate distribution to the public" "was taken from title III of the bill." Title III provided for Federal regulation of the natural gas industry, and was the basis for the Natural Gas Act passed several years later. It included in initial declaration of purpose to the effect that "the business of selling, transmitting, and distributing, as a part of interstate commerce, natural gas for ultimate public consumption is affected with a public interest * * *" (H.R. 5423, supra, p. 141). The draft also contained a provision, similar to that used in the draft of title II of the Power Act, providing that "persons" owning or operating natural gas facilities subject to the Commission's jurisdiction should themselves be subject to the jurisdiction of the act, and utilizing the term "distributor" as the shorthand name for all such persons.

Because the Congress recognized that title III would have to be rewritten, see hearings at 2212–13, it was not discussed in the committee reports or in the congressional debates. But eventually this phrase was incorporated in the Natural

Gas Act.[11] This strongly suggests that the phrase "ultimate distribution to the public" does not refer to the common carrier concept, since the Natural Gas Act does not make the pipelines "common carriers." [12]

We are thus left to speculation as to the intended meaning of the phrase "for ultimate distribution to the public." The most logical view is that this language was intended to do no more than to emphasize the fact that no Federal regulation was being imposed upon the transportation or distribution of power by a company solely for its own use. If so, it would be the policy statement analog of the provision in section 201(b) exempting from the Commission's jurisdiction facilities (and hence persons owning or operating only such facilities) "for the transmission of electric energy consumed wholly by the transmitter." [13]

Nor can it be argued that an electrical cooperative in providing service to its members is merely transmitting energy for consumption wholly by itself and hence its facilities are exempted by this latter provision of section 201(b). For, regardless of whether the relationship between co-ops and their members are such as to warrant different regulatory treatment than the relationship between a privately owned corporation and its customers, the cooperatives' members are no more the cooperative itself than a corporation's stockholders are the corporation. What obviously is covered by the exemption in both cases are lines used solely to transmit energy for use by the electric company itself rather than lines the company uses to serve individuals who "own" or are participating members in the company.

Moreover, even if it could be assumed that the phrase "ultimate distribution to the public" connotes a general holding out to provide service to all members of the public and that cooperatives do not fit such a classification (because they serve only their members), it would not follow that cooperatives would be exempted from the act. For the Supreme Court has conclusively determined that the general policy declaration of section 201(a) cannot serve to negate the grants of jurisdiction made elsewhere in the act. Thus in *United States* v. *Public Utilities Commission of California*, 345 U.S. 295, 310–311, the Court stated: [14]

"So we conclude that the limitations of section 201(a) on Federal regulation cannot, and were not intended to, preserve an exclusive State regulation of wholesale hydroelectric sales across State borders. Even if we conceived of the matter as one peculiarly limited to the statutory wording of section 201(a), our statement that '[e]xceptions to the primary grant of jurisdiction in the section are to be strictly construed,' *Interstate Natural Gas Co.* v. *Federal Power Commission*, 331 U.S. 682, 690–691, would be as applicable here as to section 1(b) of the Natural Gas Act. 'Production' and 'distribution' are elsewhere specifically excluded from Commission jurisdiction, section 201(b); the phrase relied on in section 201(a) was originally drafted as a declaration of 'policy,' and the rewording which gave it its present more succinct form was unaccompanied by any 'mention [of] this change as one of substance.' *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U.S. 61, 76, referring to H.R. No. 1318, 74th Congress, 1st session, 26. 'It cannot nullify a clear and specific grant of jurisdiction, even if the particular grant seems inconsistent with the broadly expressed purpose.' *Connecticut Light & Power Co.* v. *Federal Power Commission*, 324 U.S. 515, 527. To conceive of it now as a benchmark of the Commission's power, or an affirmation of State authority over any interstate sales for resale, would be to speculate about a congressional purpose for which there is no support."

---

[11] See Natural Gas Act, sec. 1(a) (15 U.S.C. 717(a) (1958)).

[12] See hearings before the Subcommittee on Interstate and Foreign Commerce on H.R. 11662, 74th Cong., 2d sess., at p. 38 (1936). *Cf.*, *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 338–339 (1956); Natural Gas Act, sec. 7(a), 15 U.S.C. 717f(a) (1958): Compare S. 1919, sec. 9(a), 75th Cong., 1st sess. (1937); Mineral Leasing Act, sec. 28, 30 U.S.C. 185 (1958).

[13] This provision appeared in the original draft of both the proposed title II of the Power Act and the proposed title III to regulate the transmission and sale of natural gas, in terms of the act not applying to facilities "for the transmission of energy [natural gas] solely for the use of the producer or transmitter or the use of his tenants on property owned or controlled by him and not for resale" (H.R. 5423, supra, pp. 104, 142).

[14] Language in the earlier opinion in *Connecticut Light and Power Co.* v. *Federal Power Commission*, 324 U.S. 515 at 525 that "the policy adminition [of sec. 201(a)] is to be heeded in determining whether particular facilities make their owner a 'public utility'" is not to the contrary. The context of this statement was whether particular facilities were "local distribution" facilities within the meaning of sec. 201(b)—a term not otherwise defined and of considerable ambiguity. As the latter citation from *Connecticut Light and Power*, cited in text above, makes clear, the policy statement has no force in undercutting a "clear and specific grant of jurisdiction" even if the latter is inconsistent with the policy declaration.

2. Despite the fact that there is no reference to cooperatives in the entire legislative history of the 1935 amendments to the Federal Power Act,[15] the proponents of excluding cooperatives from any Commission jurisdiction, argue that this history conclusively shows that only investor-owned profitmaking utilities holding themselves out to provide electric service to the public generally were intended to be covered.

This argument rests upon selected excerpts from colloquies during the House hearings on the bill between the Solicitor of the Commission, Mr. DeVane, a principal draftsman of title II, and a number of Congressmen (see hearings, supra, pp. 480, 481, 537–539, 543, 544) supplemented by some similar statements by FPC Commissioner Seavey (id. at 424, 437–438). They primarily involve questions relating to provisions of the bill, subsequently stricken, to impose common carrier obligations upon the public utilities subject to the Commission's jurisdiction and provide for certification of their lines. The issue was the scope of Congress constitutional power to impose such regulatory inhibitions on business in the light of the indefinite state of the interstate commerce clause as of 1935 and a series of decisions under the due process clause of the 14th amendment limiting the States power to interfere with business in general and the utility business in particular. In this posture Messrs. DeVane and Seavey not unnaturally stressed the existing cases which had held that private companies dedicating their services to the public generally—the group which made up the great bulk of the utility industry—were subject to such regulation.

There is absolutely nothing in this testimony which indicates that either DeVane or Seavey believed that the scope of the term "public utility" was limited to investor-owned companies holding themselves out to serve the public generally to the exclusion of cooperatives or other persons not assuming such obligations. On the contrary, in a memorandum on the constitutionality of the proposed part II of the act, submitted to the Senate by Mr. DeVane (and Oswald Ryan, the FPC General Counsel), the argument was carefully stated in terms that "*most if not all* of the companies affected by the present bill are undoubtedly organized as public utilities under laws of the States which created them. *Most, if not all of them,* have made use of the power of eminent domain * * *" (hearings on S. 1725, Public Utility Holding Company Act of 1935, before Senate Committee on Interstate Commerce, 74th Cong., 1st sess., p. 803). [Emphasis added.] Moreover, if this view had been adopted by the Congress, there would have been no need for inserting into the act the provisions of section 201(f) expressly excluding Federal or State instrumentalities (but significantly not cooperatives) from the regulator jurisdiction of the Commission under title II.

3. The cooperatives' other principal argument is that the Federal Power Act should not be construed to confer jurisdiction over them because some State courts have held that cooperatives are not public utilities subject to the jurisdiction of State utility commissions. Obviously, State cases are not dispositive of the question whether co-ops are public utilities under the Federal Power Act, since the State laws are different in important respects from the Federal Power Act and since Federal, not State, law governs this question.[16]

The argument cannot be made that Federal law should "follow" State law and exempt co-ops from regulation, because State law is not uniform. It runs the gamut from complete exemption of co-ops from regulation by State commissions,[17] through exemption from certain aspects of State commission juris-

[15] The only reference to REA in the legislative history of the Federal Power Act relates to the proper exercise of the certificate power which was contained in H.R. 5423, but deleted from the final bill. See hearings before the House Committee on Interstate and Foreign Commerce on H.R. 5423, 74th Cong., 2d sess., pt. 3, pp. 2159–2160 (1935). The cited colloquy concerned competing efforts by a hypothetical REA-financed municipality and a private power company to serve a rural area. Since the draft statute would not have given the Commission certificate jurisdiction over municipalities, the apparent assumption throughout the colloquy that the Commission's certificate jurisdiction would be exercised solely with respect to the private utility says nothing about FPC jurisdiction over REA borrowers, or cooperatives in general.

[16] Cf. *Waling* v. *Portland Terminal Co.*, 342 U.S. 197 (1952); *Jerome* v. *United States*, 318 U.S. 101 (1948); *Morgan* v. *Commissioner*, 307 U.S. 78, 80 (1940); *Burnet* v. *Harmel*, 287 U.S. 103 (1932).

[17] E.g., Alabama Code, title 18, sec. 57 (1958); Florida Statutes, sec. 366.02.11 (1959); Georgia Code Annotated, title 34A, secs. 131, 132 (1962); Purdon's Pennsylvania Statutes Annotated, title 14, sec. 282 (1958).

diction[18] to complete subjection of co-ops to the jurisdiction of State commissions.[19]

The argument may be that the phrase "public utilities" in the Federal Power Act should be interpreted as excluding co-ops because State cases construing that same phrase in State statutes have frequently held that it does not include cooperatives. See, e.g., *Sutton* v. *Hunziker*, 75 Ida. 395, 272 P. 2d 1012 (1959); *Socorro Electric Cooperative, Inc.* v. *Public Service Co. of New Mexico*, 66 N.M. 343, 348 P. 2d 88 (1959);[20] *Colorado Public Service Co.* v. *Public Service Comm'n*, 142 Colo. 135, 350 P. 2d 543 (1960);[21] *Inland Empire Rural Electrification* v. *Department of Public Service*, 199 Wash. 527, 92 P. 2d 258 (1939); *Garkane Power Co.* v. *Public Service Comm'n*, 98 Utah 446, 100 P. 2d 571 (1941). But, the State cases holding that co-ops are *not* "public utilities" were not decided in vacuo, but in the context of specific statutory definitions of "public utility," and as will be seen, where the definition follows the same pattern as that in the Federal Power Act, the State courts have held the cooperatives to come within this term. The State definitions generally differ from the definition of public utility in the Federal Power Act, Thus, the Utah statute at issue in *Garkane Power Co.* v. *Public Service Comm'n*, 98 Utah 446, 100 P. 2d 571 (1941), upon which the co-ops rely heavily, states that the term "public utility includes every * * * *electric corporation * * * where the service is performed for, or the commodity delivered to, the public generally*." [Emphasis in original.]

In the *Socorro Electric Cooperative* case, the preamble to the statute read:

"(A) Public utilities as hereinafter defined are affected with the public interest in that, among other things,

"(1) A substantial portion of the business and activities involves the rendition of essential public services to large numbers of the *general public*. [Emphasis added.]

"(2) Their financing involves the investment of large sums of money, including capital obtained from many members of the general public.

* * * * * * *

"(B) It is the declared policy of this State that the public interest, * * * and to the end that capital and investment may be encouraged and attracted so as to provide for the construction, development, and extension of proper plants and facilities *for the rendition of service to the general public and to industry*." 348 P. 2d at 89–90. [Emphasis in original.][22] And, in *Inland Empire Rural Electrification Inc.* v. *Department of Public Service*, 199 Wash. 527, 92 P. 2d 258 (1939), while the court appears to have decided the case largely on the basis of abstract principles of utility law, the State statute defined a "public service company" as an "electric company" and an "electric company" as "every corporation operating or managing any electric plant *for hire* within this State." 92 P. 2d 258, 261. [Emphasis in original.]

By contrast, in *Rural Electric Co.* v. *State Board of Equalization*, 57 Wyo. 451, P. 2d 741 (1942) the statute defined "public utility" in terms much like those used in the Federal Power Act.

The State statute reads:

"* * * The term 'public utility,' when used in this chapter, shall mean and include every person, or municipality, that owns, operates, leases, controls, or has power to operate, lease, or control:

* * * * * * *

"(c) Any plant, property, or facility for the generation, transmission, distribution, sale, or furnishing to or for the public of electricity for light, heat, or

---

[18] See, e.g., Burns Indiana Statutes Annotated, sec. 55–4418 (1962 supp.); *Boone County Rural Elec. Membership Corp.* v. *Public Service Comm'n.*, 129 Ind. App. 175, 155 N.E. 2d 1949 (1958). See also New Mexico Statutes Annotated, secs. 68–3–2(F)(1), 68–5–4.1 (1961); id., sec. 45–4–29 (1954).

[19] New Hampshire Revised Statutes Annotated, sec. 301.57 (1951); Michigan Revised Statutes, sec. 460.6; Colorado Revised Laws, sec. 115–1–3(b) (1961 supp.). The Colorado statute overruled the decision of the Colorado Superior Court in *Public Service Co.* v. *Public Utilities Comm'n*, 142 Colo. 135, 350 P. 2d 543 (1960), holding co-ops exempt from Commission jurisdiction.

[20] This decision was overruled by an amendment to the State statute explicitly making co-ops public utilities. New Mexico Statutes Annotated, sec. 68–3–2(f)(L) (1961 supp.).

[21] This decision was overruled by subsequent amendment to the State statute explicitly making co-ops public utilities. Colorado Revised Laws, sec. 115–1–3(b) (1961 supp.).

[22] The court also relied on the fact that the statute expressly exempted cooperatives from public service commission jurisdiction. On these grounds the court held that the public service commission was powerless to grant relief from a claimed encroachment on the co-op's territory, such relief being available only to "public utilities." This determination was overruled by the legislature. See footnote 13, supra.

power, including any conduits, ducts, or other devices, materials, apparatus, or property for containing, holding, or carrying conductors used or to be used for the transmission of electricity for light, heat, or power; etc."

The Court held that under that language, co-ops were "public utilities."[23] Like the Federal Power Act, and unlike the Utah, New Mexico, and Washington statutes, the term "person" in the Wyoming statute is written in terms of the types of facilities the "person" owns or operates and not whether he holds himself out to serve the public "generally" or "for hire."

Not only are most of the State cases cited by the co-ops and holding that they are not public utilities based upon statutes containing definitions of "public utility" distinguishable from the definition in section 201 of the Power Act, but also there are numerous cases in which State courts have held that co-ops are public utilities or public service corporations. See cases cited at notes 17–21, infra. The co-ops rightly point out that many of the State cases holding that co-ops are "public utilities" did not involve the question whether they were subject to State commission jurisdiction. This is hardly surprising. As we have seen, in many States where co-ops are active, legislatures have by statute either specifically exempted them from, or made them subject to some or all of the authority of the State commission. But the answers to a great many other questions not covered by these statutes may depend upon whether a co-op is accorded or denied public utility status. These questions include the constitutionality of conferring eminent domain powers upon a co-op,[24] whether it is subject to taxes levied upon "public utilities,"[25] whether it may exclude other electric companies from its service area,[26] and whether it must serve anyone willing to comply with reasonable membership requirements.[27] It is here that the State courts most frequently assign co-ops public utility status—even in the face of statutes exempting them from all or most of the State public service commission's jurisdiction.[28]

Focusing on the rate jurisdiction of a State commission, on the other hand, some State courts which have had to decide whether co-ops should be subject to such regulation have invoked the doctrine of "mutuality" and exempted the co-ops. That doctrine is set forth most clearly in *Garkane Power Co.* v. *Public Service Comm'n*, 98 Utah 460, 100 P. 2d 571, 573 (1940). The court wrote:

"In a cooperative the principle of mutuality of ownership among all users is substituted for the conflicting interests that dominate the owner vendor-nonowner vendee relationship. In a cooperative all sell to each. *The owner is both seller and buyer * * *.*" [Emphasis supplied.]

Viewed realistically, the identity of a co-op with its members is a shorthand way of expressing a more complex notion: that the interests of a co-op's management and its customers are so nearly the same that no regulation is required to mediate between them in order to assure proper, economical service.[29] In this respect, a co-op is sometimes contrasted with a public service corporation, whose management is assumed to be concerned with profits for stockholders as well as with service to customers.

But the assumed identity of the interests of a co-op's managers and members does not throw any light on many other questions bearing on a co-op's status as a utility, which do not involve the co-op's relations with members. And this Commission's jurisdiction also involves matters essentially unrelated to trans-

---

[23] The court also relies upon a provision of the statute specifically requiring any "electrical * * * public utility operating for * * * mutual benefit" to secure a certificate before constructing additional facilities.

[24] *Bookhart* v. *Central Electric Power Cooperative*, 219 S.C. 414, 65 S.E. 2d 781 (1951); *Dairlyland Power Cooperative* v. *Brennan*, 248 Minn. 556, 82 N.W. 2d 56 (1957); *Alabama Power Co.* v. *Cullman County Electric Membership Corp.*, 234 Ala. 396, 174 So. 866 (1951).

[25] *Rural Electric Co.* v. *State Board of Equalization*, 57 Wyo. 451, 120 P. 2d 741 (1942).

[26] *Kosciusko County Rural Electric Membership Corp.* v. *Public Service Commission*, 225 Ind. 666, N.E. 2d 572 (1948).

[27] *Alabama Power Co.* v. *Cullman County Electric Membership Corp.*, 234 Ala. 396, 174 So. 866 (1937); *Jordan* v. *Clarke-Washington Electric Membership Co-op*, 262 Ala. 527, 80 So. 2d 527 (1953); *Capital Elecrtic Power Ass'n* v. *McGuffee*, 226 Miss. 227, 83 So. 2d 837 (1955); see *Hagans* v. *Excelsior Electric Membership Corp.*, 207 Ga. 53, 60 S.E. 2d 162 (1950); *Kosciusko County Rural Electric Membership Corp.* v. *Public Service Commission, supra*; *Bookhart* v. *Central Electric Power Cooperative*, 219 S.C. 414, 65 S.E. 2d 781 (1951). See generally, Annot. 56 A.L.R. 2d 413 (1957).

[28] See, for example, *Alabama Power Co.* v. *Cullman County Electric Membership Corp.*, *supra*, note 20; *Bookhart* v. *Central Electric Power Cooperative*, *supra*, note 20.

[29] See, *Inland Empire Rural Electrification, Inc.* v. *Department of Pub. Serv.*, Wash., 92 P. 2d 258, 262–268 (1939); *Garkane Power Co.*, 98 Utah 460, 100 P. 2d at 573.

actions between a co-op and its members. Thus, the persuasiveness of the State cases holding that co-ops are "public utilities" is enhanced, not lessened, by the fact that most of these cases involve questions other than whether co-ops are subject to State public service commission jurisdiction. And the cases holding that co-ops are exempt from State utility commission jurisdiction by virtue of the "mutuality" doctrine are really not in point.

In sum, I believe that the language of the Federal Power Act, as further elucidated by its legislative and administrative history, clearly supports the conclusion previously reached by the Commission that cooperatives and other borrowers from the REA are public utilities within the meaning of section 201(e), if such persons own or operate jurisdictional facilities.

II

DOES THE COMMISSION HAVE AUTHORITY UNDER SECTION 204 OF THE FEDERAL POWER ACT TO PASS UPON LOANS BY THE REA TO PUBLIC UTILITIES AS A CONDITION PRECEDENT TO THE UTILITY OBLIGATING ITSELF?

The fact that borrowers from the REA may be "public utilities" within the meaning of section 201(e) of the Federal Power Act does not answer the question whether such utilities must secure Commission approval pursuant to Federal Power Act section 204 before issuing notes to the REA.[30] Section 204 provides: "No public utility shall issue any security, or assume any obligation or liability as a guarantor, indorser, surety, or otherwise in respect of any security of another person, unless and until, and then only to the extent that, upon application by the public utility, the Commission by order authorizes such issue or assumption of liability." This language, standing alone, could be read as conferring jurisdiction upon the Commission over notes issued to a Government agency like REA, since section 3(16) of the act defines "security" as "any * * * evidence of * * * indebtedness of a corporation subject to the provisions of the act." But for reasons set forth below I do not believe the Federal Power Act properly can be read to give the Commission such authority merely because it can be spelled out from the literal language of the statute. I reach this conclusion because (1) unlike analogous statutes there is no express authorization for the Commission to review or approve the lending functions of the REA, and (2) such action, unlike its exercise of jurisdiction over cooperatives under the other provisions of titles II and III of the act, would be basically inconsistent with the exercise of the broad discretion Congress intended to delegate to the REA Administrator.

1. The REA Act is silent on the question whether REA loans to public utilities are subject to approval by the FPC. This silence may reflect Congress failure in 1935 to recognize that borrowers from the REA would one day own facilities for the interstate transmission or sale for resale of energy which would make them subject to the Federal Power Act. But Congress silence does not end the inquiry. For where Congress intends one agency of the Federal Government to review the performance of another agency, it normally says so specifically.[31] This is especially so where one agency must approve loans to be made by another. The most directly analogous situation is that involving the Interstate Commerce Commission. Since 1920, it has had authority under section 20(a) of the Interstate Commerce Act over the security issues of railroads equivalent to this Commission's jurisdiction over security issues of public utilities. In fact, section 204 of the Power Act was patterned after section 20(a) of the Interstate Commerce Act. Yet, when Congress established the Reconstruction Finance Corporation in 1932, it expressly wrote into that act a provision making RFC loans to railroads subject to prior ICC approval.[32] The legislative history of the

[30] A cooperative would in any event not need Commission approval of an initial loan since as of that time it would neither own nor operate jurisdictional facilities. This would be true also of a new G. & T. "super-co-op" formed by a number of existing distribution utilities, unless, as I understood is not typically the case, a member co-op itself issued a note or other certificate of indebtedness to the REA. And, of course, no co-op would be subject to Commission jurisdiction if its security issues were subject to prior approval by a State commission.

[31] See *Chapman* v. *El Paso Natural Gas Co.*, 204 F. 2d 52 (1953); Federal Power Act, sec. 4(e) (approved by Chief of Engineers and Secretary of Army required before Commission issues licenses); Bonneville Act, sec. 5(a), 50 Stat. 731 (1937) (Bonneville Administrator's contracts for wholesale sales of electric energy subject to FPC rate approval); Flood Control Act of 1944, sec. 5, 58 Stat. 890 (1947) 16 U.S.C. 825a (1958) (same with respect to Secretary of the Interior).

[32] Reconstruction Finance Act, sec. 5, 47 Stat. 6 (1932).

Reconstruction Finance Act shows that the Chairman of the ICC testified at the hearing that under section 20(a) of the Interstate Commerce Act any RFC loan to railroads would have to be approved by the ICC even though the RFC Act was silent on the matter. (Hearings before Senate Subcommittee of the Committee on Banking and Currency on S. 1, 72d Cong., 1st sess., pp. 120–122 (1931).) But some Senators and some of the other witnesses doubted this would be the case, See id., at pages 119–120, 141–142, and accordingly a special provision was written into the RFC Act, Reconstruction Finance Act,, section 5, 47 Stat. 6 (1932).

The Civil Aeronautics Act provides another illustration of Congress' practice of making explicit its intent to give an agency authority to pass upon loans made by another agency. Section 410 of the Federal Aviation Act of 1958, 72 Stat. 769, 49 U.S.C. 1380 (1958) provides:

"The Board is empowered to approve or disapprove, in whole or in part, any and all applications made after the effective date of this section for or in connection with any loan or other financial aid from the United States or any agency thereof to, or for the benefit of, any air carrier. No such loan or financial aid shall be made or given without such approval, and the terms and conditions upon which such loan or financial aid is provided shall be prescribed by the Board."

So too, this Commission must approve TVA loans to States, counties, municipalities, and nonprofit organizations made pursuant to the TVA's statutory authority. Section 15c, 53 Stat. 1083 (1939), amending Tennessee Valley Act, section 15, 48 Stat. 67 (1933), 16 U.S.C. 831(o) (1958). Here again, reviewing authority has been expressly conferred.

The light of Congress practice of making explicit its intent that one agency review the determinations of another—especially determinations to make loans pursuant to statutory authority granted the lending agency—and the absence of any explicit direction to the Commission to review REA loans, I conclude that no such review was intended.

The legislative history of the REA Act buttresses this conclusion. The act as finally passed (see 49 Stat. 1364) contained a provision (sec. 3) authorizing the Reconstruction Finance Corporation to make loans to the REA Administrator up to the amount of $50 million for a period expiring on June 30, 1937. When an amendment to the bill to achieve this objective was introduced in the Senate, Senator Norris, the Senate spokesman, was asked whether the RFC would exercise any control over the REA Administrator's discretion in making loans. He responded that "[t]he judgment of the Rural Electrification Administrator is the judgment that would prevail" (80 Congressional Record 3237).[21] See also 80 Congressional Record 3308, 5281. The entire attitude of Congress was, in the words of Representative Rayburn—the House spokesman on the bill to "lodge this power [to make loans for rural electrification] in one man's hands" in full recognition of the "great power that was [thus] given to the Administrator" (80 Congressional Record 5281). And as indicated, supra, pages 19–20, in subsequent efforts to expressly give the FPC the responsibility to approve REA loans, there was no suggestion in the congressional reports or debates that the Commission had any existing authority, under section 204 or otherwise, to pass upon the propriety of the loan propoed to be made by the REA Administrator.

2. Despite the above, I would be reluctant to conclude that the Commission lacked any authority to approve the security issues of public utilities constituting notes or other indicia of obligation given to the REA; if this authority could be exercised by the Commission without interfering with the operations of the REA Administrator in carrying out his tasks under the REA Act. I think it is clear, however, that no such accommodation is possible. Either the standards by which the Commission under section 204 must evaluate a public utilities' proposed borrowing are the same as those by which the REA must determine whether to make a loan, in which case the Commission would be acting merely to review action of a cognate agency of the Government, with the consequent delay, or the stand-

[21] The colloquy in full reads as follows:

"Mr. McNary. I recall the authority granted to the Administrator in the original bill. In this amendment I understand it is provided that for 2 years the money is to be borrowed from the Reconstruction Finance Corporation by the Administrator. Then the question naturally arises, whose judgment would be followed as a business proposition?

"Mr. Norris. There is not any doubt about that. I am not trying to conceal anything.

"Mr. McNary. No; I appreciate that.

"Mr. Norris. The judgment of the Rural Electrification Administrator is the judgment that would prevail.

"Mr. McNary. Then does the amendment fit into the philosophy of the act creating the Reconstruction Finance Corporation?

"Mr. Norris. I would not say that it does or that it does not. To my mind, that is immaterial."

ards for Commission approval of borrowing are different from those under which the REA lends, in which case the Commission's exercise of authority could thwart congressional policy as set out in the REA Act. I see neither necessity nor grounds for interpreting our act in a manner which would achieve either such objective.

This aspect of the problem can, I believe, best be approached by examining the scope of the Commission's authority under section 204, as most definitively set forth in *Pacific Power & Light Co.* (27 F.P.C. 623). In that case the Commission stressed that its authority under section 204 did not extend to the type of public interest considerations which would have been appropriate if it had been given certificate authority over the construction of facilities by public utilities[34] but instead was directed to insuring that the company expenditures were related to the improvement, extension, or development of the utility system and did not involve improper financial practices—excessive interest rates and underwriting charges, lopsided capitalization, etc. Accordingly, in *Pacific Power & Light*, the Commission refused to consider whether approval of a security issue should be withheld because the funds were to be utilized in part for a transmission line capable of being converted into 500-kilovolt tie line, which arguably should be built by the Federal Government rather than the private companies involved. As the Commission stated (id., at 628):

"Whether a publicly owned interconnection should be constructed, whether such interconnection would meet the growing demand for power in the region and thus remove any economic justification for applicant's proposed expansion of the intertie, and whether Bonneville power should be made available to applicant for transmission to California are not for us to decide. It is not for this Commission to exercise the role of Congress as arbiter of these competing claims. That responsibility Congress has yet to delegate."

This ruling is significant here. It is arguable that the Commission should have authority to disapprove loans to co-ops to prevent them from constructing uneconomic or duplicative facilities. But it seems clear that such authority could only be assumed by the Commission at the expense of inserting itself into policy matters which Congress has delegated to the REA Administrator, subject only to review by the Congress itself in making its annual appropriations for REA loan funds.[35]

It is true that the Administrator is given no special directive to conduct his program in the interests of the overall national power picture—his mission is simply "to make loans for rural electrification * * * for the purposes of financing the construction and operation of generating plants, electric transmission, and distribution lines and systems for furnishing of electric energy to persons in rural areas * * *" (Rural Electrification Act of 1935, as amended, sec. 4, 7 U.S.C. 904). The Administrator may thus be in a position to make a loan which he conceives to be in the interests of rural electrification, but which the Commission might believe from its vantage point is for an unnecessary or uneconomic project. But if it had veto power over REA loans, the Commission would be in a position to forestall construction of projects the Administrator believed essential. And the Commission in making its determination would necessarily be called upon to determine the policy question whether rural electrification should be encouraged by low-interest Government loans in situations where investor-owned companies could provide the needed facilities. I see no more reason for believing that this was the intent behind section 204, than was the resolution of the public-private power controversies which the Commission held to be beyond its competence in *Pacific Power & Light, supra.*

There will, of course, be many aspects of a cooperative's financing which clearly are within the Commission's frame of reference in section 204 cases. It is obvious, however, that many of the problems with respect to private financing—prevention of excessive interest or underwriting rates, the need for competitive bidding, etc.—simply are not applicable to REA loans. Nor are normal concepts of the proper security structure of a public utility or the proper period within which to repay the loan—the REA cooperative will almost always

---

[34] "The surveillance exercised by the Commission under sec. 204 is far more limited in scope than we would exercise if, for example, we were issuing certificates of public convenience and necessity" 27 F.P.C. at 626. "Sec. 204 * * * [is a] particularly unsuitable vehicle for comprehensive licensing-type regulation such as that exercised by this Commission under the Natural Gas Act" (ibid.).

[35] To aid this review the REA Administrator now, pursuant to resolution of the Appropriations Committee, regularly makes information available to Congress as to his loan activities (see S. Rept. 474, 80th Cong., 1st sess. 12 (1947)).

be 100-percent debt financed and the REA Act itself requires that the loans be repaid within 35 years. About the only question normal to a section 204 proceeding which the Commission could consider with respect to an REA loan would be whether the proposed project was self liquidating so that the borrower could be expected to pay off its obligations within the fixed period. Commission action in this sphere would merely be duplicative of the Administrator's.

3. It may be suggested that the logic of this argument must be to deprive the Commission of all jurisdiction over persons who are REA borrowers. This clearly does not follow. For no provision of part II or III of the act giving the Commission Jurisdiction over public utilities conflicts with the REA Administrator's statutory functions. Certainly his activities are not interferred with because a borrower, who is also a "public utility" within the meaning of section 201(e), is subject to the restricted interconnection and service provisions of sections 202(b) and 207,[36] or, if it makes sales of energy in interstate commerce for resale, is subject to the rate requirements of sections 205 and 206.[37] Nor is there any inconsistency between the statutory functions of the REA and the Commission's authority under section 301 to prescribe a uniform system of accounts for borrowers who are public utilities, under section 302 to establish rules of depreciation or under section 208 to ascertain the actual legitimate cost of the property.

The only provision of part II or III (outside of sec. 204) which could involve action by both the Commission and the REA is section 203 requiring approval of a public utilities disposal of jurisdictional facilities valued in excess of $50,000, the merger or consolidation of such facilities with any other person or the acquisition of the security of any other public utility. Section 7 of the REA Act 7 U.S.C. 907, precludes any REA borrower whose loan has not been repaid in full from selling or disposing of its property, rights or franchises without the approval of the Administrator. Accordingly, under some circumstances an REA borrower would have to secure the approval of both agencies. But it is difficult to see how this minor degree of duplication could seriously interfere with the program of either the REA or the Commission since in both cases the agency is given authority solely to insure that its statutory objectives are not harmed by an ill-advised disposition. Thus, if either the REA or the Commission disapproves a proposed disposition for reasons pertaining to its responsibility, this action would not adversely affect the other agency, even if it had in the meantime approved the proposal.[38]

I conclude therefore that exercise of the Commission's authority under section 204 to review loans made by the REA to public utilities is neither required by the language of the act nor consistent with the overall statutory scheme established by Congress.

RICHARD A. SOLOMON,
General Counsel, Federal Power Commission.

MAY 20, 1963.

Mr. SWIDLER. Our general counsel concluded, Senator, that our statute did not exempt enterprises engaged in interstate commerce in electric power merely because the form of their organization was cooperative, but with respect to the issuance of securities by REA cooperatives, that we had no jurisdiction because under the REA Act the jurisdiction of the Rural Electrification Administrator was intended by Congress to be exclusive.

We found a great deal of resistance and resentment at our inquiring into the subject of jurisdiction, at even looking at this question. I

---

[36] Since the Commission, in ordering interconnections under section 202(b), may not place an undue burden on a public utility, nor compel the enlargement of its generating facilities, nor impair its ability to render adequate service to its existing customers, it is clear that the Administrator's security cannot be impaired. The same is true of section 207 which authorizes the Commission, upon complaint of a State commission, to order a public utility to provide more "adequate" or "sufficient" service only where enlargement of generating capacity or impairment of its ability to render adequate service to existing customers is not compelled.

[37] While "super-co-ops" would have to file the rates they charge their distributor members for resale to their members, the Commission in considering the justness and reasonableness of such rates would be obligated to consider the co-ops obligation to secure revenues sufficient to repay its loan within the statutory prescribed period.

[38] In fact a number of the cases in which the Commission in the past has asserted jurisdiction over REA co-ops involved sales of REA facilities to other utilities (see p. 18, supra).

might say that the Commission had in the past on many occasions accepted jurisdiction over cooperatives. It never had asserted it, let me repeat, it never had asserted it but there had been contracts filed in, perhaps, a dozen cases. The Commission had referred to cooperatives as utilities, all without controversy. Senator, it made no difference in the days when the Commission was not doing anything, you see, but it becomes an important question when the Commission is attempting to exercise the responsibilities which Congress has conferred upon us.

We decided, therefore, that we would suspend judgment, defer the decision, and decide this question whether we have jurisdiction over cooperatives in interstate commerce upon a formal record in a proceeding brought for that purpose, and we initiated such a proceeding. I have here the order to show cause which I will ask, in the interests of a full exposition of this question, to have made a part of this record, if that is agreeable, Mr. Chairman.

The CHAIRMAN. Without objection.

(The document referred to follows:)

UNITED STATES OF AMERICA FEDERAL POWER COMMISSION

Before Commissioners: Joseph C. Swidler, Chairman; Howard Morgan, L. J. O'Connor, Jr., Charles R. Ross, and Harold C. Woodward.

DAIRYLAND POWER COOPERATIVE, MINNKOTA POWER COOPERATIVE, INC., SOUTH CENTRAL RURAL ELECTRIC COOPERATIVE, INC., DOCKET NO. E-7113

ORDER TO SHOW CAUSE WHY RESPONDENTS SHOULD NOT BE REQUIRED TO COMPLY WITH REQUIREMENTS OF THE FEDERAL POWER ACT

(Issued July 22, 1963)

This is an order directing Dairyland Power Cooperative, La Crosse, Wisconsin, Minnkota Power Cooperative, Inc., Grand Forks, North Dakota, and South Central Rural Electric Cooperative, Inc., Lancaster, Ohio, to show cause why they should not be required to comply with this Commission's reporting, accounting and rate schedule filing requirements by filing, variously, annual financial and statistical report forms, original cost statements, accounting entries and rate schedules for wholesale electric services. Each of the aforementioned cooperatives owns or operates facilities for the transmission or sale of electric energy at wholesale for resale which is generated in one state and consumed in another, and therefore may be a public utility within the meaning of the Federal Power Act, Section 201(e), and, for reasons set forth below, the proper administration of the Act and exercise of our jurisdiction, if any, over those cooperatives requires that:

(1) Dairyland file its original cost statement pursuant to the Commission's Uniform System of Accounts, Electric Plant Instruction No. 1, and Section 120.3 of the Commission's Regulations under the Federal Power Act, and its rate schedules for wholesale electric services to the customers as set forth in Appendix A* pursuant to Part 35 of the Commission's Regulations:

(2) Minnkota file its original cost statement and its rate schedules for wholesale electric services to the customers as set forth in Appendix B; * and

(3) South Central file its FPC Form No. 1, Annual Report, for 1962, pursuant to Section 141.1 of the Commission's Regulations under the Federal Power Act, its original cost statement, and its accounting entries recording the transfer of facilities among South Central, Ohio-Midland Light & Power Company and Columbus and Southern Ohio Electric Company, pursuant to the Commission's Uniform System of Accounts, Electric Plant Instruction No. 5, and Account 102.

Dairyland, Minnkota and South Central are organized under the laws of the States of Wisconsin, Minnesota, and Ohio, respectively, as cooperative corpora-

*Currently Dairyland and Minnkota each have on file with this Commission pursuant to Section 205 of the Act a number of rate schedules for interstate wholesale electric services which each cooperative renders.

tions. They are financed in part by loans from the Rural Electrification Administration. The contention that any such cooperative corporation is not properly classifiable as a public utility within the meaning of Section 201(e) of the Federal Power Act because it is incorporated as a cooperative has been raised in informal communications to the Commission in response to a finding in *Southwestern Power Administration*, Docket No. E-6975, 27 FPC 895, 898 (1962) that Associated Electric Cooperative, Inc. and several other cooperatives are "public utilities." In our subsequent consideration of this matter we have had the assistance of an opinion of our General Counsel prepared at our request, as well as briefs submitted informally by the Office of General Counsel of the Department of Agriculture and by a Committee of Rural Electric Cooperatives. The Commission, to date, has not yet reached any consensus on these difficult matters.

We believe that the "public utility" status of REA cooperatives should be determined upon a record made in a proceeding in which all interested parties may participate. Accordingly, we are issuing this show cause order, in part, to determine the public utility status of the aforementioned cooperatives and others similarly situated. If those cooperatives are public utilities, the original cost statements, accounting entries, and rate schedules (and the original cost statements, accounting entries, and rate schedules of other cooperatives owning or operating jurisdictional facilities), are essential to the proper discharge of the Commission's ratemaking and accounting responsibilities and will be required to be filed just as we normally secure such statements, entries, and rate schedules from all persons who have been classified as public utilities.

Accordingly, the Commission under its authority contained in Sections 203, 205, 206, 208, 301, 304, 307, 308, 309, and 311 of the Federal Power Act and under the Commission's Rules of Practice and Procedure finds it necessary and appropriate for the purposes of that Act that a public hearing be held on this matter in the manner hereafter provided and the Commission directs the aforementioned cooperatives to show cause at that public hearing to be held on October 22, 1963, commencing at 10 a.m. (EDST) in a hearing room of the Federal Power Commission, 441 G Street NW., Washington 25, D.C., why they should not be required to file, as "public utilities," the aforementioned report form, original cost statements, accounting entries, and rate schedules.

The following schedule for the service of testimony, motions to strike prepared testimony, and answers to motions to strike prepared testimony, is ordered:

September 20, 1963: Service of direct testimony by all parties, including the Commission staff.

October 10, 1963: Service of rebuttal testimony by all parties, including the Commission staff.

October 16, 1963: Service of motions to strike testimony by all parties, including the Commission staff.

October 21, 1963: Service of answers to motions to strike by all parties, including the Commission staff.

Notices of intervention or petitions to intervene may be filed with the Federal Power Commission, Washington 25, D.C., in accordance with the Commission's Rules of Practice and Procedure (18 CFR 1.8 and 1.37) on or before August 16, 1963.

For the convenience of the parties, copies of the General Counsel's opinion and of the briefs filed by the Department of Agriculture and the Committee of Rural Electric Cooperatives will be made a part of the record in this proceeding and copies thereof are available for distribution at the offices of the Commission.

By the Commission. Commissioner Morgan, dissenting, filed a separate statement.

JOSEPH H. GUTRIDE, *Secretary.*

APPENDIX A

DAIRYLAND POWER COOPERATIVE

Lake Superior District Power Company, Ashland, Wisconsin.
Northwestern Wisconsin Electric Co., Grantsburg, Wisconsin.
City of Rochester, Minnesota.
City of Platteville, Wisconsin.
Allamakee-Clayton Electric Co-op., Inc., Postville, Iowa.
Barron County Electric Cooperative, Barron, Wisconsin.

Buffalo Electric Cooperative, Alma, Wisconsin.
Cedar Valley Electric Cooperative, St. Ansgar, Iowa.
Chippewa Valley Electric Co-op., Cornell, Wisconsin.
Clark Electric Cooperative, Greenwood, Wisconsin.
Crawford Electric Cooperative, Gays Mills, Wisconsin.
Dunn County Electric Cooperative, Menomonie, Wisconsin.
Richland Cooperative Electric Ass'n, Richland Center, Wisconsin.
Taylor County Electric Cooperative, Medford, Wisconsin.
Tri-County Electric Cooperative, Rushford, Minnesota.
Winnebago Rural Electric Cooperative Association, Thompson, Iowa.
Eau Claire Electric Cooperative, Eau Claire, Wisconsin.
Freeborn-Mower Cooperative Light & Power Association, Albert Lea, Minnesota.
Grant Electric Cooperative, Lancaster, Wisconsin.
Hawkeye Tri-County Cooperative, Cresco, Iowa.
Jackson Electric Cooperative, Black River Falls, Wisconsin.
Jo-Carroll Electric Co-op., Inc., Elizabeth, Illinois.
Jump River Electric Co-op., Inc., Ladysmith, Wisconsin.
Lafayette Electric Cooperative, Darlington, Wisconsin.
Oakdale Cooperative Electric Ass'n, Oakdale, Wisconsin.
Peoples' Cooperative Power Ass'n, Inc., Rochester, Minnesota.
Pierce-Pepin Electric Cooperative, Ellsworth, Wisconsin.
Polk-Burnett Electric Cooperative, Centuria, Wisconsin.
St. Croix County Electric Cooperative, Baldwin, Wisconsin.
Trempealeau Electric Cooperative, Arcadia, Wisconsin.
Vernon Electric Cooperative, Westby, Wisconsin.

APPENDIX B

MINNKOTA POWER COOPERATIVE, INC.

Baudette Village, Minnesota.
Cass County Electric Cooperative, Inc., Kindred, North Dakota.
Nodak Rural Electric Cooperative, Inc., Grand Forks, North Dakota.
Sheyenne Valley Electric Cooperative, Inc., Finley, North Dakota.
Cavalier Rural Electric Cooperative, Inc., Langdon, North Dakota.
Red River Valley Cooperative Power Ass'n., Halstad, Minnesota.
Red Lake Electric Cooperative, Inc., Red Lake Falls, Minnesota
Wild Rice Electric Cooperative, Inc., Mahnomen, Minnesota
P. K. M. Electric Cooperative, Inc., Warren, Minnesota
Beltrami Electric Cooperative, Inc., Bemidji, Minnesota
Clearwater-Polk Electric Cooperative, Bagley, Minnesota
North Star Electric Cooperative, Inc., Baudette, Minnesota
Roseau Electric Cooperative, Inc., Roseau, Minnesota
U.S. Bureau of Reclamation
City of Grafton, North Dakota
City of Halstad, Minnesota
City of Thief River Falls, Minnesota
City of Hope, North Dakota
City of Sharon, North Dakota

DAIRYLAND POWER COOPERATIVE, MINNKOTA POWER COOPERATIVE, INC., SOUTH CENTRAL RURAL ELECTRIC COOPERATIVE, INC., DOCKET NO. E-7113

(Issued July 22, 1963)

MORGAN, Commissioner, *dissenting:*

I dissent from the subject order for several reasons.

First, I dissent because I do not believe Congress intended that this Commission should attempt to use the power Congress provided in 1935 for the regulation of privately-financed electric companies to regulate the rural electric cooperative movement Congress established in 1936;

Second, I dissent because I do not believe this Commission should dissipate its limited staff and resources in an attempt to expand its jurisdiction when, by this Commission's own admission, limitations of staff and other resources already prevent it from solving problems in areas where it does have jurisdiction, require it to deny the substantive and procedural rights of parties appearing before it, and prevent it from setting just and reasonable rates;

Third, I dissent because I do not believe this Commission should attempt to regulate rural electric cooperatives absent a showing that abuses exist which require such regulation for the protection of the consuming public;

Fourth, I dissent because I do not wish to be associated with an attempt to expand the jurisdiction of a Federal agency merely for the sake of or the gratification to be obtained by expanding its jurisdiction;

Fifth, I dissent because I do not believe the nonprofit endeavors of rural electric cooperatives to provide low-cost power in the sparsely settled regions of this country should be harrassed and hampered by the cost of fending off the desire of this agency to expand its jurisdiction at their expense;

Sixth, I dissent because no law—other than Parkinson's—has ever contemplated this expansion of jurisdiction.

* * * * * * *

For more than the past year, a certain segment of this Commission has exhibited a peculiar preoccupation with the question of whether or not rural electric cooperatives could somehow be made subject to FPC jurisdiction. The provisions of Part II of the Federal Power Act, it is said, "* * * apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce";[1] some rural electric cooperatives may transmit or sell electric energy wholesale in interstate commerce; ergo, FPC should extend its jurisdiction over rural electric cooperatives. This was, and remains, the argument. That is all there is to it. It is very tidy. Its simple beauty is unadorned with reasons which might justify it. Why gild this legal lily?

Perhaps for that reason my repeated queries as to why this should be attempted have gone, and remain, unanswered. My repeated requests to be informed of the way or ways in which the rural electric cooperative movement of 1936 are frustrating the attainment of the low-cost power supply objective of the Federal Power Act of 1935 have been dismissed as beside the legal point. I do not think they are. But, neither do I think that the decision to embark upon a matter of this consequence should turn upon the interpretation of an unclear and purely legal point.

In any event, the failure of the Commission and its staff to demonstrate that the endeavors of rural electric cooperative conflict with or otherwise prevent the attainment of the objective of the Federal Power Act has confirmed my previous belief that they do not. For this and for other reasons mentioned below, I therefore believe it is unnecessary for the Commission to engage in this costly legal expedition, and I totally disassociate myself from the majority's obdurate determination to do so.

* * * * * * *

The question presented here is whether, even though rural electric cooperatives organized pursuant to the Rural Electrification Act of 1936 did not exist when Part II of the Federal Power Act was enacted in 1935, we should now interpret that Part of the Federal Power Act to apply to those cooperatives? The nature of the inquiry on which we embark is set forth well in a passage in Justice Cardozo's book, *The Nature of the Judicial Process:*

"[T]he difficulties of so-called interpretation arise when the legislature has had no meaning at all; when the question which is raised on the statute never occurred to it; when what the judges have to do is, not to determine what the legislature did mean on a point which was present to its mind, but to guess what it would have intended on a point not present to its mind, if the point had been present" (p. 15).

Following this approach, as we must if we are to avoid arrogating to ourselves the functions of Congress to legislate in the first instance on matters of substance, we must determine—

(a) the intended scope and purpose of Part II of the Federal Power Act of 1935;

(b) the nature and character of the rural electric cooperatives Congress provided for in 1936; and

(c) whether Congress would have made these cooperatives subject to Part II of the Federal Power Act if the question had been presented to it in 1935—or in 1936, for that matter.

* * * * * * *

[1] Section 201(b) of the Federal Power Act.

As introduced, the companion bills[2] that became the "Public Utility Act of 1935" provided, among other things, as follows: "Section 201(b) The provisions of this title [II] shall apply to the transmission and sale of electric energy in interstate commerce * * *."

Naturally, Congress wanted to know just what and whom would be covered by that language; it wanted "a picture of this operating industry." This was provided by one of the spokesmen for the Federal Power Commission. He said:

"There are at present approximately 3,500 electric utilities in the United States, of which 1,900 are municipal and 1,600 are private. The 1,900 municipal utilities produce between 4 and 5 percent, and the 1,600 private utilities produce between 95 and 95 percent of the total power produced."[3]
The municipal systems (or, more accurately, the power systems of any and all Governmental agencies or subdivisions) were not covered or were not meant to be covered by the bill, he continued, for the reasons that they were owned by Government and were not run for profit.

This was the total picture of the operating industry at that time. It was comprised of Government systems and private profit companies. The industry had no other segments. When the Government systems were eliminated, only the private companies remained. The privately owned and financed segment of the industry was all the bill was aimed at. This was made clear time and time again in both the House and Senate hearings.

This picture and definition of the operating segment of the industry at which the bill was aimed squared with Congress understanding. The reason why Congress had undertaken to legislate here was to remedy the abuses that had been perpetrated in the electric power field. These abuses had not been perpetrated by Governmental or nonprofit systems: they had been perpetrated through and by means of privately owned and financed electric power companies and the holding companies that controlled them. Congress itself had directed that those abuses be investigated; the abuses had been thoroughly studied for the preceding 8 years; the studies had been reported to Congress; and Congress had undertaken to legislate on them.

The bases upon which and the reasons why Congress undertook its consideration of this legislation were set forth in the 83-volume, Federal Trade Commission study of the privately owned and privately financed electric utility industry, begun in 1928 at the request of Congress; the separate 4- and 6-volume summarizations and extensions thereof prepared for the House and Senate Commerce Committees; the Federal Power Commission's (interim) National Power Survey report called for by the President in 1933; the 1935 report of the National Power Policy Committee appointed by the President; and the President's March 1935 message to Congress on public-utility holding companies. Legal minions of Government agencies and of privately owned utilities have, for many years, searched through this massive literature and the later Congressional hearings and debates for an indication—any indication—that Congress was aiming at cooperatives. They have come up just as empty handed as my colleagues of the majority.

The essence of the purpose, scope and intent of Title II of the Public Utility Holding Company Act, which is Part II of the Power Act, was explained at the outset of his testimony by the FPC spokesman before the Senate and House Commerce Committees:

"What I have to say of title I of the bill is simply this: I think you can illustrate a holding company, more or less, as a pasture fence that is built around groups of these utilities, here and yonder, scattered all over the country. Now, title I of the bill proposes to tear down that pasture fence and to turn the stock loose, that stock being the operating companies. * * * Title II provides that as you tear down this fence you shall place in the Federal Power Commission supervision over the integration of these operating companies into strong regional systems."[4]

In sum, the entire legislative foundation of Part II of the Federal Power Act, including the hearings thereon, make it unmistakably clear that the abuses in the electric power field which that legislation sought to correct were perpetrated solely and exclusively by the privately owned and financed segment of the industry; that these abuses were the sole reason why Congress undertook to enact the

---

[2] S. 1725 and H.R. 5423, amended and reported as (a "clean bill"), S. 2796, 74th Congress.

[3] Senate Commerce Committee hearings on S. 1725, at page 240. Identical expositions of the applicability and purpose of Title II of the bill were made by FPC witnesses in the House Commerce Committee hearings on H.R. 5423.

[4] Senate Commerce Committee hearings on S. 1725, at p. 288.

legislation in question; that in enacting that legislation Congress expressly excluded all other known segments of the industry from its aim; and that by the language it used in Section 201 of the Federal Power Act, Congress intended to regulate only the privately owned and financed or the profit segment of the electric power industry when it enacted Part II of the Federal Power Act in 1935.

* * * * * * * *

Throughout the 1935 House and Senate hearings (totalling 3,500 pages) on the bill that became the Public Utility Holding Act, only one reference was made to the Federal Government's rural electrification program. This reference was made on April 11, 1935 during the (earlier) House hearings by a Congressman in an attempt "to find out if both [municipal and privately financed systems] are going to be treated impartially and alike and the Government will not be engaging in competition with private industry in carrying out its rural electrification program."[5] The discussion that followed shows that Committee members and the witness had only confused ideas about that program, which then was in a very inchoate form; and the discussion sheds no light on the question considered here.

The Rural Electrification Administration and Program was established by Executive Order No. 7037 of May 11, 1935 (promulgated under the Emergency Relief Appropriation Act of April 8, 1935). Subsequently, and until March 13, 1936, the REA entered into contracts for 27 rural electrification projects, including contracts with a few privately owned profitmaking companies.[6]

On January 6, 1936, the Chairman of the Senate and the House Commerce Committees introduced companion bills to give the REA a separate, statutory foundation. The Senate passed the measure (S. 3483) on March 9, 1936, without hearings, in a form that provided for loans to Governmental units and to nonprofit cooperatives only, and not to private, profitmaking companies. During the accompanying discussion, it was explained that the Administration and the sponsors of the bill had excluded private profit companies because experience had shown that *nonprofit* agencies were the preferred instrumentalities for achieving the purposes sought by the rural electrification program, and that private, profitmaking companies were not.[7] This point was expanded upon during the brief hearings that were held in the House[8] and during House consideration of the measure. As passed by the House, however, and as enacted, S. 3483 provided that REA could make loans to private, profitmaking companies, but that it had to give loan preference to *nonprofit* Government agencies and to cooperatives.[9]

In sum, and in marked contrast to the legislative history of Part II of the Federal Power Act, the entire legislative history of the Rural Electrification Act shows that Congress there undertook to assist or bring into being a series of nonprofit Governmental and cooperative agencies for the purpose of electrifying rural areas, and that these agencies were essentially different from the private, profitmaking companies for which Congress in the preceding year had created a separate and exclusive regulatory pattern.

In general, by the Rural Electrification Act of 1936, Congress established a program whereby specially created cooperatives, exempt from Federal taxes, could borrow money at low interest rates from the Federal Treasury with no collateral, for the construction of facilities for the distribution and sale on a nonprofit basis, of power purchased when available at reasonable rates from electric generating plants, in the remote or rural areas of the country which private profit companies had failed or declined to serve.

Naturally, Congress assumed that to carry out this objective, cooperatives located almost exactly on the border between two states (such as the Dairyland and Minnkota cooperatives named in the subject order) would engage in interstate commerce in the course of electrifying or supplying the immediately contiguous rural area in the adjoining state. And naturally, Congress assumed that in purchasing its power supply from a private company, a cooperative (such as the South Central cooperative named in the subject order) might buy from a private profit company subject to regulation under Part II of the Federal Power

[5] House Commerce Committee hearings on H.R. 5423, at p. 2163.
[6] House Commerce Committee hearings of March 12–14, 1963, on S. 3483 in the 74th Congress (the bill that became the Rural Electrification Act of 1936), at pp. 67–68.
[7] 80 Cong. Rec. at 2754–55, 2826–27.
[8] At footnote 6.
[9] 80 Cong. Rec. at 7247–48, 7362.

Act. But there is no evidence that Congress intended that nonprofit rural electric cooperatives which found themselves in such positions were to be subject to regulation under Part II of the Federal Power Act.

That Act (enacted in the previous year) is silent on the subject. We must assume that Congress knew this. If Congress, in setting up a new program for a new method of rural electrification, intended their new program to be covered by their legislation of 1935, they could have said so in 1936 either by amending the previous Act (The Federal Power Act) or by specific provision in the REA Act. They did neither. They did not even discuss doing either.

In general, by enacting Part II of the Federal Power Act in 1935 Congress established a comprehensive regulatory pattern, tailored, refined, and amended to prevent a recurrence of the abuses perpetrated in the electric power field by and through privately owned profitmaking companies; and to meet problems indigenous to private electric profit companies alone. This is shown unequivocally by the legislative history of that Act; as well as by a mere reading of the sectional headings and the provisions of Part II of that Act.

In conclusion, therefore, it is plain to me that, in addition to the reasons mentioned in the attached briefs of the Department of Agriculture and the Committee of Rural Electric Cooperatives, the language of Section 201(b) of the Federal Power Act (which provides that "the provisions of this Part shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce") is not to be literally interpreted to include rural electric cooperatives organized and financed pursuant to the Rural Electrification Act of 1936, because—

(a) the legislative history of Part II of the Federal Power Act shows that Congress intended that Act to apply only to privately owned profitmaking electric power companies; and

(b) because the legislative history of Part II of the Federal Power Act of 1935 and of the Rural Electrification Act of 1936; the intent of Congress in enacting Part II of the Federal Power Act; and the past operations and practices of nonprofit rural electric cooperatives show, together and separately, that if the question of making nonprofit rural electric cooperatives subject to Part II of the Federal Power Act had been presented to Congress when it had that measure under consideration in 1935, Congress would have made those nonprofit cooperatives exempt from the regulatory scheme it enacted for privately owned, profitmaking companies, exactly as it made all the then-existing nonprofit electric agencies exempt; and

(c) because Congress specifically refrained, when it enacted the REA statute in the following year, from conferring jurisdiction over REA cooperatives on any Federal agency other than the Rural Electrification Administration.

I am not alone in this opinion. It is stoutly held by many others more learned in these technical matters than I. The majority order states that the Commission itself "* * * has not reached any consensus on these difficult matters." Accordingly, I do not feel that this Commission should attempt, by a show cause proceeding, to force the owner customers of the rural electric systems of this land to shoulder the full burden of proving or disproving the alternative propositions that they are or are not subject to the jurisdiction of this Agency. This Commission may initiate show cause proceedings against parties clearly subject to its full jurisdictional powers, but I do not believe this Commission should employ this harsh technique on the parties here, over whom the Commission itself cannot even agree whether it has jurisdiction.

If the majority of this Commission which is so peculiarly preoccupied with this question really feels that the role played by the rural electric cooperatives of this country requires additional attention, then, rather than lurching into this important policy matter in the anomalous manner described, that majority should follow the procedure which the Act has prescribed for treating questions of this nature, as follows—

"SEC. 307(a) The Commission may investigate any facts, conditions, practices, or matters which it may find necessary or proper in order to determine whether any person has violated or is about to violate any provision of this Act or any rule, regulation, or order thereunder, or to aid in the enforcement of the provisions of this Act or in prescribing rules or regulations thereunder, or in obtaining information to serve as a basis for recommending further legislation concerning the matters to which this Act relates * * *."

and

"SEC. 311. In order to secure information necessary or appropriate as a basis for recommending legislation, the Commission is authorized and directed to conduct investigations regarding the generation, transmission, distribution, and sale of electric energy, however produced, throughout the United States and its possessions, whether or not otherwise subject to the jurisdiction of the Commission * * *. The Commission shall report to Congress the result of invetigations made under authority of this section."

If the majority will follow that procedure, it will get a clear and unmistakable set of directions from the Congress regarding this matter, and in very short order.

I am perfectly willing for this Commission, with my active participation and support, to proceed with the regulation of any electric agency, whether publicly or privately owned and financed, provided only that theretofore:

(a) the regulation of such agency has been found genuinely necessary for the protection of the public interest; and

(b) the necessity for that regulation has been spelled out clearly and convincingly and has been transmitted to the Congress for its consideration; and

(c) the Congress has issued a clear and unmistakable directive to the Commission to proceed with such regulation.

I am convinced that those conditions do not exist here. And I am equally convinced that an attempt to proceed, as the majority does, in the absence of those conditions is a wrongful attempt to arrogate to this Commission jurisdiction and powers not conferred upon it by the Congress.

The plain fact is that this Commission never asked Congress to confer this particular jurisdiction on it; Congress never even discussed this particular grant of jurisdiction at the time our enabling legislation was enacted, and nowhere in any law—again excepting Parkinson's—is this particular expansion of jurisdiction even so much as hinted at.

HOWARD MORGAN, *Commissioner.*

Mr. SWIDLER. Those proceedings are now underway. So that we are attempting, Senator Carlson, in as orderly and as careful a way as we can, to determine, on the basis of a comprehensive record, just what our jurisdiction is with respect to electric power cooperatives, considering the opinion of our general counsel that this jurisdiction would not in any event, extend to security issues, but would relate to transactions, at wholesale, for purchases and sales of power in interstate commerce.

I might say this involves more than the REA question, because if we were to conclude that we do not have jurisdiction over cooperatives, it could hardly be because a cooperative had borrowed or had not borrowed from REA. The question, I think, would necessarily depend upon whether the mere cooperative form effected an exemption, and this might well involve, ultimately, a great many enterprises which were not rural in nature, and which had no relationship to REA.

So the question is not only an REA question; it is a question of what difference does this particular corporate form have upon the Commission's jurisdiction.

Senator CARLSON. Would this letter writer be correct in stating that your agency has already designated over 25 rural electric cooperatives, consumer-owned cooperatives, as subject to the regulation by your Commission?

Mr. SWIDLER. No, sir. We have suspended any effort to exercise jurisdiction over electric power cooperatives until the conclusion of these proceedings.

Now, the status of these proceedings is that the Commission staff, on the 8th of this month, filed its testimony. The Commission took the responsibility for having its staff put in the initial case, and then at various other times the reply testimony is to be introduced, and

finally there will be a hearing for cross-examination and rebuttal, and so forth.

Now, unless and until the Commission shall conclude in these proceedings that it has jurisdiction, there would be no effort to exercise it.

Senator CARLSON. But on that point, there is some question then as to whether you do have, your own opinion as to whether you have, jurisdiction.

Mr. SWIDLER. Yes, sir.

Senator CARLSON. Is it not a fact that the Congress has on many occasions defeated proposals which would have extended Federal Power Commission jurisdiction to this?

Mr. SWIDLER. I am not aware of that, Senator.

Senator CARLSON. I think the record would show that is the case; at least it has been up for discussion.

I happened to be in Congress in 1936 in the House of Representatives when this REA program was enacted, and I remember some of the early discussions on it.

Mr. SWIDLER. I think you might be interested in the opinion of our general counsel, Senator Carlson, where the legislative history on both sides is put together.

Sentor CARLSON. I shall read it.

Mr. SWIDLER. We do not rely on this opinion, but I think it would add quite a bit to the background of this discussion.

Senator BENNETT. Have you published a list of companies that you consider to be——

Mr. SWIDLER. Yes, sir.

Senator BENNETT. Were there some REA's on that list?

Mr. SWIDLER. No, sir; there were not.

Sentor BENNETT. There were not?

Mr. SWIDLER. No, sir; it was announced at the time there would be no REA cooperatives included.

Senator BENNETT. I wonder if that list was the source of the 25 the Senator raised.

Mr. SWIDLER. No, sir. in the explanation accompanying the list we made this statement:

> The Commission has not decided the question of its jurisdiction over cooperatives and, for that reason, cooperatives that may be public utilities are not included in the list.

Senator CARLSON. Mr. Chairman, I have a number of questions. It will take a little time, and it is 12:30. I do not know how long you expect to run. I know you normally close at 12:30.

I would be willing to do this: these are questions that I think are vital to our corporations dealing particularly with the electric energy and pipelines, gas distribution, about which we are greatly disturbed, and I would be willing to have Mr. Swidler take these and make them a part of the record, if it would help, because we have an important matter on the floor this afternoon, and it is of some concern to me.

Mr. SWIDLER. I shall be very glad to provide written responses to any questions the Senator has.

Senator CARLSON. I would be willing to do that.

The CHAIRMAN. We can insert it in the record.

Senator CARLSON. I would be glad to ask these questions, but it is going to take an hour.

Senator GORE. Mr. Chairman, I have one further question.

The CHAIRMAN. You are going to present your questions in writing?

Senator CARLSON. I have them in writing.

The CHAIRMAN. You will answer them, and they will be inserted in the record at this point.

(The questions and answers referred to heretofore follow:)

Senator CARLSON. No one has examined the possible effects of denial of tax incentives to regulated industry if there is a period in which no expansion occurs. If the investment tax credit, for example, is flowed through to the consumer through rate reduction 1 year and no investment for expansion occurs the next year, the rate structure would have to be revised if the industry is to make proper earnings.

Suppose that expansion of any given company satisfied all demands for its service—that it does not expand in any given period. Wouldn't you then have to raise its rates which had been lowered previously by the flow through of investment tax credit?

Mr. SWIDLER. All items in the cost of service which support the utilities' rates, including taxes, are based on its experience in a test year which is typical of the company's future operations. If the company can present evidence that its expenditures for new plant will decrease in the future or that the test-year expenditures were higher than normal, it can propose adjustments to the test-year figures. I might add that the no-growth assumption is one that seems unlikely to occur in the foreseeable future, considering the trends in population growth and energy use. Even if there were no net additions to plant, presumably new investment would be needed for replacement and to care for shifts of load. At any rate if 202(e) is not enacted, the Commission would have flexibility in meeting new situations.

Senator CARLSON. Suppose an area becomes depressed through a shutdown by its major industry or some similar economic disaster. The demand for utility service would drop suddenly because of the loss of the plant. There would be more than an ample supply of service to meet demand and no need for expansion. If investment tax credit has been passed on to the citizens of that community, wouldn't they suddenly find their utility rates must go up at a critical time when they are least able to afford higher rates? Wouldn't the flow-through theory actually impose an economic hardship on those people on top of unemployment and other economic disturbance? Wouldn't the retention of tax benefits by the utility in the first place actually cushion the shock of an economic blow to the community?

Mr. SWIDLER. The proposed law is not designed as a cushion against a declining demand for utility services. It is intended to stimulate investment in new facilities, and if the credit is so applied by the companies, or if it is reflected in greater payout to stockholders, it would not serve to cushion the shock of a depression. However, most pipelines serve large regions of this country and electric power companies are usually not dependent on a single industry. In certificating the initial construction of pipelines and any expansions of their facilities, the FPC requires a showing of the market for the gas which minimizes the possibility of the type of sudden economic disaster which you suggest. On the whole the utilities fare better than other industries in a depression because of the essential nature of their product.

I want to emphasize that there is nothing in section 202(e) to require a company to use its tax savings so as to cushion the shock of a depression or to use the money to avoid a rate increase. On the contrary, regulatory agencies would be prohibited from considering these additional earnings resulting from tax savings as having any bearing on rate levels.

Senator CARLSON. In view of the fact that Congress provided a specific investment tax credit for regulated industries—7 percent for one group and 3 percent for another—what is the basis for your apparent belief that Congress has not clearly indicated whether these industries should have the advantage of this tax benefit?

Mr. SWIDLER. The focus of the investment credit discussion with respect to the regulated industries was whether they should be included at all, and as you suggest, Congress decided that certain of the regulated industries would receive a 7 percent credit and the others 3 percent. In my judgment, this action sheds no light on the separate question of the proper regulatory treatment for the

credit. My position that the congressional purpose of stimulating investment can be achieved to the advantage of the industries involved by using the tax savings to reduce rates is supported by the testimony of leading spokesmen for the electric utility industry. For example, Mr. Donald Cook, president of the American Electric Power Co., in supporting inclusion of the regulated industries within the coverage of the investment credit, testified as follows:

"* * * From the point of view of whether the tax credit would operate as an incentive to construct additional plant and equipment, it is almost a matter of indifference as to whether the tax reduction is passed on to customers or not.

"This is true because as indicated above, it is the reduction in fixed charges with the resulting decrease in revenues necessary to support the expenditures for plant that operates as the incentive to build, not the receipt and retention of cash resulting from reduced expenditures for taxes.

"But the fact is that just as a company is entitled to rates which will cover the taxes that must be provided for, so too is the customer entitled to receive the benefit of reductions in taxes." (Senate hearings on Revenue Act of 1962, p. 938.)

Senator CARLSON. How can you reconcile your testimony and your position with the 7 percent and 3 percent distinction which Congress has enacted?

Mr. SWIDLER. I didn't understand that the distinction had anything at all to do with the regulatory treatment. As I understand it, the pipelines were given 7 percent in order to accord them the same treatment as other transportation media, such as the railroads, the trucks, and others, many of whom were believed to face stiffer competition and greater difficulty in raising funds than the utilities given the 3-percent credit.

Senator CARLSON. From your argument, it is assumed that the present statute will not induce the Federal Power Commission to allow the regulated industries to retain the tax benefit. Then it is perfectly clear, isn't it, that if the Senate agrees with the House that the regulated companies should retain the tax benefits specifically authorized, you leave us no choice but to enact this proposed amendment?

Mr. SWIDLER. The Commission will certainly provide regulatory treatment of the investment credit in a manner to carry out the congressional purpose of stimulating investment. My plea is that Congress leave to the Commission's discretion the regulatory treatment that will best carry out the purpose of the tax bill. I should hope that Congress would not want to take on the detailed job of ratemaking which it has delegated to the Federal Power Commission. To sum up, there are two separate questions involved. One is the substantive question of the proper rate treatment of the credit. The second question is the extent to which Congress wishes to substitute congressional rate regulation for Commission rate regulation.

Senator CARLSON. If the investment tax credit is denied to regulated industry and flows through to the customer, how much will this mean to the average household customer in his monthly bill?

Mr. SWIDLER. We do not know the dollars and cents effect of the investment credit on the individual rates of each company and the resultant meaning to the householder, because the effects will vary with the circumstances of each company and the usage of each customer. It would mean large sums for the large industrial consumers of fuel and power. Even small rate reductions are important to consumers in the lower income groups. In the aggregate, as I have already testified, passing the savings on to all consumers would mean hundreds of millions of dollars to them annually.

Senator CARLSON. Is it not true that for every dollar reduction in the net income of a regulated industry such as a pipeline the Federal income taxes payable by the company are reduced by $2.08?

Mr. SWIDLER. A reduction of $1 in net income after taxes would have the effect of reducing the company's Federal income taxes by $1.08 (not $2.08). In other words, it takes $2.08 in revenues to generate $1 of net income, if we are looking only at the effect of income taxes. The ratepayers save $2.08 for every $1 reduction in net income to the company.

Senator CARLSON. Does it not follow, then, that the Treasury Department will lose in revenue 108 percent of the tax credit which is denied to regulated industries?

Mr. SWIDLER. Not necessarily. The loss to the Treasury is 108 percent of each dollar reduction in the net income of the regulated company, but this amount may be offset by new tax sources resulting from increased sales and profits. The

revenue situation to the Treasury is the same as would occur if a nonregulated company reduces its prices by the amount of the investment credit. In either case any tax loss to the Treasury will be offset to the extent the lower prices stimulate greater business and larger profits. Businesses which have their energy costs reduced and which have higher earnings as a consequence will pay higher taxes as a result. Consumers of course have to pay $2.08 in rates for every $1.08 the Treasury will receive under the existing tax rates.

Senator CARLSON. Do you have any estimate of the total amount of loss to the Treasury Department if investment tax credit is denied all regulated industries? Is it $100 million? a billion dollars? $2 billion?

Mr. SWIDLER. In the figures I put into the record we estimated tax savings in bulk of about $60 million annually for the natural gas pipelines and about $86 million annually for the privately owned electric power companies, but it is difficult to estimate how much these amounts would be offset by increased sales.

Senator CARLSON. Do you know of any instance in which rate reduction through flow through of tax benefits will create utility expansion but retention of the investment tax credit by regulated industry will not? In oher words, will a rate reduction of 7 cents a month create demand for expansion?

Mr. SWIDLER. The 7-cent-a-month figure must relate to a small user of gas or electricity. Certainly the large commercial and industrial users of gas and electricity and even the householder who heats or cools his home would have a much larger stake in what happens to the investment credit. My own experience is that consumer demand for electricity is indeed responsive to price.

Senator CARLSON. Why do you believe that if flow through would stimulate demand and create expansion the utilities wouldn't take that course of action—why do you think they would retain tax benefits to keep profits up?

Mr. SWIDLER. Of course, if the utilities voluntarily pass through the reduction in taxes in the form of reduced rates, there is no need for the regulatory agency to take action. If the utilities propose to flow through the tax savings there is no need for this legislation. It seems to me to presuppose an intention to retain the savings—not to keep profits up, but to increase them over existing levels.

Senator CARLSON. What was the purpose of this legislation, Mr. Swidler, if it was not to give management, acting on behalf of the stockholders, an incentive to make new investments and thus spur the economy?

Mr. SWIDLER. I agree, Senator Carlson, that the purpose of the legislation was to stimulate new investment, but my point is that for the regulated industries, the determination as to how this can best be achieved should not be left to the unlimited discretion of the company but as with other such matters should be subject to review by the regulating agency entrusted with this task by Congress.

Senator CARLSON. Then, what you are saying is, if we allow the Commission to reduce rates in this manner, it will be able in effect to force companies to expand?

Mr. SWIDLER. It is Congress which is encouraging expansion by the investment credit device. Expansion with concomitant investment is the expressed purpose of the credit. FPC itself cannot force any company to expand; but the rate treatment of the tax credit we decide upon will necessarily be consistent with the congressional purpose of encouraging expansion of facilities.

Senator CARLSON. Mr. Swidler, with respect to your statement that Congress never deemed it necessary to specifically prescribe the regulatory treatment of liberalized depreciation, percentage depletion, and intangible drilling expenses, is it not possible that Congress never thought that the Commission would ever deprive companies of these tax benefits?

Mr. SWIDLER. FPC cannot deprive a company of a tax benefit, but can only determine the treatment of cost reductions for rate purposes. Thus far, Congress has not limited FPC in these determinations. The courts have held also that Congress has left to the Commission's discretion the proper regulatory treatment for each of the tax benefits you mention and that the Commission's actions in each case did not deprive the companies of these tax benefits. I am supplying the following citations for the record: *El Paso Natural Gas Company* v. *Federal Power Commission*, 281 F. 2d 567, 573 (CA5, 1960) cert. denied sub nomine; *California* v. *Federal Power Commission*, 366 U.S. 912; *Cities of Lexington, et al.*, v. *Federal Power Commission*, 295 F. 2d 109, 116–117 (CA4, 1961); *Panhandle Eastern Pipeline Co.* v. *Federal Power Commission*, 305 F. 2d 763, 767 (CADC. 1962), cert. denied 372 U.S. 916: *Panhandle Eastern Pipeline Co.* v. *Federal Power Commission*, 316 F. 2d 659, 663 (CADC en banc, 1963), cert. denied.

Senator CARLSON. Mr. Swidler, don't you think Congress knew that the management of an unregulated company might or might not elect to pass on the benefits of an investment tax credit savings by reducing prices to the consumers of its products?

In view of this awareness on Congress' part, would you say that unregulated companies which elect to make the investments Congress intended to stimulate but do not lower their prices are collecting a windfall profit?

If your answer is "No," then how can you claim regulated companies whose rates are not lowered are collecting a windfall profit?

If your answer is "Yes," then aren't you claiming that the credit provision itself is a windfall created by Congress?

Mr. SWIDLER. Congress relied on the forces of competition to determine how unregulated companies would treat the investment credit. In strict economic theory, in the long run, competition will require the unregulated companies to reflect the full savings in their prices. In the case of the regulated companies the same competitive forces are not present. Here it is apparent that much of the tax savings will be retained if regulation is not permitted to function with respect to this factor. I do not claim that the unregulated companies will pass along all the tax savings and the regulated companies will retain all if permitted to do so, but I do say there is a vast different between the two kinds of companies.

Senator GORE. Mr. Swidler, can you tell us the possible financial benefits to the Tennessee Natural Gas Transmission Co. if the entire section 202, as it appears on page 326 of the bill, is enacted, that section containing, also, the repeal of a requirement that the basis be reduced with respect to investment credit?

Mr. SWIDLER. No, sir; I do not have those figures, by company.

Senator GORE. Do you know in what order of magnitude it would be?

Mr. SWIDLER. Well, all I can say, Senator, is that the Tennessee Co. is roughly 10 percent of the jurisdictional business before our Commission, but that does not mean that its income tax would necessarily be 10 percent.

I gave an overall figure of $60 million for savings to customers of natural gas companies, but I would hesitate to suggest that you apply a 10 percent factor to that because it could vary a great deal depending upon its particular circumstances.

Senator GORE. Does that $60 million estimate relate only to the provision to which you have testified or did it include the repeal of the Long amendment of last year?

Mr. SWIDLER. Our estimates include the effect of the repeal of the Long amendment.

The CHAIRMAN. The Chair wants to offer for the record a statement from Mr. Norman Mason, chairman of the Massachusetts Department of Public Utilities.

(The statement referred to follows:)

STATEMENT OF NORMAN MASON, CHAIRMAN, MASSACHUSETTS DEPARTMENT OF PUBLIC UTILITIES ON H.R. 8363 BEFORE THE SENATE FINANCE COMMITTEE

The accounting for "investment credit" has been a matter of great concern to the Massachusetts Department of Public Utilities. Our staff has devoted much time examining various proposals and has met with representatives of the various utilities under our jurisdiction. This is not a matter which we have treated lightly.

We have found the main point of discussion to be whether the investment credit should be permitted to affect income:

(a) In the accounting period in which it is realized (initial year flow through) or,

(b) Over the life of the property generating the credit (service life flow through).

Essentially, the Federal Government is taking an accounting shortcut by allowing an investment credit to be applied against income taxes. This might well have been split up into two accounting entries. First, the regular Federal income taxes payable might be paid. Then upon sufficient proof that the company had expended certain sums for plant investments, the Government could return a sum equivalent to 8 percent of said expenditures. The fact that, as a practical matter, both features are combined does not change the nature of the investment credit which, according to the conference report (H. Rept. 2508, p. 14), was intended "* * * to encourage modernization 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 the new facilities over their productive lives."

This Department has ordered the 274 utilities under its jurisdiction to follow the "service life flow through" method of accounting for the investment credit. We feel that such a ruling follows the intent of Congress and in our opinion is the only sound accounting principle. For a Federal regulatory agency to take a different position with respect to the accounting of a utility subject to the jurisdiction of this department unnecessarily complicates regulatory procedures.

The income statement of any business, and particularly that of a business subject to regulation, should be so designed that earnings show the results of operations for the year under report. A reduction in income taxes in the current year, which would result from initial year flow through, improves the "earnings" in the year under report. This improvement in "earnings" is directly related to capital investment and has no relationship to the actual operating results for the year and hence produces distortion of the income statement. In our opinion this is a backward step in public utility accounting where so much progress has been made in the past quarter century.

We are not unmindful of the fact that in the States that have declared themselves on this matter, 22 regulatory commissions have adopted this department's position, while only 6 have prescribed initial year flow through.

Initial year flow through can only contribute to the ups and downs of our economic cycles. In good times, demands for service require increases in construction expenditures and therefore in investment credits, thus increasing income. In poor times, with customer demands abating, construction is curtailed, resulting in fewer credits and lower income. Income is thus artifically improved in good times and decreased in poor times.

The above emphasizes to us the necessity of adhering to generally accepted accounting principles as enumerated by the accounting principles board of the American Institute of Certified Public Accountants. This board issued a bulletin which states that generally accepted accounting principles require that the investment credit be reflected in the net-income over the productive life of acquired property and not the year in which it is placed in service. This department is of the opinion that it is important that accounting procedures for ratemaking purposes be as nearly alined to accepted accounting principles as possible.

The CHAIRMAN. We will now recess until 2:30 this afternoon.

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

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order. The first witness is Mr. George G. Grover, public utilities commission of the State of California. Mr. Grover, take a seat, sir, and proceed.

STATEMENT OF GEORGE G. GROVER, PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Mr. GROVER. Mr. Chairman, Senator Bennett, I am George G. Grover, a member of the public utilities commission of the State of California, and I am here as the official representative of that commission.

Under our law, in addition that makes me the official representative of the State of California, since the public utilities commission is authorized to represent the State government in matters of this type.

We certainly appreciate the opportunity to be here and express our views in connection with section 202(e) of the bill. I might say right at the outset that I am not a utilities expert. I happen to be a lawyer, but not a utilities lawyer. I am not an accountant, a financial analyst, an engineer, or an economist. There are others who will speak to you on this subject who are experts.

The California Commission thought it might be best to be represented by one of our own members, because of the fundamental problems in this section, rather than from the standpoint of the technical problems. We have essentially, on a much smaller scale of course, the same general problem which you gentlemen have; namely, attempting to grasp the fundamental significance of a proposal like this, and making a decision in the public interest with the aid of our expert advisers.

It is because we think that we have gone through the process which you are necessarily going through that we wish, if I may use the phrase, to have a personal confrontation and underline the significance of our views. We think this is tremendously important, and in a State the size of California, it is many, many millions of dollars every year.

There are two points not stressed in my written statement which I would like to emphasize at the outset, because of the fact that the discussion this morning on this subject seemed to me to justify a special word on these two points. The first is I am not sure of the exact operation of the section. It actually proposes that this difference between the normal taxes and the investment credit taxes, that is, this difference measured by the investment credit, would be a part of the tax bill in a rate case. The Commissions would be required to assume that that additional tax had been paid even though it was not.

Our interpretation of the bill is that in spite of its being continued as tax expense, it wouldn't necessarily go to the stockholders. It would go to the company, of course, but one of the methods of treating this type of differential in the past has been to allow the amount in a special account which is then deducted from rate base, and in a portion of my prepared statement, when I talk of the rate payers being called upon to invest in the company, I was thinking of investing the amount measured by the investment credit through the collection of rates and holding it in the company as an investment by rate payers. I was not thinking of its being distributed to the stockholders in the sense of ultimate net profit for dividends.

Because of some remarks that have been made, and because this may not be the universal interpretation of this, I would like to refer to H.R. 7111, the bill to which Senator Gore addressed himself this morning, and point out that unlike section 202(e), H.R. 7111 does specifically require that a rate of return on this amount be allowed by the commissions.

It seems to me significant that in the bill reported out by the House of Representatives, that provision was deleted, since as I understand it, H.R. 7111 is the forerunner of 202(e).

The second point that I thought might be worth some special attention is an underlining of something that has been said many times, but

is tremendously important, and that is the fact that this is not a tax proposal. It is a regulatory proposal, section 202(e). It happens to come up in the context of a tremendously large, complicated tax measure, and it gets its plausibility it seems to me from this incidental connection to tax legislation.

Suppose the regulatory commissions were called upon to pretend that wages are more than they are, or that pencils cost more than they do. You would not feel that that was anything but a regulatory proposal. But because it is put in a tax bill, and because Congress happens to have, in addition to its regulatory jurisdiction, tax authority, it tends I think to give the impression that Congress has a special power over taxes as utility expense, which it does not have over wages as utility expense.

I think I can illustrate this by calling attention to the effect which the bill would have upon a State commission such as ours. There is a line, and it is essentially drawn by Congress, between State regulation and congressional, Federal regulation, and a large part of the regulation of California utilities is by the State commission. But Congress does not supervise the way we do our regulating.

This bill not only is not nominally directed to our commission, I do not believe it could constitutionally be directed to our commission in this sphere of regulation which the Constitution permits us to carry out.

Senator BENNETT. Mr. Grover, are you aware that the bill limits—let me read you the words:

> Accordingly Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to the taxpayer shall without consent of the taxpayer.

Mr. GROVER. I understand that. It applies only to the Federal agency.

Senator BENNETT. This doesn't affect your power to regulate the industries in California, in any way, does it?

Mr. GROVER. No, it does not, not directly. But that was merely an incidental point I was making about the constitutionality. It was a gratuitous comment.

Senator BENNETT. I am not objecting to the comment. It seems to me that since the bill is limited, in effect, to the Federal Power Commission or any other agency or instrumentality of the United States, that you only have an academic interest in it.

Mr. GROVER. We have a dollar interest in that—we are also before the Federal agencies. We represent the ratepaying public of California, and are very active in the cases, the interstate cases which affect us.

As I point out at the end of my written statement, the supremacy clause does have a tendency to give the Federal agencies control of the acounting of the utility that is under both jurisdictions, and does tend to influence us, and the fact that separate accounts would be maintained is a complication for us. But it is essentially because our ratepayers will be paying Federal rates, and we represent our ratepayers, that I am here.

But the point that I was making, Senator, was that Congress does not even purport to have regulatory authority over the State, but it is because it happens to have regulatory authority over the Federal agen-

cies that this regulatory measure has been put in the tax bill. You have tax authority over everyone.

Senator BENNETT. Isn't it really the other way around? We attempted to write a tax bill, we did it last year, we wrote into the tax bill last year certain privileges, tax privileges for those companies that would make investments, qualify themselves for the purpose and so far as regulated industry is concerned, this as an accident happens to impinge on a question of regulation.

We were not attempting to interfere with regulation. We were attempting to extend to regulated industries the same tax privilege that we made available to all industry, and now this created some problems which we are attempting now to clarify.

Our purpose, our function, our interest is in the tax effects, not in the regulatory affects. We are trying to push the regulatory effects out of the way to protect the value of the tax proposal for the industries who, because of accident or law, are also regulated. So aren't you looking at this backward?

Mr. GROVER. I respectfully think that I am not, Senator. The point I was making about the States is that our intrastate companies, like say, Southern California Water Co., entirely within our State, are just as much affected by the tax aspects as are the interstate companies. Congress has complete control as to taxation.

Senator BENNETT. That is right.

Mr. GROVER. And I was merely trying to call your attention to the fact that this is a regulatory law, section 202(e) is a regulatory law as witnessed by the fact that it only purports to apply to those agencies over which you have regulatory jurisdiction.

Senator BENNETT. Again you and I are looking at it from the opposite point of view. We wrote a tax law for the benefit of all corporations, including regulated corporations. Then we discovered that the impact of our law, that our law had an impact on the regulatory side of these corporations, so we are trying to say to you in this law, "Get the regulatory effects out of the tax law unless the customer is willing to have you bring your regulatory powers to bear on the situation created by the tax law." So that is why this section says in effect only if the customer is willing can this be taken into consideration in ratemaking.

Looking at it from our point of view, we had a program for all industry that would increase this investment. We are going to give it a tax benefit for investment. One segment of industry is regulated. The question is immediately raised whether it is at the State or the National level, what are we going to do with this benefit that this tax law provides for this segment of industry as a part of all industry.

So we are saying to you, you can't take it into effect in carrying out your function as a regulatory agency. This is a tax benefit. And unless the taxpayer is willing to have you take it in effect, you leave it alone. Isn't that the effect of this particular——

Mr. GROVER. Again, I am sure from your remarks, Senator, that you have thought this out yourself at some length.

Senator BENNETT. This is the way it appears to me. Otherwise, if it hadn't been for the questions raised after we passed the law last year, raised by regulatory authorities as to how they were going to use this tax benefit as a part of their regulatory program, we would not have anything in the law this year.

We thought we did our job last year. We are not writing anything in here for the unregulated industries. We are trying to get you out of the tax benefit that we set up for these people.

Mr. GROVER. My only point, Senator, at this point at least was to emphasize that this is a regulatory proposal, and that in saying what to do with tax expense in a regulation proceeding, in a rate regulation proceeding, it is only incidental that Congress also happens to be the taxing authority.

Senator BENNETT. No; we are the taxing authority. It is the regulatory side that is incidental. This wasn't written as a regulatory law. We have no authority. This committee has no authority to write regulatory legislation. That would fall in the jurisdiction of another committee. Our responsibility is to write tax legislation.

Mr. GROVER. But it seems to me that that is what this bill does. It tells a regulatory agency what to do about a certain expense, and you might just as well stimulate the economy by "pretending"—that isn't the word that I want to use—by instructing them that wages should be increased 10 percent, in order to stimulate company profits.

Senator BENNETT. Apparently we chose to say that if a corporation would invest money in new equipment, a certain type of fixed assets, we would give them a tax credit. It just happens that part of the industry that is entitled to that tax credit is also regulated. So we are saying in this bill we did not intend that this should change your pattern of regulation.

We did no intend that you should maybe deprive the taxpayer of some of the benefits that he might get from the tax program because you have the power under your regulatory laws to insist that this amount of money be taken into consideration in your ratemaking structure. So we are saying, "Get out of it."

Mr. GROVER. Well, we view it in this way, Senator, that this money that comes in, it is gross revenue for a company; a part of the money collected by rates is money that the company does not spend for taxes. That is the significant thing.

The fact that last year or rather the year before they were spending such money for taxes is not to us significant. The point is, it is an expense that they are no longer forced to meet.

Senator BENNETT. In order to have the benefit of this particular tax exclusion or reduction, they have got to do certain things. Every company, unless they make the investment, they don't get the benefit.

It was intended to have a limited application available only to those people who met the qualifications and spent the money for a certain purpose, which makes it completely different from the benefit that would come from a general tax reduction.

Mr. GROVER. I wonder then, Senator, if I could jump to the second——

Senator BENNETT. Let me say one other thing. You have the situation where company A, which chooses not to make the investment, doesn't get the benefit, and company B, which does make it, gets the benefit. And so that faces you with the problem, this is a situation in which one company gets an advantage taxwise over another company.

Mr. GROVER. Do I understand, Mr. Chairman, that my written statement will be made a part of the record?

The CHAIRMAN. Without objection.

Senator BENNETT. I am not trying to cut you off. You go ahead and finish up what you want to say.

Mr. GROVER. I just thought it might save us all time, since I have covered some of the points in here, if I continued on a summary of the statement, and then the detailed statement would be included.

Senator BENNETT. Fine.

Mr. GROVER. I think in view of your remarks, I would like to turn now to the second major point in my statement which was that even under the flow-through method, the purpose of the investment tax credit will be served.

Now I think there again that there is a plausibility to section 202 (e) in the mere way in which it is worded.

It says that there is a desire for incentive for modernization and growth, and incentive is at the heart of this thought that the companies that do it should get the benefit. The companies that don't should not. But I agree wholeheartedly with Chairman Swidler this morning, who emphasized the real reason for the utilities building is the demand of the service, the growth of the company. The vast bulk of investment in utility construction is dictated by the legal necessities of the utility to provide service.

I doubt that any great amount would carry any incentive as a result of this tax provision as Chairman Swidler put it, "the marginal project only." As a result, the great bulk of the benefit comes from the program they already had in mind.

Senator BENNETT. This is more true of the electric energy utilities than the gaslines which were in open competition with other forms of energy. They don't have a monopoly.

Mr. GROVER. I am just not in a position to comment on that. We think of, say, the El Paso company's gaslines into southern California as the only gaslines into that area.

(Mr. Grover subsequently advised Senator Bennett that he inadvertently omitted naming Trans-Western Pipeline Co. as another pipeline in southern California.)

Senator BENNETT. There are other areas where there are competing gaslines.

Mr. GROVER. To the extent that there is competition, this may be less true.

Senator BENNETT. And this is one reason why the gaslines get 7 percent and the electric utilities only get 3 percent. In changing that rate, we recognized this factor you are talking about.

Mr. GROVER. But 202(e) makes the method which it uses mandatory in all cases.

Senator BENNETT. That is right.

Mr. GROVER. And we would prefer that your regulatory commissions be entrusted with the job of judging case by case, situation by situation what is in the public interest.

Now in my written statement I have given a few examples of the way it might be treated. You will recall that the transportation tax, the excise tax was removed a while back. In the case of our passenger service, rail passenger service in California, the Interstate Commerce Commission immediately, and we, I must confess with more reluctance—we had to be sure we were doing the right thing, and we found

the Interstate Commerce Commission was right—with more reluctance we also gave that tax benefit 100 percent as profit for the company simply because under the regulatory system, they hadn't been able to maintain adequate profits.

So there is no objection under the present system to a company which really has a justification for increased profits getting those profits.

Senator BENNETT. As I look at this, and I realize we are looking at it from completely different points of view, unless we pass this particular section, we are leaving you to decide who is going to get the tax benefit when, under our standard procedure, every taxpayer who qualifies is entitled to the benefit by qualification.

We don't let somebody else come along and say, "Well, General Motors is doing so well that they don't need the benefit of this 7-percent investment credit, so we will just decide Chrysler hasn't been doing so well, Chrysler can have it but General Motors can't."

In other words, we have put another agency in the stream that will decide who is going to get it, or how the benefit of this tax program is going to be distributed as between individual taxpayers. I don't think that is consistent with the general tax policy, which is that every taxpayer should be treated alike so far as the application of the law is concerned.

Mr. GROVER. Well, I would like to make two comments upon that. First, your very illustration calls attention to a vital difference in utility regulation, namely, that you seldom have a Chrysler-General Motors situation in the utility industry. By and large it is monopolistic.

Chrysler and General Motors may not get a nickel of this tax credit. It may come under the forces of market competition right into the price structure and into lower prices for cars. I don't know. I haven't the slightest idea.

Senator BENNETT. They have the choice.

Mr. GROVER. They have the choice.

Senator BENNETT. And this bill gives the utility the choice.

Mr. GROVER. Yes.

Senator BENNETT. It can pass it on or hold it.

Mr. GROVER. Yes, but because of its monopolistic nature, which is the very reason for the commission in the first place, because of its monopolistic nature there is not sufficient protection for the public as there is in a competitive situation. That would be our position.

The second point that I would like to make about passing this law is that in many cases it will be passed along to the utility companies, as I pointed out, themselves. Perhaps I could illustrate with a 50-percent tax cut. Just cut everybody's tax bill in half. From what I read about H.R. 8363——

Senator BENNETT. A consummation devoutly to be wished.

Mr. GROVER (continuing). It is not like to happen, but suppose it did happen. Now the corporations of course that are not in the utility business would get the benefit of this tax cut. You wouldn't say how they would use it. I imagine a lot of it would go into the prices, into decrease in prices.

But the utility companies, you see, because of their monopolistic position, the fact that the utility commissions fix the prices and the

people have to pay that, and they have nowhere else to go for telephone service or whatever the other utility may be, if a law like this were passed for that 50-percent cut, it would mean that all of that money would be in the hands of the utilities, an enormous amount, when actually what we would expect the commissions to do in that case would be to adjust rates downward in each case, depending upon all the facts that go into a rate proceeding.

Senator BENNETT. If we cut taxes 50 percent, we wouldn't tack this kind of a bill onto their use. This is a particular tax for a particular purpose, and it is a limited amount, 3 percent so far as monopolistic utilities are concerned.

Mr. GROVER. Although I believe 202(e) is narrow in its phrasing in limiting it to this incentive situation, I believe there will be some cases where that incentive occurs.

But in the utility business it would be relatively few cases. It is really essentially a tax reduction for utilities. For that reason, in the utility situation it seems to me best to leave it to the commissions involved, to say whether this results in unreasonable profits.

Senator BENNETT. I recognize the difference between the two points of view. One is expressed in the bill, and the other is expressed in your reaction to the bill.

Mr. GROVER. My third point, Mr. Chairman, was the effect upon State commissions, and this is not a direct legal effect. As I mentioned in the statement, I believe our California commission would stick to the flow through.

We went through this over a period of years, and as it happens, all five commissioners now are for flow through. As I pointed out in the case of the Bell System Co. in California, over 85 percent of its revenues are controlled by the California commission, because they are intrastate revenues.

Yet naturally the Federal Communications Commission—I am not objecting to this, this isn't a State flag-waving argument—the Federal Communications Commission does set the standards for regulation of the entire telephone industry in many ways, and because of the difference in importance, in dollar importance between the State and the Federal, it is a case as I suggest of the tail wagging the dog, if Congress does not allow the flexibility which Congress in the past has allowed the Federal commissions.

In the case of accelerated depreciation, for example, the Federal commissions, have by and large adjusted the accounting procedures so that the States are not burdened. There will be States of course that will follow the Federal lead, and that is another reason I am here, to urge what I believe to be the correct Federal position.

We feel that it will be a burden upon the States, and it is something which is of secondary importance to you gentlemen, but it is something which we do urge you to consider, to put a mandatory provision upon the Federal commissions who are always the leaders in the utility field.

If I have spoken with some earnestness, too much earnestness, I apologize, Mr. Chairman. But we do feel this is important, and we do believe in our point of view. I appreciate the indulgence of Senator Bennett in permitting me to be as frank as I have been.

The CHAIRMAN. Thank you very much, Mr. Grover.

Senator BENNETT. Thank you.
(Mr. Grover's prepared statement follows:)

STATEMENT OF OPPOSITION TO SECTION 202(e). BY GEORGE G. GROVER, COMMISSIONER, PUBLIC UTILITIES COMMISSION, STATE OF CALIFORNIA

I. SECTION 202(e) IS IN CONFLICT WITH THE ACCEPTED PRINCIPLES OF PUBLIC UTILITY REGULATION

Section 202(e) overlooks the fundamental difference between utilities and nonutilities. Utilities are regulated—directly, comprehensively, continuously regulated. If profits are too high, rates are reduced; if profits are too low, rates are increased; it is unlawful to charge more, or less, than the rates fixed by public authority. If a utility pays excessive salaries to its officers, or if it pays unreasonably high prices for materials, or if it overbuilds its distribution system in relation to the number of customers, such excess expenditures may be disallowed. On the other hand, if its facilities are not adequate, the utility may be ordered to build the necessary additions. Utility construction and operations must be safe, both for employees and for customers, and the service ultimately rendered must meet prescribed standards of quality and uniformity. In many situations financing by utilities is also controlled, both as to borrowings and as to issuance of stock. Utility property can be sold only with regulatory approval. A utility cannot even quit without permission; and when abandonment is justified and allowed, regulatory authority may impose reasonable conditions in the public interest.

All of this is different in the case of nonregulated companies. Direct governmental control of nonutility enterprise is relatively limited, and company management is left with much more authority. As a result, in nonutility situations there has frequently been resort to indirect methods of governmental control, such as the taxing power. The investment tax credit is a case in point. It is designed, at least in part, as indirect regulation, for it is expected that allowance of the credit will stimulate the economy. We agree that it will (and I will have more to say about that in a moment), but the way in which it will stimulate the economy will be different for regulated and unregulated business. The present proposal to prohibit flow-through treatment of the investment credit fails to recognize this vital difference in governmental treatment as between utilities and nonutilities. Section 202(e) merely recites that it was, and is, the intent of Congress to provide an incentive for modernization and growth of private industry—"including the portion thereof which is regulated." The suggestion is that the regulated portion of private industry is just like the unregulated portion. In actual fact, that is not true.

Oddly enough, after justifying itself on the idea of treating utilities just like nonutilities, what section 202(e) then proposes is that they not be treated alike after all. Ironically, from an accounting standpoint it is we who propose that they be treated in the same way. Manufacturing companies will record this tax saving as an increase in net profit. In one sense, it might be more accurate to say that they will not record it at all, but since they will pay less income tax than without the credit, the effect of the credit is to leave more of the gross revenues as net revenues, that is, to increase profit. In this way the tax credit is said to "flow through" to profit. We propose that the same accounting treatment be followed by utilities. The reason a manufacturing company uses flow-through accounting is that flow through accurately records the facts; the company has, in fact, paid less tax and it has, in fact, more profit to use for additional construction, for dividends, or for price reductions. We propose flow-through accounting of utility investment credit for exactly the same reason—it accurately records the facts. There is, in fact, less tax paid by a utility for the year in question; there is, in fact, more profit in that year; and that profit is, in fact, available for additional construction, for dividends, or for rate reductions. The reason the supporters of section 202(e) do not wish to record these facts in the same way an unregulated company would record them—the reason they do not wish to show this profit—is that in the case of utilities profit is subject to regulatory control. Manufacturing companies are allowed by law to decide whether or not higher profit for a given year will be passed on to customers in the form of price reductions; we know that manufacturers will act selfishly in making this decision, but the competition of other manufacturers whose taxes have been similarly reduced is expected to provide appropriate

protection for the public. The law does not give such a choice to public utilities, however, because their monopoly position does not allow sufficient protection for the public. To the extent that the decision as to disposition of this tax saving is transferred from the regulatory commissions to the utilities themselves, then to just that extent public utility regulation as we now know it will have been abandoned. Section 202(e) is nothing more nor less than a proposal to remove a portion of the profits of public utilities from the jurisdiction of Federal regulatory agencies. As such, it is a direct assault upon the integrity of the regulatory process.

Since section 202(e) is in reality a regulatory proposal and not a tax proposal, it may be helpful to examine it more closely in the context of regulatory law rather than in the context of taxation. In this way we may be able to get a clearer picture of how it would operate and what its proponents hope to accomplish. The "cost of service" method of rate regulation is in general use by commissions throughout the United States today and is expressly referred to section 202(e). This ratemaking approach involves three elements: expenses, investment, and profit. A typical rate case considers these elements in two stages: first, the regulatory agency analyzes recorded expenses and investment and adjusts them, if necessary, to conform to standards of reasonableness; second, the agency determines a reasonable profit, usually expressed either as a percentage of investment (rate of return on rate base) or in relation to total expenses (operating ratio). The sum of the allowed expenses and profit becomes the revenue requirement which the ratepayers are then called upon to satisfy. That first stage (determination of reasonable expenses and investment) is one of relative precision and objectivity; in most cases actual costs are allowed. From a regulatory point of view, if a particular expense is actually incurred and if it is reasonable, then the specific nature of that expense is not material—rent, wages, maintenance, pencils, or income tax are all alike. Since taxes are considered in a rate proceeding merely as a subdivision of total expenses and since the investment credit is just what it says—a tax credit and not a tax expense—we respectfully submit that it would be absurd to require a regulatory agency to treat the credit as an expense. Such treatment could only distort the final result. It is no more justified than pretending that rent or wages or the cost of pencils are higher than they really are.

Viewed as a regulatory measure and divorced from the fiction of tax expense, what section 202(e) actually proposes is that a portion of utility investment in each year (that is, the portion measured by the amount of the investment credit) will be supplied not only by the utility but by its ratepayers. For certain kinds of property this money will never be returned to the ratepayers, and for the remaining property it can be returned only by ratemaking credits over the life of the property. Under this arrangement, the ratepayers would not only provide this capital (some of it permanently) but also, even as to the portion that can be returned to them, they would take all the risk that the utility might not be able to return it; the ratepayers would receive no interest on the use of their money; and, since most utility properties have long lives, it is almost certain that the ratepayers who would pay this excess charge would not be the same ratepayers who would get it back. Such an arrangement is public enterprise, not private enterprise. The essential element of private enterprise is private investment.

It is now apparent why this proposal is not presented to Congress as an amendment of the public utility regulatory statutes—we respectfully submit that it would be too utterly preposterous. It can be made even superficially plausible only by burying it in a tax statute where Congress is dealing largely with the problem of indirectly regulating all forms of business enterprise.

Recent history has no doubt played a role in the formulation of this proposal and in the failure in some quarters to perceive that it would have a crippling effect upon regulation. Under present law, the basis for depreciation of the property is reduced by the amount of the investment credit; since that much less depreciation can be claimed over the life of the property, 52 percent of the credit will ultimately be paid in higher taxes in future years. On the theory that the result is a tax deferral rather than a tax reduction, it has been argued that the credit should be considered for ratemaking purposes only over the life of the property. There are at least four reasons why this argument has no application to section 202(e). First, the tax deferral theory can apply to only 52 percent of the credit, whereas section 202(e) would operate on the entire credit. Second, section 202(a) of the bill would repeal the requirement that the depreciation basis be reduced by the amount of the credit; with this amendment there can no longer be

any contention that the investment credit amounts to a tax deferral rather than a tax reduction. Third, as to some of the property involved, section 202(e) would not permit the regulatory agencies to treat the credit even as a tax deferral, that is, it would not permit them to spread the credit over the life of the property; as to such property the credit would amount to an outright contribution to the utility. Fourth, in connection with tax benefits based on accelerated depreciation, where in theory the effect was a tax deferral rather than a tax reduction, the evidence presented to the California commission showed that as a practical matter, in view of the tremendous growth of our economy, it really amounted to a tax reduction. In any event, if the tax saving in any given future year should turn out to be less than the tax deferrals which become due in that year, the utility's rates can be adjusted upward in that year and under a proper application of the cost-of-service principle they would be. There is no need to burden the ratepayers with such taxes prior to the time when the taxes must be paid.

Section 202(e) is inconsistent with the cost-of-service method for yet another reason. In the second stage of a rate proceeding, the regulatory agency is called upon to determine a reasonable profit. Outside the transportation field, this is usually stated in terms of percent of return on investment. Necessarily the determination of such a rate of return is not subject to absolute precision, but a century of experience has led to considerable agreement concerning the standards to be followed, and the law recognizes certain factors which should be considered. Among these are the prevailing returns in other businesses, the relationship between common stock and debt in a utility's capital structure, the utility's construction needs, including the need for "modernization and growth," and also the availability and cost of financing such construction. Results will differ from commission to commission and from year to year, but for any given commission at any given time, a significant change in one of these factors should bring about a change in the rate of return allowed. In this way, section 202(e) will be self-defeating, at least insofar as it constitutes an effort to increase utility profits. The cost-of-service approach is a single concept; if Congress tinkers at one end by changing the facts upon which the regulatory agencies are required to base their decisions, then those agencies will necessarily undo that tinkering at the other end when they consider the changed facts and change the rate of return accordingly. To be specific, if Congress by this statute requires ratepayers to finance a portion of the cost of utility construction, then utilities will have just that much less difficulty attracting capital for the portion which they must finance; the regulatory agencies should then allow a lower rate of return in recognition of this easing of financial requirements. The supporters of section 202(e) may hope that the Federal agencies will not fully offset in rate of return the advantage gained by utilities with the adoption of this section; but surely Congress, in considering this legislation, cannot assume that the agencies will not do their job.

In opposing section 202(e) we urge that the appropriate place to deal with the construction needs and financing needs of regulated industry is in the regulatory process itself. The regulatory agencies are already charged with the task of considering these needs in connection with the determination of reasonable rates based on reasonable profit. When lower taxes result in higher utility profits, the regulatory agencies, not the utilities, should decide how much of that increase in profit shall be retained and how much shall be passed on to the ratepayers in the form of reduced rates for the public; no other approach is consistent with the public utility concept.

II. SECTION 202(e) IS NOT NEEDED IN ORDER TO ACCOMPLISH THE OBJECTIVES OF THE INVESTMENT CREDIT

Another distinction between utilities and nonutilities is the degree to which tax incentives can enlarge or contract their construction programs. Here again, section 202(e) erroneously equates the two kinds of enterprise. Most utility construction is necessitated by the legal obligation to provide service. In an economy, growing as ours is, the increasing demands for utility service have placed a heavy burden upon utilities, and it is these demands which largely determine the size of their construction budgets. One utility alone in California has a budget this year for expansion which runs in the hundreds of millions of dollars. The job of raising the necessary capital is already a sizable one, and it is unlikely that much additional utility construction will be undertaken merely because the cost will be reduced by 3 percent.

This does not mean that extending the investment credit to utilities is not desirable; on the contrary, it produces very substantial public benefits. The "incentive for modernization and growth" to which section 202(e) refers is far too narrow a decription of this tax bill or of the investment credit; section 1 of H.R. 8363 much more accurately refers to the objective of stimulating the economy. Although investment credit may not induce utilities to undertake much additional construction, the application of the credit to the extensive construction which is already planned will give the utilities a substantial tax reduction. The reduction will indeed stimulate the economy. Regardless of the manner in which regulatory agencies decide to utilize this reduction, it will aid in achieving the overall economc objectives of the bill. As a matter of fact, I personally wish that Congress had seen fit to provide a 7-percent credit for public utility property rather than 3 percent.

In opposing the right of a utility to say where this tax saving shall go, we do not mean to suggest that regulatory commissions will never decide to allow it as higher profit. In many cases they will do just that. For example, the recent repeal of the Federal tax on passenger transportation by rail was used by both the Interstate Commerce Commission and the California Public Utilities Commission to increase rail passenger profits. Profits had fallen below reasonable levels, and in many cases there were deficits; rate increases, however, either had not been sought or had not been granted simply because even at the existing rate levels, passengers had been changing to other methods of transportation. By allowing the railroads to keep the tax saving, their earning position was improved without an increase in rates.

In many cases, and especially where profits are already at reasonable levels, the regulatory agencies will use all or part of the investment tax credit to reduce utility rates. A stimulation of the economy will result. Like taxes, the cost of buying utility service is very close to a necessity for most people. Utility rate reductions, like tax reductions, therefore have the effect of improving public purchasing power and stimulating economic activity. These rate reductions are not at the utilities' expense, and the net result is to spread the tax reduction more widely over the economy. This is especially in accord with the objective of business stimulation, for a large part of utility service is performed for business. In the case of Pacific Gas & Electric Co., for example, in 1962, 55 percent of its gas revenues and 64 percent of its electric revenues came from sales to other business enterprises. A reduction in utility rates to these customers would give additional stimulation to business activity of all kinds.

No doubt there will be situations in which a given utility would consent to using the tax saving for rate reductions; in 1961, for example, we authorized one large gas utility to reduce rates to certain large industrial customers who were in a position to use fuel oil instead of gas, but we required that such reduction be at the company's expense and not shifted to other ratepayers; the utility made the reduction at its own expense in order to keep these customers. This situation differed from the rule contemplated by section 202(e), however, in that in this case the California commission also consented and imposed conditions which protected other ratepayers.

Still other uses could be made of the tax saving. Thus, a tax saving resulting from accelerated depreciation, amounting in the course of several years to about $30 million, was used by one California utility, with our approval, to convert from sinking fund to straight line remaining life depreciation—an important step in the company's financial program. Without the tax reduction, a burdensome increase in rates or decrease in profits would have been necessary. Such other beneficial uses of the investment credit further illustrate the narrowness of the objective stated in section 202(e).

III. SECTION 202(e) WOULD BURDEN STATE REGULATION OF THE UTILITIES

Section 202(e) is not binding upon State commissions. In California, our commission unanimously favors the flow-through treatment, and I believe we will not change even if section 202(e) is adopted. The result would be to place many of our utilities under a dual system of control and would force them to maintain two accounting systems. The failure thus far of the Federal Power Commission to decide on the treatment of investment credit has already caused confusion and made our task more difficult. One large California utility, for example, has had to keep the amount of the credit in a special suspense account, and because of the uncertainty we have not sought to reach that account for

rate reduction purposes. Millions of dollars each year are involved in connection with this company alone.

A special complication results from the fact that in many of these cases, perhaps in most of them, State commissions have jurisdiction over most of the revenues involved. For example, Pacific Telephone, the Bell System company in California, is regulated by the California Commission as to more than 85 percent of its revenues; interstate revenues amount to less than 15 percent. Under the supremacy clause, primary accounting records might have to be maintained in accordance with section 202(e), in spite of the small portion of the company's revenue which is under Federal control. We recognize the propriety of Federal regulation of the interstate traffic, and we certainly recognize the supremacy clause, but from an economic point of view it would appear to be a case of the tail wagging the dog. Almost all of the revenues of California's large electric and gas utilities are likewise under State regulation, and these companies might be similarly affected.

Without section 202(e), the various Federal regulatory agencies would be free to agree with us on the propriety of flow-through; in any event, they would be free to adapt their accounting requirements to meet the needs of varying circumstances, and with a minimum of interference in the jurisdiction of the State commissions.

California respectfully urges that section 202(e) be deleted from H.R. 8363.

The CHAIRMAN. The next witness is Mr. William H. Harrar of the 42nd Street Association. Take a seat, sir, and proceed.

STATEMENT OF WILLIAM H. HARRAR, 42ND STREET ASSOCIATION, INC.

Mr. HARRAR. Mr. Chairman, my name is William H. Harrar.

On behalf of the 42nd Street Association, Inc., a civic organization comprising several large commercial office buildings in Midtown Manhattan, New York City, and the commercial real estate industry in general, I wish to draw your attention to the provisions of H.R. 8363 which extend the coverage of the investment tax credit provisions of IRC section 38 to elevators and escalators and respectfully to urge upon you the passage of this legislation.

I may say that this is a different part of section 202 which we have been dealing with so far. In view of what Senator Dirksen said this morning, and I hope, just because what I am recommending comes after 3 o'clock, it won't receive a cool reception.

When the Congress provided the basic investment tax credit to stimulate the national economy in the Revenue Act of 1962, it made one specific disallowance: the credit was not to extend to "buildings and their structural components" (I.R.C. section 48). The committee reports of both Houses described this nonqualifying category as including "a structure or edifice enclosing a space within its walls and usually covered by a roof"--the basic structure of an improvement to land, the purpose of which is * * * to provide working, office, display or sales space. "Structural components," according to the Reports, included "such parts of the building as central air-conditioning and heating systems, plumbing, and electric wiring and lighting fixtures, relating to the operation and maintenance of the building." Note that neither report mentions elevators. In none of the documents pertaining to the 1962 bill is there any direct evidence of your intent as to elevators or escalators under the 1962 Revenue Act.

This last spring, however, the Commissioner of Internal Revenue, apparently acting on his own motion, supplied an intent for you. In his proposed regulations, under section 38, promulgated on March 28, 1963, he defined the nonqualifying phrase "structural com-

ponents" as including "elevators, including all components thereof." At the hearing on these regulations, representatives of the elevator industry, of certain department stores and this association presented objections to this view of what the law meant; so far, the regulations have not been finalized. As far as can be determined, the Commissioner apparently feels that if elevators and escalators are to qualify for the credit, administrative difficulties will arise when the building is sold in determining what part of the profit shall be treated as capital gain and what part as ordinary income. H.R. 8363, section 202(d), takes care of this in commendable fashion by tying section 1245 to any adjustments in respect of elevators and escalators.

Presented with the Commissioner's adverse view of what the 1962 act was meant to exclude, a view from which he has so far not receded, the Ways and Means Committee and the House of Representatives have decided that it is appropriate to reconsider the treatment of escalators and elevators, that such items are clearly akin to assets accessory to the operation of a business which already qualify, and that new elevator and escalator equipment forms an important aspect of the modernization of plant and facilities (H. Rept. No. 749, 88th Cong., 1st sess., pp. 35–36).

As in other industries, competition among the operators of commercial office buildings is keen. In New York City the situation has been heightened and aggravated for the older operators by the recent enormous increase in new, modern structures, such as the Pan Am Building, the First National City Building, Chase Manhattan Plaza, and many others which have been, or are about to be, opened to tenants. According to the Real Estate Board of New York, 50 million square feet of rentable space have been newly constructed in New York City since 1945, and 15 million more are presently under construction. One of our members' largest buildings was opened in 1927, and another in 1930. There are many like them. It is vital to the continued existence of such older buildings for their proprietors to modernize their equipment to as great a degree as is financially possible. Otherwise, the best business will inevitably go elsewhere.

One of the most obvious items for modernization is a building's elevators. The elevator is perhaps the one part of a building's appointments which makes the most telling impression upon the public, upon potential tenants and upon the customers of existing tenants—the lifeblood of this industry.

I would like to point out to you that modernization of elevators, usually undertaken so as to change them from the manual type requiring an operator to automatic pushbutton, is essentially an installation of machinery and equipment: It does not involve modification of the structural shell of the building. The items of an elevator modernization are new cabs, new communication equipment, new starter panels, reconditioning of hoisting machines, commutators, bearings, field coils and motor generators, and new brake assemblies and governors. Such a work of modernization permits more efficient use of the building and increases its taxable profits. In essence, its function for a building owner is entirely analogous to the installation of an oxygen furnace by a steel mill or a new type of assembly line for an auto manufacturer. The motivation is an increase in profits and a strengthening of the competitive position. In other words, if it was wise tax policy to provide the investment credit for manufacturers, it is equally wise tax

policy in the case of machinery necessary to building owners, benefiting not only them, but also the elevator, electronic, and steel industries which do the work and supply the materials. The beneficial effect on the revenue is obvious.

Accordingly, it is respectfully urged that you pass this important remedial legislation.

As already stated, it is not clear to the general public that you ever meant to deny the credit in 1962 for elevators. In the debate on that bill on the floor of the Senate the late Senator Kerr went so far as to say:

> The facilities whereby the building is utilized in the trade or business of the occupant are eligible for the credit" (Congressional Record, Sept. 5, 1962, page 17549).

So, in conclusion, we also ask that you now ascertain whether you did not mean to allow the credit for elevators and escalators in 1962. If you did, then the effective date of sections 202 (c) and (d) should be changed from June 30, 1963, to December 31, 1961. Thank you.

The CHAIRMAN. Thank you very much, Mr. Harrar.

The next witness is Mr. Asel Colbert, chief of Accounts and Finance Department, Public Service Commission of Wisconsin.

STATEMENT OF ASEL R. COLBERT, CHIEF OF ACCOUNTS AND FINANCE DEPARTMENT, PUBLIC SERVICE COMMISSION OF WISCONSIN

Mr. COLBERT. Thank you, Mr. Chairman.

My name is Asel Colbert, chief of Accounts and Finance Department, Public Service Commission of Wisconsin. I am chairman of the Committee of Accounts of the National Association of Railroad and Utility Commissioners.

I am appearing here on behalf of the Public Service Commission of Wisconsin, and also on behalf of the Public Service Commission of New York, which has authorized me to do so by letter dated November 12, 1963 and filed with this committee. I would ask that that letter be made a part of the record if you please, Mr. Chairman.

The CHAIRMAN. Without objection.

(The letter referred to follows:)

STATE OF NEW YORK PUBLIC SERVICE COMMISSION,
Albany, November 12, 1963.

Re the Revenue Act of 1963 (H.R. 8363 and particularly the investment tax credit provisions in bill section 202(e).

The COMMITTEE ON FINANCE,
Senate Office Building,
Washington, D.C.

GENTLEMEN: Public Service Commission of the State of New York endorses the views expressed in the statement, dated October 28, 1963, submitted to the committee by Hon. Asel R. Colbert, chief, Accounts and Finance Department of the Public Service Commission of Wisconsin on behalf of that commission.

Further, should Mr. Colbert appear before the committee on behalf of the Public Service Commission of Wisconsin in any public or other hearings on the subject matter of bill section 202(e) of H.R. 8363, we should like it to be understood that his representations on this subject coincide with those this commission would make if otherwise represented. In any such pursuit Mr. Colbert is fully authorized to enter his appearance as on behalf of this commission.

Very truly yours,

JAMES A. LUNDY.

Mr. COLBERT. The Public Service Commission of Wisconsin objects to the provisions of bill section 202(e) of the revenue bill of 1963[1] which provides in essence that agencies or instrumentalities of the United States regulating utilities eligible for the investment tax credit shall not be allowed, without the consent of the utility, to treat any reduction in taxes arising from the investment tax credit as a reduction in the cost of service for the purpose of ratemaking, except for a proportionate part of the tax credit determined with reference to the average useful life of the property with respect to which the credit was allowed. We believe that bill section 202(e) should not be enacted as a part of the Internal Revenue Code for the following reasons:

1. The investment tax credit is a reduction of Federal income tax expense and does, in fact, reduce the aggregate cost of service and increase the net income of a taxpayer.

2. The requirement of bill section 202(e) that the tax credit may be included in the cost of service only over the life of the property to which the credit is related erroneously assumes that the tax credit is a reduction in the cost of property or is realizable only over the life of property.

3. The provisions of bill section 202(e) would in effect operate as an amendment of Federal regulatory acts requiring the determination of just and reasonable charges and result in such determination including an allowance for phantom taxes and being based, in part, upon the wish of a taxpayer rather than upon the judgment of the regulatory tribunal.

4. The intent of Congress in providing for an investment tax credit in the Internal Revenue Code of 1954 can most successfully be accomplished by recognizing that the tax credit is a tax reduction which reduces the cost of service.

1. The investment tax credit is a reduction in the Federal income tax expense.

The investment tax credit is simply a procedure adopted by Congress in the Revenue Act of 1962 to give selective tax reduction to those taxpayers who invest in additional qualified plant facilities. As such, the proper accounting and rate treatment is to base the charge for tax expense upon the actual liability for taxes with the benefit of the tax reduction arising from investment tax credit flowing through to net income.

Because the provisions of the Revenue Act of 1962 required that the basis of section 38 property be reduced by the amount of the investment tax credit, there were some who argued that the investment tax

---

[1] Bill sec. 202(e):

"(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—

"(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

"(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."

credit was only a reduction in taxes to the extent of 48 percent of the credit as 52 percent (the presently effective tax rate) would, in effect, be offset by future higher taxes because of lowered depreciation deductions. But under the proposed Revenue Act of 1963, H.R. 8363, this reasoning is no longer apt. Bill section 202(a) provides for repeal of subsection (g) of section 48 of the Internal Revenue Code requiring that the basis of section 38 property be reduced by the amount of the investment tax credit. Thus, under the provisions of H.R. 8363, there is no longer any question but that the tax credit is a reduction in tax expense.

As a matter of fact, from my experience as chairman of the Committee on Accounts of the National Association of Railroads and Utilities Association and resulting contacts with commission and utility accountants throughout the United States, it is my judgment that, if the Revenue Act of 1962 had not provided for the reduction in basis of the property by the amount of the investment tax credit, the differences of opinion regarding the accounting and rate treatment of the tax credit would not have arisen and instead there would have been general unanimity that the investment tax credit was a reduction in tax expense and in the cost of utility service.

There are some who claim that the investment tax credit should not be permitted to reduce tax expense and, hence, increase income because income cannot be created simply by acquiring plant. But taxes can be abated when, as provided by the Internal Revenue Code, the tax liability is reduced by a prescibed percent of qualified plant additions. The essential point is that the investment tax credit is a selective reduction of taxes; the amount of qualified plant additions is only a means of measuring the amount of the tax reduction.

It is to be kept in mind, also, that there can be no realization of investment tax credit unless there is taxable income. Thus, the investment tax credit is solely a credit against taxes based on income and is a reduction of such tax expense.

2. Bill section 202(e) erroneously assumes that the investment tax credit is a reduction in the cost of property or is realizable only during the life of property.

Bill section 202(e) provides that the reduction in taxes occasioned by the investment tax credit shall not, without the consent of the taxpayer, be taken into cost of service more than proportionately over the life of the property with respect to which the tax credit was allowed. It appears that this provision is based upon the premise that the investment tax credit is a reduction in cost of property or is realizable only over the life of property.

It has already been shown that the tax credit is not a reduction in the cost of plant. As a matter of fact, bill section 202(a), which repeals section 48(g) of the Internal Revenue Code of 1954 and thus provides that the investment tax credit does not reduce the cost of plant for depreciation purposes, has by its own terms decreed that the tax credit does not reduce the cost of property.

It is well that this is so, for consider the result that could happen if the tax credit were applied to reduce investment. This is more readily visualized if a higher rate of investment tax credit is assumed. Obviously, the accounting and ratemaking treatment should be the same in any event. Accordingly, let it be assumed the investment tax

credit was 100 percent of qualified property additions and that earnings permitted realization of the tax credit. In this circumstance, if the tax credit were deferred and applied to reduce the cost of plant, directly or indirectly, a zero rate base would result for a utility. With no earnings, there would be no dividends for common shareholders. Indeed, there would be no need for common stock investors at all as 100 percent of the cost of plant would have been obtained through the investment tax credit.

Senator BENNETT. I would like to stop you at that point. That would be true if the cost of plant were the only asset that would be required in order to operate a facility, but you have to have accounts receivable, and you have to have a lot of other things.

Mr. COLBERT. In the usual utility, Senator Bennett, the current assets of a utility are more than offset by the current liabilities. So primarily all the amount included in the rate base is comprised of——

Senator BENNETT. That is true for the rate base, but the dividends are earned out of the entire investment, not just out of the so-called rate base. You say there would be no earnings. If there were then, no rate base, there would be no income.

Mr. COLBERT. And there would not be if there was not rate base, because there would be nothing upon which to earn a return, and having no return, there would be nothing against which to issue common stock, and having no common stock, there would be no dividends.

This would be 100-percent socialization of the industry and, if deferral of a 100-percent investment tax credit would bring about this result, then deferral of a 3- or 7-percent investment tax credit is a 3- or 7-percent step in that direction.

Senator BENNETT, I would have to do a little thinking about the assumptions. I can't quite accept them.

Mr. COLBERT. It is submitted that a provision of a tax statute which would tend toward such result, even in small degree, is repugnant to our American capitalistic system.

The premise that the investment tax credit is realizable only over the life of property is negated by the fact that the credit is actually realized by a cash saving when the taxes are paid. To postpone recognition of such savings and spread them over future years is accounting and ratemaking error which, considering the long life of many classes of utility plant, borders on the ridiculous. To illustrate, the privately owned water utility in the city of Superior, Wis., spent $25,000 for additions and replacements of its cast iron water mains in 1962. The tax reduction by virtue of the investment tax credit was $750. In 1963, and in each future year, more or less similar amounts of additions and replacements of mains will be made so that in each year an investment tax credit will be realized.

But if the procedure set forth in bill section 202(e) were followed, the 1962 investment tax credit would be spread over the 150-year average life used for depreciating cast iron mains and only $5 of the credit applied to 1962 operations with the balance of $745 spread over the following 149 years. Similarly, the tax credit of each succeeding year would, in turn, be spread over 150 years.

If this kind of tax provision could have been, and were effective during the War of 1812, a private water utility would just have completed, in 1962, amortization of the tax savings on 1812 additions to

mains. Amortization of tax savings of 1813 and all subsequent years would remain to be completed.

This will illustrate also that, if tax savings from investment credit are deferred as provided in bill section 202(e), there will no doubt be many instances in the case of partnerships and sole proprietorships where the death of the taxpayer occurs before the life of the property has expired.

Senator BENNETT. That is true of all depreciation schedules.

Mr. COLBERT. For individuals and proprietorships; yes.

Senator BENNETT. Well, sure.

Mr. COLBERT. But if you defer this tax credit as proposed in 202(e) and the death of the proprietor or the partnerships occurs before the remaining unamortized part of that credit has been returned to income, then there is a windfall in the year of his death.

Similarly there would be a windfall under the provisions of 202(e) at any time a utility sold its property to another utility or was merged with that utility. That is an extremely undesirable effect of that provision.

3. The provisions of bill section 202(e) would in effect operate as an amendment of Federal regulatory acts requiring determination of just and reasonable charges for service.

The provisions of the Federal Power Act,[1] the Natural Gas Act,[2] Communications Act of 1934,[3] and perhaps other Federal regulatory acts, provide in general that the charges fixed by the regulatory authority shall be just and reasonable and that unjust and unreasonable charges are unlawful.

Bill section 202(e) would in effect amend these provisions by providing that, without the consent of the taxpayer, a Federal agency or instrumentality shall not allow in the cost of service more than a proportionate amount of the investment tax credit determined with reference to the average useful life of the property with respect to which the credit was allowed.

It appears this means that in determining just and reasonable charges a Federal regulatory agency would be required to allow, in addition to the full cost of service including return (but without reduction for the investment tax credit), an amount equal to the full tax credit less a proportionate amount thereof equal to the tax credit divided by the average life of the property. This is equivalent to the full and complete cost of service, including fair return, plus an addition for phantom taxes—taxes which are not payable and never will be payable.

This would be the creation of a new standard of measurement for just and reasonable charges by a regulated utility. It is submitted

---

[1] Federal Power Act:
"SEC. 205. (a) All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful."

[2] Natural Gas Act:
"SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful."

[3] Communications Act of 1934:
"SEC. 201. (b) All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is hereby declared to be unlawful: * * *"

that, if any such new standard is to be created by the Congress, it be done by way of a specific bill designed to amend the appropriate regulatory act with such bill being investigated and passed upon by the appropriate committees of the Congress and that new regulatory standards not be enacted by means of a provision of a revenue act.

Further, application or nonapplication of such new standard of measurement for just and reasonable charges would depend upon the consent of the taxpayer. It is submitted that it is highly undesirable to have the standard for just and reasonable charges for utility service dependent in part on the wish of a utility instead of upon the judgment of the regulatory tribunal.

The provision of bill section 202(e) for inclusion in the cost of service of regulated utilities of more than the actual tax expenses—that is, phantom taxes—is discriminatory with respect to taxpayers not so regulated. In commercial and industrial enterprises generally, the force of competition will demand that the tax savings from investment tax credit be reflected in sales prices. But under bill section 202(e) the tax savings of utilities could be reflected in sales prices only ratably over the life of property which means, in a continuing enterprise, there would be a deferral of part of the tax credit in perpetuity. This seems to be an unreasonable preference to utilities. Further, it is unnecessary as the earnings of utilities are good. In fact, as reported by First National City Bank of New York for each of the years 1958–62 the percent earned on net assets of utilities was higher than for the aggregate of other industry and the average for the 5 years was 9.9 percent for utilities and 8.9 percent for all other industry.

We believe that it is desirable in the public interest that the long and lawfully established practice of having just and reasonable charges for utility service fixed by a regulatory commission, subject to review by the courts, be continued and that no legislation to circumscribe such practice should be enacted. While bill section 202(e) applies only to Federal agencies or instrumentalities, it should be remembered that a great segment of the utility industry is engaged in both interstate and intrastate operations and is subject to both Federal and State accounting and rate regulation. Because of this dual regulation, the provisions of bill section 202(e), if enacted into law, may, as a practical matter, have a substantial effect on regulation of intrastate operations of utilities by State agencies. It is submitted that the only effect a Federal revenue act should have on intrastate utility regulation should be in reference to the actual tax liability of a utility.

4. The intent of Congress in providing an incentive for modernization and growth can most successfully be accomplished by recognizing that the investment tax credit is a reduction in the cost of service of utilities.

Bill section 202(e) states that "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 which is regulated)."

This is consistent with statements made regarding the intent of the investment tax credit when it was enacted by the Revenue Act of 1962, H.R. 10650.

The Secretary of the Treasury in his appearance before the Senate Finance Committee on that bill stated:

> As chief financial officer of the Nation, I do not lightly regard tax abatements on the scale proposed here. I urge this legislation because it will make a real addition to growth consistent with the principles of a free economy; because it will provide substantial help in alleviating our balance-of-payments problem, both by substantially increasing the relative attractiveness of domestic as compared with foreign investment and by helping to improve the competitive position of American industry in markets at home and abroad; and because, far from adding to the forces responsible for alternative recessions and recoveries, it will be of major assistance in strengthening our present recovery and enabling us to attain a higher rate of growth and sustained full employment. Early action will resolve uncertainty or hesitancy and begin at once a strong and lasting incentive for modernization of the productive facilities of our national economy.

Again it is stated in the report of the Senate Committee on Finance on the Revenue Act of 1962 that:

> This investment credit, coupled with the depreciation guidelines recently liberalized by the administration, by stimulating capital formation, will provide growth in the economy consistent with the principles of a free economy. This investment credit, by encouraging the modernization and expended use of capital equipment, will improve our competitive position abroad and thus aid in meeting the balance-of-payments problem. Moreover, the capital formation induced by this credit will both aid in providing the longrun growth needed by our domestic economy and be of major assistance in our more immediate problem of economic recovery.

How can an investment tax credit to utilities most effectively "improve our competitive position abroad, and in meeting the balance-of-payments problem, increase the relative attractiveness of domestic as compared with foreign investment, be of major assistance in strengthening our present recovery," and provide "incentive for modernization and growth?"

It is common knowledge to those familiar with public utilities that customers' demands are largely determinative of the capital expenditures required by utilities. Simply reducing the cost of utility plant by the investment tax credit will do little or nothing to stimulate the economy of the country. But, when the tax credit is applied to reduce tax expense, it increases the net income of the utility. Ours is a capitalistic economy. It thrives best with reasonable profits. When the tax credit is applied immediately to increase profits—the flow-through treatment—the cash savings from the investment tax credit are available for three possible uses:[1]

1. Finance cost of plant additions.
2. Increase dividend to shareholders.
3. Decrease rates to consumers.

The proportion of the cash savings which are applied to each of these uses would depend upon the circumstances in each instance. But, if the greatest incentive for modernization and growth is to prevail, the investment tax credit must flow through and be passed on to consumers just as rapidly as the overall return earned by a utility permits. Such procedure will reduce the operating costs of American

[1] Ignoring for illustrative purposes possible use to retire debt or improve current asset position.

industry, thus improving its competitive position abroad, provide help in alleviating the balance-of-payments problem and in making domestic investment more attractive. Reductions in residential and commercial rates would increase the purchasing power of the American public and stimulate growth in the national economy. All of this would occur in a manner consistent with the principles of free economy and devoid of any subsidization, or any appearance of subsidization, of the privately owned utility industry.

Remember, too, that, when the investment credit is applied in this way, the economy obtains the stimulus of $2.08 for each dollar of investment tax credit that can be passed on to consumers. The better than 2 to 1 odds is highly persuasive of the merits of the flow-through accounting and ratemaking procedure in providing an incentive for modernization and growth. As stated by Northern State Power Co. in a letter to Federal Power Commission in docket No. R-232:

> The effects of flow-through accounting will provide opportunities to lower rates which tend to increase customer demand. Flow-through accounting will thus accelerate utility construction programs and will be the most effective method of promoting the desired growth in the general economy of the Nation.

The provisions of bill section 202(e) would require deferral treatment of the investment tax credit for rate purposes. Advocacy of this treatment probably stems, in part at least, from the belief that, if the tax credit is deferred, the utility will have the cash benefit of the tax savings, thereby reducing the amount of outside financing required and decreasing the number of shares of common stock necessary to be issued, thus lessening dilution of earnings per share. However, the longrun effect of such a program produces a reverse result and is detrimental to the growth prospects of shareholders.

The effect of growth in paid-in common capital of utilities is commented upon by Graham, Dodd, and Cottle, "Security Analysis—Principles and Techniques," McGraw-Hill, fourth edition, pages 597–598, as follows:

> "* * * the fact that utility common stocks sell at significant premiums above book value provides an important element of growth potential. This results from the fact that, when new common stock is sold at a price above book value, the *per share* book value of the old stock is increased and thus permits higher *per share* earnings even though the overall rate of return does not increase.
>
> "As long as regulation restricts earnings to some determined rate of return on capital, the only way that per share earnings can show real growth is by increasing the per share book value of the common stock. In a period of expansion, the sale of new stock at a price premium is a very important factor in achieving this earnings growth." [Italic in original.]

We already have experience as to the effect of deferred income taxes, arising largely from the liberalized depreciation provisions of section 167 of the Internal Revenue Code of 1954, on the growth rate in shares of stock.

FPC statistics show that the amount of deferred taxes by the end of 1962, aggregated 3.7 percent of total capitalization and surplus, plus deferred taxes, of electric utilities. This amount accumulated during the period 1954 to 1962, inclusive. During the same period, the ratio of paid-in common stock capital declined from 29.5 percent of total capitalization and surplus, plus deferred taxes, to 25.8 percent. This is a decline of 3.7 percent, exactly equal to the 3.7 percent increase in deferred income taxes.

During this same period, based on Moody's 24 utilities, the annual rate of increase in number of shares of common stock declined by 2.7 percent per year.

Now consider these facts: During the 15 years, 1946–61, Moody's 24 utilities had average annual growth in number of shares of common stock of 4.5 percent and an annual increase in dividend rate per share of common stock of 4.6 percent. This record was made with common stock earnings averaging 9.1 percent of book value of common stock. But, if the rate of increase in shares had been 2.7 percent less a year, or 1.8 percent, then common earning would have had to be increased by 30 percent, from 9.1 percent to 11.9 percent, in order to maintain the annual growth in dividend rate of 4.6 percent.[1] It is questionable if the rate increases necessary to yield nearly 12 percent on common stock could have been obtained. Rather, a decline in rate of dividend increases on common shares would have been more likely with accompanying less favorable financial results with new common stock issues and slowdown of development of new plants and operating techniques, and reduction in personal income of shareholders. This is directly opposite to the stimulus to modernization and growth intended by the Congress.

CONCLUSION

Therefore, the Public Service Commission of Wisconsin pleads that the Senate Committee on Finance delete section 202(e) from the Revenue Act of 1963 as ordered reported by said committee to the Senate.

Thank you, Mr. Chairman, for the privilege of being here. I wish I could be with you longer and you could ask me more questions.

The CHAIRMAN. The Chair regrets that it is necessary to recess the committee for a few minutes to the allow the members to go to the Senate floor to vote on the foreign aid bill.

We have one more witness, Mr. Bonbright.

Would you care to put your statement in the record?

Mr. BONBRIGHT. I will be glad to put the whole statement in the record, and would like to, Mr. Chairman, but in view of some of the questions that have been raised this morning, I would greatly appreciate the opportunity to also make an oral statement.

The CHAIRMAN. The hearing will be resumed as soon as we return from voting.

(At this point a short recess was taken.)

Senator BENNETT (presiding). Senator Byrd is delayed, and I think we had better go ahead and make a start. He will be along when he can get here.

All right, Mr. Bonbright.

STATEMENT OF JAMES C. BONBRIGHT, PROFESSOR EMERITUS OF FINANCE, SCHOOL OF BUSINESS, COLUMBIA UNIVERSITY

Mr. BONBRIGHT. It is most kind of you, Senator, to give me an opportunity to appear before your committee. I am doing so not to discuss any of the tax aspects of the pending revenue bill but rather

[1] See my article "Common Stock Earnings Allowance for Utilities as Adjusted for Growth" in the February 1963, issue of Land Economics published by the University of Wisconsin.

to urge either the drastic revision or else the complete removal of those extraneous provisions, section 202(e), which would govern the treatment of the investment credit by the Federal regulating agencies.

First, I should, perhaps, state that my profession is that of an economist; that I am professor of finance emeritus in the school of business of Columbia University; and that for many years, more years than I like to remember, Mr. Chairman, my special field of interest has been public utility regulation.

In former years I was chairman of the power authority of the State of New York, and since then I have done considerable amounts of consulting work for public agencies and for private utility companies.

But I am appearing here solely on my own behalf because of my concern about the possible enactment of a Federal statute which might seriously impair the effectiveness of public utility regulation throughout the United States.

Before commenting on the particular restrictions which section 202(e) would impose on Federal regulating commissions, let me first note the expressed reason for the incorporation of any such restrictions in a bill concerned primarily with taxation, not with rate regulation. In establishing an investment credit as a part of the Revenue Act of 1962, Congress intended that this credit should supply a special profitmaking incentive, designed to encourage business enterprises, including regulated enterprises, to accelerate the rates of expansion and modernization of their properties. This incentive, it was feared, would be destroyed if regulating commissions should attempt to pass along the financial benefits of the tax credits to the consumers, in the form of lower rates than would otherwise be justified, instead of allowing the taxpaying companies to retain the benefits in the form of enhanced rates of profit on new investment.

This is indeed a plausible argument in favor of the provisions to which I am objecting. But I also submit that it is an invalid argument in view of the actual operation and financing of the regulated industries. What it ignores is the fact that the rapidity with which public utilities and common carriers find it necessary and profitable to expand and modernize their plants depends in a critical degree on the rates of growth in the demand for their services. And this growth is sure to be encouraged by promotional rate reductions made feasible by the investment credit.

One further point needs emphasis in this connection. The mere fact that a regulated company, whether by voluntary action or by commission order, may pass along to its customers whatever reductions in operating costs result from the investment credit by no means indicates that its stockholders are thereby denied a benefit from this credit.

Any such inference would be quite unwarranted. For it is the regular and proper practice of public service commissions to include in their calculation of corporate revenue requirements, as a basis of rate regulation, an allowed "fair rate of return" on capital investments substantially in excess of the "barebones costs" incurred by a company in raising new capital.

Hence, generally speaking, the utility companies that are most profitable from the standpoint of their stockholders are precisely those companies which enjoy the most rapid rate of growth in the de-

mand for their services and which can therefore afford the most rapid rates of growth in their capital budgets. Because of this situation, the most potent incentive effect of the investment credit, as applied to these monopolistic industries subject to rate regulation, almost surely lies in the use of the credit as a means of reducing those costs of capital equipment that, sooner or later, must be made to fall on the consuming public.

Coming now to the precise provisions of section 202(e), I note the vitally important distinction between the ratemaking treatment of the investment credit imposed by item (1) on the regulation of those "public utilities" that are limited to a 3-percent credit under the Revenue Act of 1962, and the far more restrictive treatment imposed by item (2) on those regulated industries that are entitled to the full 7-percent credit.

The latter industries would be granted complete immunity from any regulatory action which would make use of the investment credit in the calculation of corporate revenue requirements for ratemaking purposes. But the former industries, including notably the electric and telephone utilities, would receive no such unqualified privileges. Here, the Federal agencies are merely limited as to the timing of any transfer of benefits from the corporation to the consumers.

In my opinion, the same percentage of investment credit that is applied to unregulated industries, a percentage which, under the present act is 7 percent, should also be applied to all regulated industries, including the electric and telephone companies.

But quite aside from this question, which is not here at issue in the discussion today of the investment credit, the particular distinction between the two classes of regulated enterprise that is now added by section 202(e) seems to me utterly indefensible.

The special treatment to be accorded by item (2) is all the more clearly indefensible since, in fact, though not in words, it would appear to single out the natural gas transmission companies for more favorable treatment than that accorded to any other major regulated industry.

To be sure, as a matter of form, the railroads along with other transportation companies would be entitled to the same treatment. But for many years, railroad earnings have been held down by competitive forces and by other handicaps to such substandard rates of profit that no provision of the Revenue Act is needed in order to assure their enjoyment of whatever enhanced rates of return may be made possible by their tax credit.

The Interstate Commerce Act as administered by the Interstate Commerce Commission should suffice for this purpose. Indeed, the present complaint of the railroads is that they are not being permitted to reduce rates for competitive service as freely as they would wish to do in order to meet road and water competition.

I recall a point made by Senator Bennett a half hour ago that there is this distinction between the natural gas pipeline companies and the so-called public utilities which justifies a distinction in the treatment by section 202(e). Senator Bennett's point, as I recall it, was that the natural gas pipeline companies are not monopolies. On the contrary, that they are competitive industries, whereas the electric companies and telephone companies are natural monopolies.

With all due respect, I do not believe that this sharp distinction between the two classes of regulated industries is justified. To be sure, the natural gas pipeline companies, as I understand it, do not enjoy franchies that are exclusive in so many terms but, in the first place, they are protected from direct competition by the fact that they must get certificates of public convenience from the Federal Power Commission before they will be allowed to construct properties that serve the same areas as those served by other natural gas companies.

In the second place, natural gas pipeline companies are captive customers of the distributive systems that buy their gas at wholesale and resell at retail or, alternatively, the natural gas customers are themselves captives of the distribution systems, as is the case with the natural gas companies that supply the city of Chicago with most of its gas.

Consequently, the assumed distinction between classes of regulated industries that are competitive and classes of industries that are noncompetitive, seems to me untenable.

Senator BENNETT. Well, Mr. Bonbright, in my State we still mine a lot of coal. Gas is competitive with coal, gas is competitive with oil. Nobody is required to heat his home with gas, as he is required, if he wants to have the benefit of modern electricity, to buy his power from the single monopolistic source. So to that extent they are competitive.

Mr. BONBRIGHT. I quite agree with you, Senator Bennett, it is hard to think of any public utility that does not face competition of any kind. Competition is sometimes very severe. Perhaps the telephone companies, as close to that idea of a heavenly state as any, and yet even the telephone companies are today facing more and more competition.

The point that I am making, Senator Bennett, is merely that the sharp distinction made between those companies now subject to a 7-percent investment credit and those companies now entitled to a 3-percent credit seems to me utterly unjustified.

Senator BENNETT. Well, Mr. Bonbright, that is not an issue in this bill. That was decided in the bill last year, and there is no proposal in this bill which would change that relationship.

Mr. BONBRIGHT. The distinction between 7 and 3 percent is not an issue, but what is an issue is the point that the companies subject to the 7-percent investment credit are to be protected against any effort whatsoever by Federal commissions to pass along the benefits of the investment credit to the consuming public or even to let the consumers share that benefit, except to the extent that the natural gas companies themselves, in their own monetary self-interest, may decide to let the consumers share the benefit, and that seems to me to be an utterly indefensible act of favoritism toward one particular regulated industry.

Senator BENNETT. Well, that is true, also, for the 3-percent companies, is it not?

Mr. BONBRIGHT. Well, the 3-percent companies are in a different position, Senator, and I was about to come to that in a moment.

Senator BENNETT. Very well.

Mr. BONBRIGHT. I submit, therefore, that the provision of item (2) of section 202(e) is clearly objectionable and should, therefore, be

omitted from the Revenue Act of 1963. The provision of item (1) presents a quite different and more difficult problem, since it would merely govern the timing by which a Federal agency may allow the benefit of the investment credit to flow through to utility consumers, in the form of lower rates than would otherwise be justified.

In effect, the credit, instead of being treated as systematically to the income account over the lives of the acquired assets that give rise to the credit. At least, so I construe the intended meaning of the item in question.

For reasons that my time limit does not permit me to discuss orally but which I would like to summarize briefly in a written statement for the record, I am convinced that the particular treatment of the investment credit envisaged by item (1) of section 202(e) is a sound treatment alike from the standpoint of accounting principle and of ratemaking practice. Indeed, I believe that its general adoption alike by State and Federal commissions of this general principle would be in the public interest. But aside from the question whether detailed rules of rate regulation should be imposed upon Federal agencies by congressional mandate, I note that item (1) in its present form is ambiguous in its implications and would be more than likely to give rise to time-consuming controversies as to its intended meaning. Its serious deficiency—it may have others that do not come to my attention for the moment—lies in its failure to stipulate whether or not the unamortized reserve for the investment credit may be deducted from the costs of the acquired assets in the calculation of the rate base by the regulating commission.

In my own view, the reserve would indeed be deductible in fairness to the consumers of the utility services. But this view would be challenged by many public utility companies as not in keeping with the intent of Congress, and with the implied restrictions of item (1).

No doubt, given sufficient skill in draftsmanship, item (1) of section 202(e) could be amended so as to cure it of its serious present deficiency. In its revised form it could then be made applicable to all regulated industries, thereby removing the obviously unfair discrimination incorporated in the present provisions.

But if, at this late date in the history of H.R. 8363, the only feasible choice is that between the retention of section 202(e) as it now stands or else its complete removal, the latter choice seems clearly to be called for.

Thank you so much, Senator Byrd. I greatly appreciate your courtesy.

The CHAIRMAN (presiding). Thank you, Mr. Bonbright.

(The supplementary statement of Mr. Bonbright follows:)

SUPPLEMENTARY WRITTEN STATEMENT SUBMITTED BY JAMES C. BONBRIGHT

For reasons given in my oral statement, I believe that the intent of Congress in establishing the investment credit will be best served if the benefits of the credit are given to the consumers of public utility services in the form of lower rates than would otherwise be feasible. Hence I am convinced that Federal regulating agencies should not be denied the power to take account of reduced tax liabilities resulting from the investment credit in their calculation of corporate revenue requirements for ratemaking purposes.

But this does not dispose of another important question; namely, that of the method of accounting by which the benefit of the tax credit should be reflected in the corporate income accounts and hence reflected in permitted rates of charge for services. Here two opposing views have been urged upon State and Federal commissions. According to the one view, the entire investment credit should be allowed to "flow through" immediately to the corporate net income of the year in which the credit arises. Carried over into rate regulation, this viewpoint would justify commissions in attempting at once to give to current consumers the full benefit of current tax credits.

According to the other view, the investment credit does not constitute an income-tax reduction of the ordinary type—of the type that amounts to an immediate enhancement in net income. Instead, it constitutes a reduction in the taxpayer's net costs of acquiring the property that gives rise to the credit. Hence it should be credited to capital account and not to current operating income. To be sure, the credit to capital outlay can and should be made to redound to the benefit of public utility consumers through a corresponding reduction in the rate base—in the invested capital entitled to an allowance for a fair rate of return and for annual depreciation. But this method of treatment comes much more closely into accord with the generally accepted cost-of-service principle of rate regulation, since it gives the benefit of the investment credit to those future consumers on whose behalf the investments giving rise to the credit have been made.

In a study of the subject that I made and submitted, earlier this year, to the public accounting firm of Arthur Andersen & Co., I reviewed these alternative accounting and ratemaking treatments of the investment credit and came to the conclusion that the second alternative, sometimes called the service-life or cost-reduction method, is the far preferable method, alike from the standpoint of accounting principles and of ratemaking practice. Report on accounting and rate treatment of the investment tax credit, July 31, 1963. Subject to one important qualification, the views expressed in this report are in accord with the ratemaking treatment of the investment credit embodied in item (1) of section 202(e) of the pending revenue bill. The qualification is that, in my opinion, the unamortized portion of the investment credit should be treated as a reserve to be deducted from the cost of the acquired assets in the measurement of the rate base, and not as a surplus to be included as part of the invested capital on which a utility company is entitled to earn a "fair rate of return." The reserve should be treated in this manner since it does not represent any funds contributed, in form or in effect, by the corporate investors.

Unfortunately, item 1 in its present form fails to specify that the reserve for the unamortized investment credit may or must be excluded from the rate base. Hence, if it is retained as part of the Revenue Act, the item should be amended in order to remove this deficiency.

Mr. CHAIRMAN. We will adjourn until 10 o'clock on Thursday, November 21, in the morning.

(The following statements commenting on sec. 202(e) (1) were submitted for the record:)

STATE OF ILLINOIS,
ILLINOIS COMMERCE COMMISSION,
Chicago, Ill., November 15, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: The enclosed statement sets forth certain information with respect to treatment of the investment credit by regulatory agencies, and the avowed purpose of the Illinois Commerce Commission to support the provisions of section 202(e) (1) of H.R. 8363.

Since it was not possible for me to be scheduled for appearance with other witnesses on the subject, it would be greatly appreciated if this statement would be made a part of the record in the consideration of H.R. 8363 by the Senate Finance Committee.

Sincerely yours,

HENRI A. TACON, *Chief Accountant.*

STATEMENT OF HENRI A. TACON, CHIEF ACCOUNTANT, ILLINOIS COMMERCE COMMISSION, ON BEHALF OF SUCH COMMISSION, WITH RESPECT TO H.R. 8363

The following statement is submitted on behalf of the Illinois Commerce Commission to urge the Senate Finance Committee to adopt the provisions of H.R. 8363, section 202(e)(1). This section states that—

"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—

"(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, * * * 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."

This commission, in formal action on December 7, 1962, ordered all public utilities under its jurisdiction in Illinois to amortize into income the investment credit in equal installments over the life of the property which gave rise to the credit. (Hereinafter referred to as "service life flow through" method.)

On July 15, 1963, the assistant attorney general of Illinois appeared before the FCC at its hearing on the investment credit and argued on behalf of the Illinois Commerce Commission for adoption of the "service life flow through" method.

The Illinois Commerce Commission, as does some 21 other State commissions and the American Institute of Certified Public Accountants, believes that effective regulation and meaningful accounting can only be accomplished by an orderly integration of the investment credit into the accounts of the public utility over the life of the asset which gave rise to the credit.

The Illinois Commerce Commission regulates approximately 425 public utilities in the State, ranging in size from very large to very small companies, all of which utilities serve the people of Illinois. History reveals sharp variations from year to year in the construction programs of these companies, particularly in the medium- and small-sized companies. The investment credit received each year would likewise vary and if the full amount realized each year was to be reported as current earnings, then the true earnings of the company from the use of the property would be distorted. Also, since it is the tendency of public utilities to spend more on construction during good times and less during economic dips, "initial year flow through" accounting would make good times look better and poor times look worse. To properly regulate under such accounting procedures would place great additional burden on this and every other commission.

Furthermore, future users of utility services may be required to make up tax deficits and increased costs which came about because in earlier years the investment credit was wholly included in income in the initial year and possibly paid out in dividends by the company.

Financial analysts and investors on whom public utilities must rely for new capital requirements will be unable to ascertain readily the true income of the company from its operations without research and study.

This commission reached its decision to spread the credit received over the life of the property only after due consideration of all these factors and reviews of recommendations of others in the regulatory, public utility and accounting fields. Of particular significance in this latter respect is the opinion of the Accounting Principles Board of the American Institute of Certified Public Accountants. A strong majority of 14 of the 20 members of this board recommended that the credit be spread over the life of the property which gave rise to the credit.

It is essential to good regulation that public utilities adhere to sound accounting principles as recommended by the American Institute of Certified Public Accountants.

Furthermore, a public utility should not be required to follow one procedure for State regulation and another when the public utility is subject to the jurisdiction of a Federal agency. It is obvious from the action already taken by one Federal agency (Federal Communications Commission) and the recommendation of the staff of another (Federal Power Commission) that this situation will come about unless there is legislation to prevent it.

As evidence of the lack of unanimity among the Federal agencies it should also be noted that the Securities and Exchange Commission has stated that financial reports which include the full effect of the investment credit in the initial year will not be acceptable to that commission unless, of course, the filing company is required to so account for the credit by order of a regulatory commission.

Section 202(e)(1) does not in any way limit regulatory discretion. Rather, it insures that the intent of Congress in enacting the investment credit will not be thwarted by misinterpretation by a Federal regulatory body. Accordingly, it removes what could be a difficult regulatory problem.

It is evident that legislation is needed to insure uniform treatment of this investment credit by the regulatory bodies. Since the service life flow-through method" is the most desirable and meaningful from all points of view, on behalf of the Illinois Commerce Commission I urge you to adopt the provisions of section 202(e)(1) of H.R. 8363.

STATEMENT OF LEONARD SPACEK

My name is Leonard Spacek. I am managing partner of Arthur Anderson & Co., independent accountants and auditors. My office is located at 120 South method is the most desirable and meaningful from all points of view, on beinafter stated.

Section 202(e)(1) states that Congress does not intend that any Federal regulatory agency having jurisdiction over public utilities, as defined, shall use more than a proportionate part (based on the useful life of the property) of the investment tax credit in any 1 year for the purpose of reducing the cost of service of the utility, without the utility's consent. This would mean that the Federal regulatory agencies, such as the Federal Power Commission and the Federal Communications Commission, could not require public utilities subject to their jurisdiction to flow through all of the investment tax credit immediately to existing customers in the year in which new property is constructed.

Rather, if the benefits of the investment tax credit are to be passed on to customers, they should be passed on to those customers utilizing and, in effect, paying for the property giving rise to the credit. This position is entirely consistent with the historic and almost universally accepted ratemaking practice of charging the cost of new property to those customers utilizing the property rather than charging the entire amount immediately on construction to existing customers.

Although this section relates to the ratemaking authority of Federal regulatory agencies, it is my experience that the ratemaking policies of such agencies do influence, and often control, the accounting to be prescribed by such agencies.

Therefore, as a professional certified public accountant, I am vitally concerned with the influence that this legislation will have over proper accounting. I believe this section of the revenue bill will encourage proper accounting for the investment tax credit. Section 202(e) as now worded is in accordance with the accounting pronouncement of the Accounting Principles Board of the American Institute of Certified Public Accountants. This is the top accounting body of the Nation's leading association of professional accountants. It said in part:

"We conclude that the allowable investment credit should be reflected in net income over the productive life of acquired property and not in the year in which it is placed in service."

I think that this section of the bill will have the effect of reasserting to the Federal Commissions that the ratemaking treatment of the investment tax credit should be in accordance with, and be based upon, proper accounting.

Section 202(e)(1) should have the effect of preventing some companies from reporting large increases in earnings in 1 year merely as a result of having purchased equipment or having constructed property. It will be harmful to the public utilities and other companies if investors become disillusioned as a result of reporting as increased earnings the tax reductions which result, not from operations, but from construction. In any year when a company's construction would fall off or cease, reported earnings or net income would be dealt a severe blow and the economic effect of a slowdown in construction on our economy

would be seriously compounded by the effect of such improper accounting. This reaffirmation of congressional intent should prevent such false reporting. It would prevent us from adopting a system of reporting false income that would carry serious risk for our entire economy.

STATEMENT ON PROVISION REGARDING "TREATMENT OF INVESTMENT CREDIT BY FEDERAL REGULATORY AGENCIES" (SEC. 202(e)) IN H.R. 8363

(By Robert Eisner, professor of economics, Northwestern University)

I urge deletion from the current tax bill, H.R. 8363, of section 202(e), entitled "Treatment of Investment Credit by Federal Regulatory Agencies." This section states the intent of Congress either to restrict greatly or to prevent entirely the flow through of benefits of the investment credit to customers of federally regulated industries. Section 202(e) is undesirable for the following reasons:

1. It would cost customers of regulated industries in the order of hundreds of millions of dollars per year as soon as its regulatory implications were fully felt and this amount would increase, year by year, as the investment credit grows.

2. It would prevent regulatory agencies from setting rates in accordance with traditional principles aimed at a fair rate of return to stockholders and efficient, economical service to customers.

3. It would in large part defeat the purpose of the investment credit for regulated industries, as relatively higher prices would decrease demand and consequently reduce the need for additional capacity.

My arguments are based on over 10 years of professional research in the determinants of business investment and on analysis prepared for a number of hearings before regulatory bodies with regard to appropriate treatment of the investment credit and the related problem of accelerated or liberalized depreciation. An appendix to this statement lists a number of publications reporting results of my work on business investment. An intensive study bearing specifically on the investment tax credit, including a large number of detailed tables, was submitted recently to the Federal Power Commission, and copies will be made available to members of the Senate Finance Committee. I shall restrict myself here to a brief summary of essential issues.

As explained in detail in the statement for the Federal Power Commission, section 202(e)(1), which restricts compulsory recognition of the investment credit as a reduction in the cost of service in the case of public utility property to "a proportionate part (determined with reference to the average useful life of the property with respect to which the credit was allowed)," has the indubitable consequence not merely of postponing recognition of effects of the tax credit but of understating these effects year after year. For the electric power industry, for example, with relatively long-lived equipment, on the basis of rates of growth projected by Electrical World, the proportionate method would never permit recognition as a reduction of cost of service of more than 25 or 30 percent of the average annual value of the investment credit. Section 202(e)(2), which prevents any mandatory reduction in cost of service for property subject to the full 7-percent credit, of course, goes even further. It must be stressed, however, that while in the case of the 7-percent credit none of the tax saving may be reflected as a reduction in cost of service under section 202(e)(2), only a very minor fraction of these savings, depending upon length of life of property and rate of growth of equipment purchases, would be recognized as a reduction of cost of service in the case of the 3-percent credit for public utility property covered by section 202(e)(1). And, of course, for a good number of years, under section 202(e)(1), the proportion of tax savings that could be recognized as such would be considerably smaller than the 25 or 30 percent figures cited above.

The higher rates for service to which customers of regulated industries would be subject as a result of this provision would actually be considerably more than the amount of tax credit involved. For in order to afford companies a traditional fair rate of return, after taxes but excluding the benefits of the tax credit, charges to customers would have to be sufficient to pay additional corporate in-

come taxes on the added gross income. Thus even with the reduced corporate income tax rates contemplated in the current tax bill, section 202(e) would lead to charges to customers roughly twice as much higher as would be necessary merely to cover the tax credit itself.

The potentially positive effects of the investment credit may be recognized in familiar economic textbook terms as the "substitution effect" and the "output effect." Lowering the net cost of equipment will bring some substitution in favor of more equipment to produce a given output. Lowering the cost of equipment will also, however, tend in a competitive market to lower the price of output produced with this equipment. At a lower price for output, other things remaining equal, a greater amount of output would be demanded and hence produced. Additional equipment would then be necessary in order to produce the additional output.

In the mainstream of modern economic thinking is the view that the substitution effect, while present and not to be ignored, will tend to be relatively small except perhaps in the very long run. However, the demand for capital goods and, consequently, investment demand, may be substantially affected by the relation between demand or output and capacity. Indeed, it is fluctuations in the relation between expected demand and capacity that have been the underlying cause of the major fluctuations in business investment that have trouble Western economies.

In the light of this, one may appreciate why the proposed treatment of investment credit by Federal regulatory agencies in H.R. 8363 (sec. 202(e)) is particularly objectionable. For not only will it endeavor to bring about by legislative fiat an inequitable redistribution of income in favor of regulated companies and against their customers. It will also, in the case of the regulated industries to which it applies, go a long way toward frustrating the stated purpose of the investment credit.

This unfortunate result will ensue because, by preventing regulatory agencies from passing on reductions in the cost of service resulting from the tax credit, the bill would sharply restrict or completely eliminate the output effect on investment. Indeed, it may well be argued that extension of this provision to regulated industries will result in less investment in these industries than if there had been no credit at all. The reason for this is that the investment credit, in other, unregulated and presumably more competitive industries, will result in lower prices of output. Thus there will be a substitution of demand for output of the unregulated industries and against the relatively higher priced output of regulated industries. Since production will therefore be less in the electric power industry, the natural gas industry, in rail, air, truck, and bus transportation, the need for capital equipment will be less and investment may well turn out to be less than if there had been no investment credit to change the relative prices of output of regulated and unregulated industries.

It should be pointed out that some regulated companies will voluntarily use the investment credit to reduce rates even if regulatory agencies are enjoined from forcing them to do so. This may occur where regulated companies are aware of substantial longrun competitive forces or are guided by a sense of social and political responsibility that makes it appear unwise to charge the maximum rates which are permitted. It must be extremely doubtful, however, that such self-restraint would apply to most affected companies. Regulation generally exists in precisely those cases where competitive forces are presumed to be insufficient to bring about equitable prices.[1]

The proposed treatment of the investment credit would not be binding on State regulatory agencies. It would seem, nevertheless, that a definitive statement of Federal policy such as is proposed in H.R. 8363 might be influential with some State regulatory agencies. I have personally been involved in recent years in hearings on the related matter of accelerated depreciation before regulatory commissions in Ohio and in Michigan. In each case the intent of Congress and policies of Federal agencies were important elements in the deliberations. If they were not then decisive it was precisely because it was possible to stress the diversity in both the expressed intent of Congress and Federal

[1] The American Electric Power Co., the largest distributor of electric power in the Nation, has publicly indicated its use of the investment credit for rate reduction but most regulated companies are reported to be opposed to "flow-through" of the investment credit.

regulatory practice. Enactment of the provision under consideration would put many State commissions, such as those in New York, California, and Wisconsin which have been ordering benefits of the investment credit to flow through to customers, in the difficult situation of following a policy which has been proscribed for Federal agencies. If they were to hold out, the regulatory picture would become all the more confused by conflicts of practice of Federal and State agencies.

The economic effects of this provision would, in my judgment, be large. Regulated industries would tend to operate with higher prices and lower output and consequently with less need for capital equipment. In electric power alone, for example, it is estimated in the industry's Electrical World (Sept. 23, 1963, p. 128) that capital expenditures will rise from less than $4.3 billion in 1962 to more than $13.7 billion in 1980, an average annual increase of 6.7 percent, without allowing for any increase in prices. But this fact of growth, as I have endeavored to point out in some detail in my prepared statement for the Federal Power Commission, would mean that the effect of proportionate spreading of the benefits of the investment credit over the life of equipment, essentially the annual reduction in depreciation method considered in that statement, would be to deprive ratepayers of all years of the bulk of those benefits.[2] It would mean roughly that charges for electric power could be as much as $250 million higher in 1964 if the regulatory implications were felt immediately (which is, however, quite unlikely) and $600 million higher by 1980.

These effects will be magnified substantially when we consider other regulated industries, particularly those in the transportation field subject to the 7-percent credit. It might be good if the committee staff could get together figures on just how much the proposed regulatory treatment, if fully effective on Federal and State levels, would cost ratepayers over the years. A quick educated guess might indicate that the figure would soon run into billions of dollars. Ironically, for reasons quite different than they usually advance, the opponents of the current tax bill would find themselves confirmed in their predictions of its inflationary effects.

There are many other basic matters of principle which argue for deletion of section 202(e). The current tax bill is a major economic measure which will be supported or opposed in terms of its anticipated general effects on the economy. It should not become a vehicle for ad hoc, unconsidered intervention in controversial issues of accounting and regulatory practice. Yet section 202(e) would constitute precisely such intervention. As the report of the House Committee on Ways and Means indicates (pp. 36-37), appropriate treatment of the investment credit is currently being decided by Federal regulating agencies in terms of existing law, as well as principles of economics, accounting, and ratemaking which are directed at achieving optimum economic service to the public with a fair return to private investors. If these principles are to be constrained or redefined it should be on the basis of careful deliberation of the issues involved. It should not be done in the form of a "rider" to what has been appropriately designated the most important economic legislation to come before the Congress in many years. Section 202(e) should be deleted from H.R. 8363.

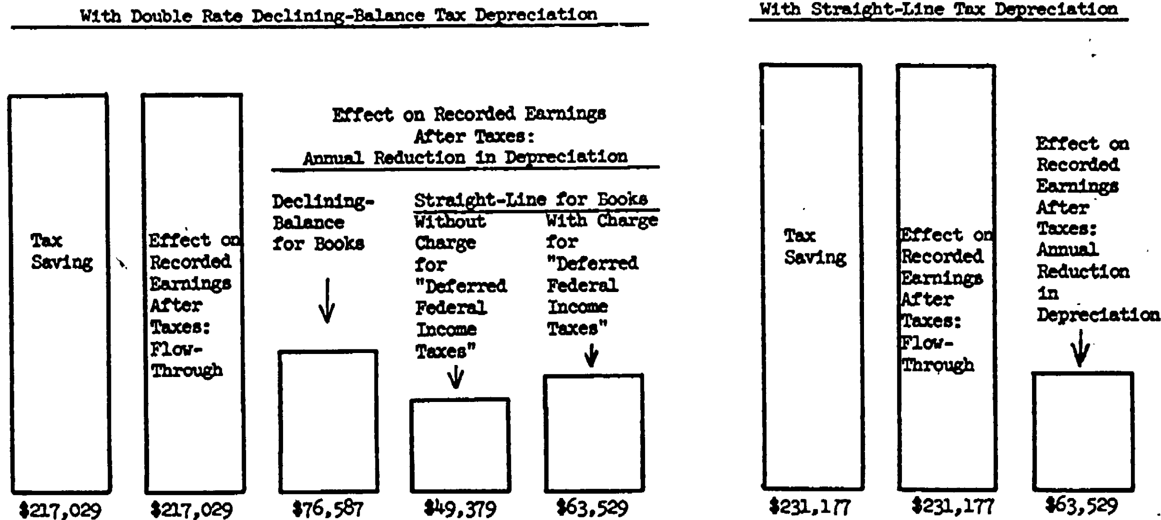
---

[2] See appended charts I, II, III, and IV.

Eisner 2/25/63

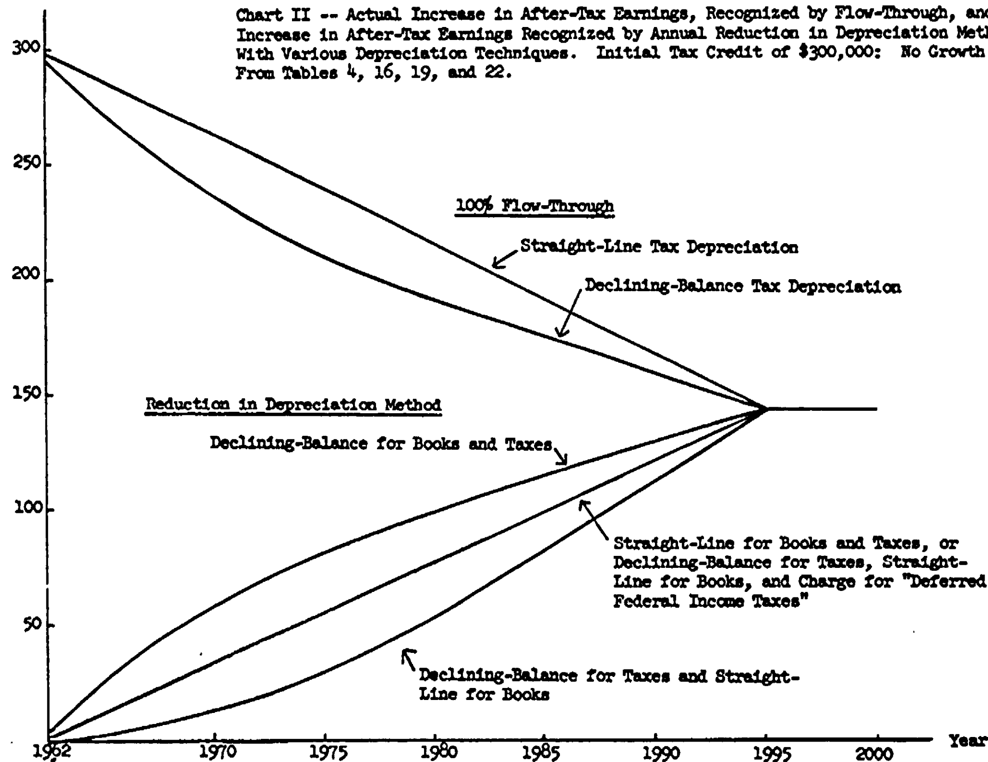
Results of Investment Tax Credit

Chart I -- Single Year's Expenditures Only. Tax Credit of $300,000: Present Value of Tax Saving and Present Value of Effect of Flow-Through and Annual Reduction in Depreciation Method on Recorded Earnings After Taxes, from Tables I and J.



Eisner 2/25/63

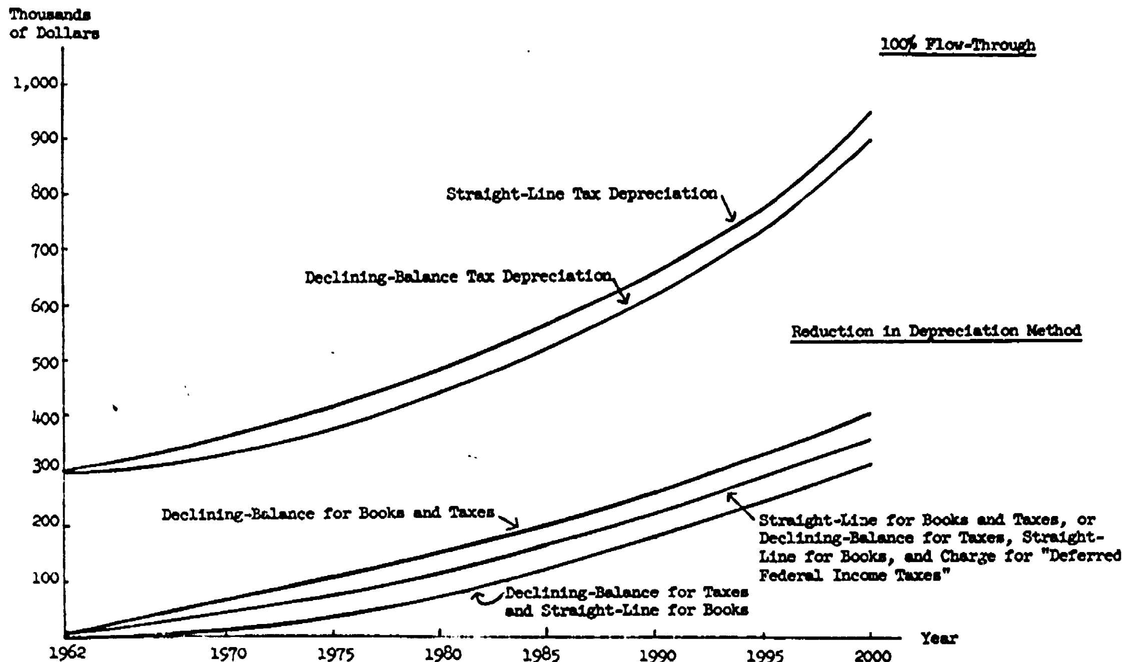
Results of Investment Tax Credit



Eisner 2/25/63

Results of Investment Tax Credit

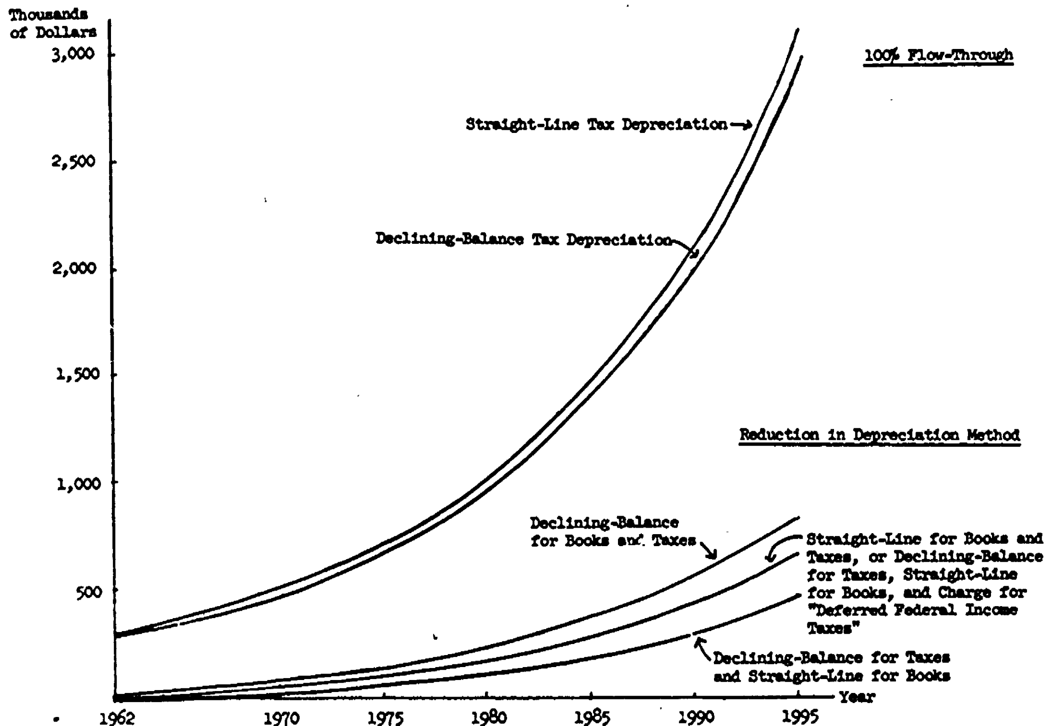
Chart III -- Actual Increase in After-Tax Earnings, Recognized by Flow-Through, and Increase in After-Tax Earnings Recognized by Annual Reduction in Depreciation Method, With Various Depreciation Techniques. Initial Tax Credit of $300,000, Growing at 4% Per Annum Rate. From Tables 5, 17, 20, and 23.



Eisner 2/25/63

Results of Investment Tax Credit

Chart IV -- Actual Increase in After-Tax Earnings, Recognized by Flow-Through, and Increase in After-Tax Earnings Recognized by Annual Reduction in Depreciation Method, With Various Depreciation Techniques. Initial Tax Credit of $300,000, Growing at 8% Per Annum Rate. From Tables 6, 18, 21, and 24.



Appendix

(Papers and publications by Robert Eisner on investment)

1. "Determinants of Capital Expenditures: An Interview Study," University of Illinois, 1956.
2. "Interview and Other Survey Techniques and the Study of Investment," in "Problems of Capital Formation, Studies in Income and Wealth," vol. 19, National Bureau of Economic Research, Princeton, 1957.
3. "Expectations, Plans, and Capital Expenditures: A Synthesis of Ex Post and Ex Ante Data," in Social Science Research Council volume, "Expectations, Uncertainty and Business Behavior" (New York, 1958).
4. "An Appraisal of Proposals for Tax Differentials Affecting Investment," in "Income Tax Differentials, Symposium," Tax Institute, Princeton, 1958.
5. "A Distributed Lag Investment Function," Econometrica, January 1960.
6. "Capital Expenditures, Profits, and the Acceleration Principle," prepared for a conference of the National Bureau of Economic Research, February 1962; to appear in "Models of Income Determination, Studies in Income and Wealth," vol. 28.
7. "Capital Expenditures and Expectations," for Joint Economic Committee (U.S. Government Printing Office, 75924, 1962, pp. 31–36).
8. "Statement on Investment Tax Credits," for Senate Finance Committee, April 1962. (U.S. Government Printing Office, 92190 O, 1962, pp. 2476–2480).
9. "Investment Plans and Realizations," American Economic Review, May 1962.
10. "Statement on Investment Tax Credit," docket No. R–232, Federal Power Commission, February 1963.
11. "Investment: Fact and Fancy," American Economic Review, May 1963.
12. "Realization of Investment Anticipations in a Quarterly Econometric Model of the United States Economy," presented to CIRET conference, Vienna, April 1963 (to be published in German translation in IFO Studien).
13. "Forecasting Investment Spending," for 11th Annual Conference on the Economic Outlook, the University of Michigan, November 1963.
14. "Determinants of Business Investment" (joint with Robert H. Strotz), Research Study 2 in Impacts of Monetary Policy, prepared for the Commission on Money and Credit (Prentice-Hall, 1963).
15. "Income Distribution, Investment and Growth," to appear in Economie Appliquée.
16. "The Aggregate Investment Function," International Encyclopedia of the Social Sciences (forthcoming).

Statement of Lawrence H. Gall, Executive Director, on Behalf of Independent Natural Gas Association of America, in Support of Section 202(e) of H.R. 8363, 88th Congress, 1st Session

To the Honorable Chairman and Members of the Finance Committee:

The Independent Natural Gas Association of America (INGAA), on behalf of its members which are subject to the regulatory jurisdiction of the Federal Power Commission, submits this statement in support of section 202(e) of H.R. 8363, 88th Congress, 1st session, relating to the investment tax credit provisions of the Revenue Act of 1962, as recently passed by the House of Representatives.

This association is a nonprofit corporation organized and existing under the laws of the State of Delaware. Among its approximately 2,200 members are individuals and companies engaged in all phases of the natural gas industry and related businesses. This membership includes almost all of the long-distance natural gas pipeline companies subject to the regulatory jurisdiction of the Federal Power Commission.

The natural gas industry is now sixth in size among domestic industries. Its three segments—production, transmission, and distribution—represent a net in-

vestment in excess of $20 billion. It is engaged in the highly competitive business of supplying energy. The industry performs a valuable public service in bringing the advantages of natural gas to virtually every corner of the country and to many types of consumers.

PURPOSE OF THE INVESTMENT TAX CREDIT

At every significant step of the legislative history of the investment tax credit provisions of the Revenue Act of 1962, Congress has made it perfectly clear that the purpose of the credit is to stimulate the economy by reducing the cost of acquiring new facilities, thereby increasing the earnings from the new facilities over their productive lives.[1]

The purpose of the credit is succinctly stated in the Conference Committee Report, 87th Congress, 2d session 14:

"* * * the purpose of the credit for investment in certain depreciable property, in the case of both regulated and nonregulated industries, is to encourage modernization 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 the new facilities over their productive lives."

This statement also makes it clear that regulated companies as well as nonregulated companies are equally entitled to the benefit of the investment tax credit. This tax measure was enacted by Congress to stimulate investment in new facilities by providing current tax relief to companies with qualifying capital expenditures. No distinction was made between qualifying companies; no limitations were placed upon the disposition of the tax savings. It was expected that the savings would spur the companies to further investments, leading ultimately to recoupment of initial tax losses. But as recognized in the recent report of the House Ways and Means Committee to accompany the bill (H.R. 8363; H. Rept. 749) under consideration, Federal regulatory agencies have failed to heed the expressed congressional tax policy:

"* * * 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" (pp. 36–37).

"Flow through," under which the tax benefits of the investment credit are denied to the taxpayer, defeats the purpose of congressional tax policy, is unfair to regulated companies, and doubles the tax loss occasioned by the credit, as hereinafter explained. The directive against "flow through," expressed in section 202(e), is necessary to preserve the purpose of the 1962 investment tax credit incentive legislation. This is what prompted the House Ways and Means Committee, in reporting section 202(e) of H.R. 8363, to state that the above treatment by regulatory agencies:

"* * * is clearly contrary to the intent of Congress in enacting this provision and as a result your committee has added a provision to this bill reasserting its position that it was and is not its intention that the Federal regulatory agencies require the benefit of the investment credit to 'flow through' in this matter" (p. 37).

CONSEQUENCES OF REGULATORY ACTION

It is submitted that any action of a Federal regulatory agency which mandatorily requires a taxpayer company to pass on the benefits of the investment credit would defeat the intent of Congress and undermine the entire purpose of the credit. A taxpayer cannot spend the same dollar twice. If regulated taxpayers are forced to pass the credit on to the customers in the form of lower rates, they won't have the money, generated from the credit, to modernize and expand plant.

If the regulated industries are required to reflect the effect of the investment tax credit as a reduction in rates to their customers, the loss in Treasury revenues by that act alone, would be more than double the amount of the investment credit. This comes about in the following manner: if a regulated company has an investment credit of $1 million for a particular year, then in order to reflect that amount as a rate reduction, the company would have to reduce its rates by

[1] See H. Rept. 1447, 87th Cong., 2d sess. 8; S. Rept. 1881, 87th Cong., 2d sess. 11, 12; Conf. Rept. 2508, 87th Cong., 2d sess. 14.

more than $2 million.[1] Therefore, the Treasury Department would not only have lost $1 million through the investment credit itself, but in addition, 52 percent of the income loss of the $2 million reduction in rates, or a total of more than $2 million.

Thus, if a regulated utility is required to reduce its rates to reflect the tax credit, such a company will not have the money to spend on new facilities, and the doubling effect in loss of revenues further undercuts the objective of Congress to recoup immediate losses by reinvestment and expansion of business operations.

Fairness requires that regulated companies not be placed at a competitive disadvantage by denial of the tax benefits of the investment credit. Congress chose to treat regulated and unregulated companies equally in extending the benefits of the tax credit. Clearly, however, this desire to give equal and fair treatment would be completely defeated if regulated companies are not allowed to retain the benefits of the tax credit.

NEED FOR LEGISLATION

A definitive directive by Congress concerning Federal regulatory treatment of the investment tax credit would avoid years of uncertainty and litigation. There is every indication that in the absence of specific directions, the Federal regulatory agencies will give little if any weight to congressional tax policy when dealing with the credit in fixing rates.

Even in cases where the Federal regulatory agencies have not, as yet, acted, but the possibility of adverse action is threatened, the regulated company cannot count on retaining the investment credit dollars for current or future expansion. The air must be cleared now. We should not have to await the decisions of the regulatory commissions and the outcome of court litigation before being able to determine whether such funds are available for plant investment. The economy, as Congress determined, needs an immediate boost. To do this, we must know now whether we have the money to invest.

The need for a clear expression of congressional intent with respect to tax legislation, as it affects regulated industries, is clearly illustrated in the remarkable history of the liberalized depreciation provisions of the Revenue Act of 1954. The question as to whether these provisions were intended by Congress to benefit industry or the consumer has been in constant litigation before the Federal Power Commission and the courts. After nearly 10 years there is still no definitive interpretation of congressional intent concerning this question, and the Power Commission is currently taking a fresh look at the entire problem.

Since the question of congressional intent, with respect to the investment tax credit, is now being litigated before Federal regulatory agencies it behooves Congress to inform such agencies as to its precise intent and leave no room for doubt on this score. The regulated industries should not be left to years of litigation and a final judgment by the courts, as to what Congress intended, before such industries know whether they have the funds, generated through the credit, available for investment in new plant.

SUMMARY AND CONCLUSION

Section 202(e) of H.R. 8363 as recently passed by the House of Representatives, provides a clear solution to the problem. This section provides:

"(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—

"(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 28 of such Code, or

[1] This amount of reduction results from the doubling effect of the income tax which requires approximately $2.08 of rates to net $1 of return to the company.

"(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."

The above-quoted provision is perfectly clear in its terms. There is no ambiguity in the language. There can be no disagreement or dispute as to its meaning. As House Report 749 (p. 37) says, the provision has been added to reassert the intent of Congress, "* * * that it was not and is not its intention that the Federal regulatory agencies require the benefit of the investment credit to flow through in this manner." Section 202(e) of H.R. 8363 very clearly and properly settles the question of the Federal regulatory rate treatment of the investment tax credit, and in doing so is merely declaratory of the tax policy of the investment credit provisions of the 1962 Revenue Act.

Therefore this association, on behalf of its members, respectfully urges this committee to report favorably the provisions of section 202(e) of H.R. 8363, and thereby insure that the intent of Congress will be observed and assure fair treatment to regulated companies.

WILMINGTON, N.C., *November 18, 1963.*

Hon. HARRY FLOOD BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR: Please give consideration to a change in section 202 of the Revenue Act of 1963 amending sections 48 and 1245 of the Internal Revenue Code of 1954. The new section and amendment provides that elevators and escalators installed or completed after June 30, 1963, shall be eligible for the investment credit and effectively under this provision that those two types of assets are not to be considered as components of a building or structure.

In my opinion, the same treatment should be accorded drive-in windows and night depositories of banks and other institutions using that type of asset. The drive-in windows and night depositories are similar in character to the elevators and escalators, as both types of assets are, in fact, movable, removable, and are subject to replacement long before the life of a building or structure is exhausted. Both types of assets are actually equipment, the drive-in windows are particularly subject to obsolescence attributable to improvements, in the asset, as time passes. The drive-in windows and the night depositories can be moved from one location to another in the building or structure; moreover, they can be removed without substantial damage or defacement of the building or structure and be replaced with more modern and up-to-date equipment. This type of asset should not be considered a component of the building or structure in which it is installed.

Here is a case where a taxpayer who owns the building or structure is placed in the position of disadvantage as compared with the taxpayer who leases the building or structure in which the drive-in windows and night depositories are installed. The lessee, who owns the drive-in windows and night depositories with the right of removal has the advantage of having the type of assets treated as equipment, with the shorter asset life and larger depreciation deduction. This is because the cited assets are the property of the lessee and, therefore, such assets are not a component part of the building. However, the actual ownership of the particular assets does not change the character of such assets nor make them a component of a building or structure, when they are, in fact, equipment.

In another section of the Internal Revenue Code of 1954 provision is made for allowance of the 20-percent first year depreciation on eligible equipment, but the Internal Revenue Service has recently disallowed the 20-percent first year depreciation on drive-in windows and night depositories of a bank who is the owner of the property (buildings) in which the windows and depositories are installed. It is suggested that your committee consider excluding from the component part of a building or structure drive-in windows and night depositories for purposes of the 20-percent first year depreciation deduction as provided in section 179 of the Internal Revenue Code of 1954.

Thanking you for your consideration of the above and with kindest regards, I am,

Yours respectfully,

CHARLES S. LOWRIMORE.

WASHINGTON, D.C., *November 21, 1963.*

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

DEAR MR. CHAIRMAN: Hawaiian Telephone Co., whose address is Post Office Box 2200, Honolulu, Hawaii, supports the recommendations of the United States Independent Telephone Association in urging your committee to retain proposed section 202(e) set forth in H.R. 8363. Hawaiian Telephone Co. is an independent telephone company which provides all telephone service within the State of Hawaii.

It is Hawaiian Telephone Co.'s position based on an analysis of its operations over the past 10 years, that the adoption of accounting regulations proposed by the Federal Communications Commission for the investment credit in contravention of proposed section 202(e) applicable to our company would result in substantial fluctuations in the indicated earnings of our company. Such regulations providing for the initial year flow through would be contrary to the preponderce of professional and regulatory accounting opinion. Hawaiian Telephone Co.'s annual construction programs, including in recent years heavy outlays for submarine cables connecting Hawaii with mainland United States and other parts of the world, vary substantially. Contrary to suggestions that apparently have been made to your committee with regard to the construction programs of regulated utilities, our construction programs do not entirely depend upon Hawaiian's legal obligation to provide service. This factor, as well as other factors, when coupled with the aforementioned proposed accounting regulations, as far as Hawaiian Telephone Co. is concerned, would have an adverse effect on tho stated purposes of the Congress in enacting the investment credit, to stimulate increased investments in plant and equipment.

HAWAIIAN TELEPHONE CO.,
By OMAR L. CROOK,
Attorney.

THE SECRETARY OF COMMERCE,
Washington, D.C., November 20, 1963.

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

DEAR MR. CHAIRMAN: As you probably know, the White House Conference on Export Expansion was held on September 17 and 18. The conference was under my chairmanship with Mr. Neil C. Hurley, Jr., chairman of Thor Power Tool Co., Mr. Fred C. Foy, chairman of Koppers Co., and Mr. Thomas J. Watson, Jr., chairman of International Business Machines, as vice chairmen. Participating were business leaders, mainly heads of corporations from all parts of the country.

The conference grouped itself into 11 committees, each of which made recommendations concerning ways and means of promoting U.S. exports more effectively.

You will be particularly interested in the report of Committee 1 on tax policies and export expansion. Mr. William E. Knox, of Westinghouse Electric International, was chairman of this committee. You will find recommendations of this committee on pages 3 and 4 of the enclosed report[1] of the White House Conference; I have marked the recommendation which reads as follows:

"That whereas the export performance of U.S. firms depends ultimately on our basic competitive strength, income taxes should be reduced * * *. The proposed liberalization of the investment tax credit in the tax bill now before the House of Representatives should be recognized as a key element of the bill because it encourages U.S. firms to modernize their plant and equipment more rapidly."

This is an endorsement of H.R. 8363, the bill to reduce corporate and personal income taxes now being heard by your committee.

I shall be grateful if you will place in the record this evidence of support for passage of H.R. 8363.

Sincerely yours,

LUTHER H. HODGES, *Secretary of Commerce.*

---

[1] The entire report was too voluminous to reprint in hearings; thus, it was incorporated in the committee files.

UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION,
Washington, D.C., November 20, 1963.

In re H.R. 8363, provisions of section 202(e) investment tax credit.

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

DEAR MR. CHAIRMAN: Appearing before your committee recently have been several witnesses who opposed the provisions of section 202(e) of H.R. 8363. Involved is the treatment of the investment tax credit for utilities by Federal regulatory agencies. Since the testimony of these individuals was noticeably quiet concerning the effects of their proposals upon the telephone industry and particularly the independent—non-Bell—segment, we would like to bring to your attention certain facts. These facts, in our opinion, would negate and deny the conclusions that might otherwise be drawn from the testimony of those witnesses so far as it applied to the 2,800 independent telephone companies of this country which operate in more than half of its geographical service area with some 13 million telephones.

Construction of plant by independent telephone companies varies widely from year to year and from company to company. A study of 100 representative independent telephone companies shows that in 1962 only 39 percent could be considered as having an average year (compared to the average of the total).

The amount of annual construction by independent telephone companies is not, as some say, dependent upon "the legal obligation to provide service." If it were, there would not be these substantial fluctuations in annual construction programs. Fluctuations for the most part are due to what is termed "modernization programs." These cover conversion to dial operation, provision of direct distance dialing, upgrading of multiparty rural service, provision of area coverage without extra charge and similar activities. These programs are undertaken only when capital is available and capital is available only when reasonable earnings are assured.

Federal regulatory policy is important even though only 49 of our 2,800 independent companies are under the full jurisdiction of the Federal Communications Commission (FCC). State regulatory commissions do tend to follow the FCC. During the period the FCC has permitted accounting which would flow the tax credit through to earnings in the initial year (as advocated in recent testimony) or spread the credit over the life of the plant (as provided in sec. 202(e)(1)) there has been wide variation in the actions of State regulatory commissions, namely:

Fifteen States currently spread the credit over the life of the plant.

Seven States currently spread the credit over the life of the plant on an interim basis.

Three States currently spread the credit over the life of the plant on an optional basis.

One State currently follows the FCC.

Five States currently flow the credit through in the initial year.

Eighteen States took no action.

It is most likely that when the accounting is finally resolved the great majority of our companies both Federal and State regulated will be following the Federal pattern.

The preponderance of professional and regulatory accounting opinion supports the spreading of the tax credit over the life of the plant (sec. 202(e)(1)). The Accounting Principles Board of the Institute of Certified Public Accountants, which is the recognized accounting authority in this country, has so recommended. In the table of the preceding paragraph the ratio of State regulatory commissions is 22 to 5 for amortization over the life of the plant.

Section 202 represents the last opportunity for Congress to protect its own intent, i.e., the tax credit should provide a real incentive to utility taxpayers. This situation is not one, as has been erroneously suggested, where Congress is attempting to interfere with the regulatory prerogative of ratemaking. On the contrary it is a much needed correction or clarification of the intent of Congress so as to protect it from subversion on confusion by regulatory authorities. That such subversion or confusion does exist is demonstrated by the variety of conflicting positions that now prevail.

Section 202 protects the right of utility taxpayers to take the benefits of the tax credit according to the requirements of the respective utilities involved. It gives them the option of reflecting the benefits over the useful life of the

property or during the taxable year in which the investment is made. Section 202 permits the utility taxpayer to take advantage of investment tax credit accounting according to his needs free from regulatory interference and within the spirit of the congressional intent to encourage plant investment.

We can foresee that if section 202(e) is not included in enacted legislation there may be undersirable consequences in the independent telephone industry. These would include speculation in telephone properties with unusual tax credits, difficulty of rate regulation with fluctuating tax credits, and the fact that tomorrow's subscribers would bear some of today's costs. We, therefore, strongly urge the retention of the provisions of section 202(e) in your proposed legislation.

Sincerely yours,

CLYDE S. BAILEY,
Executive Vice President.

STATEMENT OF WALTER BOULDIN, PRESIDENT OF THE EDISON ELECTRIC INSTITUTE, AS TO THE NEED AND JUSTIFICATION FOR THE CONGRESSIONAL DIRECTIVE CONTAINED IN SECTION 202(e) OF H.R. 8363, RELATIVE TO THE TREATMENT TO BE ACCORDED THE INVESTMENT TAX CREDIT BY FEDERAL REGULATORY COMMISSIONS

Mr. Chairman and members of the committee, this statement is submitted on behalf of the Edison Electric Institute to supplement its views on the need and justification for the congressional directive as to the manner in which the investment tax credit is to be treated by Federal regulatory agencies in determining the cost of service of a regulated company and, accordingly, deals specifically with section 202(e) of H.R. 8363 as passed by the House on September 25, 1963.

As stated in our testimony before this committee on October 31, 1963, we are in accord with the proposal of a congressional directive to Federal regulatory commissions as to the proper treatment to be accorded the investment tax credit for rate regulatory purposes. However, we should like to comment further on this section, and make it clear that we do not believe, in light of the legislative history of the credit, that there is any sound basis for a distinction between the terms of such directive as applied to the electric utility industry as distinguished from other regulated industries. In effect, paragraph 1 of section 202(e) directs that the appropriate part of the credit taken over the average useful life of the property shall be applied to reduce the Federal income taxes of the regulated company for the purpose of establishing the cost of service for rate-regulation purposes.

In paragraph (2), on the other hand, there is a directive that no part of the credit applicable to "any other property" shall be applied to reduce the tax liability for the purpose of establishing the cost of service. The term "any other property" includes properties of certain regulated companies, as, for example, natural gas pipeline companies.

In the report of the Committee on Ways and Means of the House of Representatives, which accompanied H.R. 8363, it is stated, at page 39, that, by way of the justification for this distinction, "* * * it was recognized that in their case (certain regulated industries including the electric utility industry) part of the benefit from the investment credit would be likely to be passed on eventually to the customers in lower rates." Although a statement of this general purport appeared in the House committee report relative to the investment tax credit, significantly no such statement was included in the Senate report which related to this same investment tax credit. In fact, excerpts from the Finance Committee report relating to the credit which appear at page 36 of House Report No. 749 relating to H.R. 8363 make it quite clear that the effect of the credit should be applied equally "in the case of both regulated and nonregulated industries."

Accordingly, we urge paragraph (1) of section 202(e) which discriminates against the investor-owned electric power and other regulated industries be deleted so as to subject all regulated industries to the same and proper treatment as is prescribed in the case of "other property" in paragraph (2) of section 202(e).

The regulatory commissions have expressed preference for permitting the exercise of their discretion in the treatment of the investment tax credit for rate regulatory purposes. In general, they seek to justify this position on the ground that the credit in effect is a reduction of income tax expense which should

be taken into account for rate regulation purposes, and the Commission should be permitted to deal with such tax relief as the circumstances of any particular regulated company might appear to dictate.

It is our position that the investment tax credit does not have the same characteristics, nor was it intended to be viewed as an outright reduction of tax. We believe it is appropriate to state that this provision of law relating to the credit is unique in that it offers the inducement of a partial liquidation of tax liability the quid pro quo for which is an investment by the taxpayer in capital goods.

The entire panorama of the legislative history depicts the credit as not a reduction of tax expense.

The President's tax message referred to the credit as "more effective as an inducement to investment than an outright reduction in the rate of corporation income tax."

The Secretary of the Treasury's statement before the House Committee on Ways and Means, at least three times, by clear and specific language, referred to the purpose of the credit as "not to give general tax reduction" and "not to provide general tax reduction for recipients of profit income," the latter phrase appearing twice in the Secretary's statement. The Secretary made these statements in the context of urging the credit as a stimulation to capital investment "to encourage modernization and expansion."

Throughout the long consideration by Congress, the investment tax credit proposal and its desirability was advanced by the administration and by others on the ground that it would stimulate capital investment "by increasing the rate of profitability" in respect of such investment.

The intention of increasing the "rate of profitability" through the operation of the investment tax credit was stressed time and again; by the President (1962 economic report), by the Ways and Means Committee (committee report), by the Secretary of the Treasury (Senate Finance Committee hearings), by the Senate Finance Committee itself (Senate Finance Committee report), and in the final agreement upon the legislative provisions by the House and Senate conferees (conference committee report).

Secretary of the Treasury Dillon in his statement before the Senate Finance Committee in urging enactment of the credit illustrated the intended effect by noting that as to a 10-year asset whose normal return after taxes would be 5 percent per annum (using straight-line depreciation), with an 8-percent investment credit, such return would be increased to 7.9 percent per annum, representing an "increase in profitability of more than 40 percent." Necessarily such increase in profitability would be less as to a longer life asset.

We believe the plain meaning of the term "increased rate of profitability" is that it is the same as an "increase in the rate of return" in respect of capital investment by regulated industries. By the plain and unequivocal statement of the Congress which enacted the credit, this increase in rate of return is intended to apply to regulated and nonregulated industries alike. The Conference Committee of the House and Senate in the final consideration of the bill which enacted the investment tax credit has so stated in categorical terms.

It has been urged that flow through of the credit to the benefit of consumers of regulated utilities would tend to stimulate consumers' demand and thus the basic intention of the credit would be accomplished.

This concept of the intended effect of the credit was specifically repudiated by the Senate in its Committee Report No. 1881, at page 12, wherein it stated:

"Some have suggested that tax changes designed to add to consumer demand are the appropriate way to raise the level of investment. However, to rely only on such an approach suggests primarily expansion of existing kinds of equipment and techniques, rather than more efficient and larger quantities of capital per worker and therefore greater productivity. The credit adds to the quantity and quality of capital available per worker, and increases the relative attractiveness of investment at home compared with investment abroad."

Thus repeated references to stimulation of consumer consumption in respect of the effect of the credit as related to regulated industries and their consumers are directly contrary to the fact that the Congress has categorically rejected this concept of the credit.

We believe, therefore, the legislative history relative to the enactment of the investment tax credit makes it crystal clear that the credit was intended to stimulate capital investment on the part of capital using industries of which category the electric utility industry is a most prominent member.

We are basically in accord with the limitations placed on Federal regulatory agencies in the treatment of the investment tax credit contained in section 202 of H.R. 8363 and urge the retention of this principle in the bill. We submit, however, that section 202(e) when read only in conjunction with paragraph (2) is the correct interpretation of the congressional purpose in the enactment of the credit and that this interpretation should have equal application as to all taxpayers, regulated and unregulated alike as the Senate and House have stated, where the credit is operative.

MILLER & CHEVALIER,
Washington, D.C., November 22, 1963.

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

DEAR SENATOR BYRD: Section 222 of H.R. 8363 provides for the repeal of the 2-percent penalty tax on the filing of consolidated returns by affiliated corporations in order to encourage the filing of such returns. However, there are at least two other problems which restrict the use of consolidated returns which we urge the Senate Finance Committee to resolve.

The first is the problem of equitably determining the earnings and profits of affiliated corporations that file a consolidated return; this is particularly difficult in light of the provisions of present law relating to the investment credit. The manner in which the investment credit would be allocated between such affiliated companies for purposes of determining earnings and profits was not considered by Congress at the time of the enactment of the investment credit. Present law (sec. 1552) does not adequately provide for the allocation of the investment credit in situations in which one affiliated company shares in the tax benefit resulting from the qualifying investment of another company. Similarly, where one affiliated company obtains the tax benefit resulting from the loss of another affiliated company, present law does not adequately provide an equitable method of determining earnings and profits in situations where minority shareholders are involved or where the same shareholders have differing participations in the affiliated companies. Moreover, the inadequacy of the tax law has led to confusion in corporate law regarding proper methods of handling tax benefits which arise from the filing of a consolidated return.

The second problem has arisen because of the position taken by certain Federal regulatory agencies. Where an affiliated group of corporations engaged in both regulated activities and nonregulated activities files a consolidated return, these regulatory agencies are proposing to use losses or credits incurred by the nonregulated corporations to reduce rates charged to the customers of the regulated corporations. We believe that the taxes of the regulated business which are taken into account in fixing rates should be determined without regard to the results of the business of the nonregulated corporations in the group.

The enclosed memorandum outlines the problems more fully and suggests solutions which may be helpful to the Committee.

Respectfully submitted.

DAVID W. RICHMOND.

MEMORANDUM RE CONSOLIDATED RETURN PROBLEMS

1. ALLOCATION OF INVESTMENT CREDIT AND EARNINGS AND PROFITS BETWEEN AFFILIATED CORPORATIONS

(a) In general

Under the consolidated return provisions of the Internal Revenue Code (sec. 1501, et seq.) an affiliated group of corporations, with certain limitations, has the privilege of making a consolidated return with respect to income tax in lieu of separate returns. Under these provisions, if a member of the affiliated group sustains losses and other members of the group have taxable income, the losses and the taxable income are in effect offset thereby producing a lower tax liability with respect to the whole group than the sum of the tax liability of the members of the group had separate returns been filed. If the amount of the losses exactly equaled the amount of the taxable income, the affiliated group would, of course, pay no income tax. Under section 1552, relating to earnings and profits, the tax liability of the affiliated group is allocated among the members of the group in accordance with each company's share of the consolidated taxable income, on

the basis of the tax that would have been borne by the member had it filed a separate return, or by a combination of these methods. Under this provision, the investment credit is in effect apportioned or allocated to the members of the group having taxable income since a loss corporation making the qualified investment and entitled to the benefits of the credit has no tax liability against which it could have applied the tax. In addition, one or more of the companies in the affiliated group may have substantial losses and, in effect, shift the benefit of the investment credit to other members of the group.

When all stockholders have an identical interest in each corporation in the group, the allocation scheme of section 1552(a) is a workable device of allocating both tax liability and the investment credit. In many instances, the affiliated company directly involved has minority stockholders whose equity rights can be protected only by preserving such company's own tax benefits. If common stockholders or security holders have varying interests in the several corporations in the group, special problems arise which may adversely affect the course of management's decisions, stockholders and other security holder's rights, cost accounting for products produced or services rendered and the competitive position of the company in the industry. In some instances, the company may want to pass on to its customers its own investment credit during the time of its development period when it may be operating at a loss or is actually paying little, if any, taxes.

(b) *Corporate law problems arising from inadequacy of tax law*

Where stockholders or security holders have varying interests in several corporations in an affiliated group, and where one or more members of the group have utilized the investment credit or net operating loss of other members of the group to effect a tax benefit for the other members, management of many corporations have sought an equitable method of recording the tax benefit resulting from the filing of a consolidated return which will recognize and provide for the varying interests. Since a corporation which permits its net operating loss to be used in a consolidated return is surrendering a putative future tax benefit in the form of a net operating loss carryforward or an actual present benefit in the form of a net operating loss carryback, and since some shareholders of such a corporation may not participate in the resulting benefit to other members of the group, the equitable procedure is for the corporations which surrender the putative future or present benefit to be reimbursed by the corporations which receive such benefit.

The proper concept of the reimbursement arrangement is that the transfer of funds between members of the group represents on the one hand a nondeductible expense in lieu of Federal income taxes and on the other hand a nontaxable reimbursement in lieu of a refund of Federal income taxes, both to be reflected in the computation of earnings and profits of the separate corporations.

Unless this concept is followed and adjustments to earnings and profits are permitted as proposed, any such reimbursement will cause the net income of the company making the payment to be overstated and the basis of its investment in the recipient to be inappropriately increased. Concurrently, the losses of the company receiving the payment will be overstated and its capitalization will be unduly inflated. Such distortion of the capitalization and the financial results of the operations of the recipient will hamper the ability of management to finance the expansion of the activity through borrowing from independent financial institutions. In most instances, the availability of credit from such institutions depends upon the financial situation of the particular borrower, and not upon the financial situation of other members of the group who are restricted in their credit activities by their own debt indentures.

However, there is no provision of present tax law which permits adjustments to earnings and profits where a member of the group reimburses another member whose losses or investment credit has brought about a reduction in consolidated tax liability or increases the net operating loss of the group.

Under present tax law, if members of such groups enter into an agreement whereby members who have realized tax savings from the filing of the joint return reimburse the members whose losses or investment credits have created such tax benefits, the following tax treatment results:

1. If the member providing the reimbursement is the parent of the member receiving the reimbursement (subsidiary)—

(a) the parent is considered to have made a "capital contribution" and its basis for the stock of the subsidiary is increased,

(b) the subsidiary is considered as having received a "capital contribution," and

(c) no adjustment is made to the earnings and profits of either member.

2. If the member providing the reimbursement is a subsidiary of the member receiving the reimbursement, the payment is considered to be a "dividend." Therefore, the earnings and profits of the subsidiary are reduced and the earnings and profits of the parent are increased by such amount.

3. If both the member providing and receiving the reimbursement are subsidiaries of a member who is a common parent corporation—

(*a*) the subsidiary providing the reimbursement (brother corporation) to another subsidiary (sister corporation) is considered to have paid a "dividend" to the parent,

(*b*) the parent is considered to have made a "capital contribution" to the sister corporation receiving the reimbursement,

(*c*) the earnings and profits of the brother corporation and the parent are each adjusted for the "dividend" as in subparagraph 2 above, and

(*d*) no adjustment to the earnings and profits of either the sister corporation or the parent is made for the "capital contribution," as in subparagraph 1 above.

The inadequacy of present law, which fails to recognize the propriety of reimbursement arrangements between affiliated corporations, has been reflected in the confusing state of corporate law regarding the propriety of such arrangements. On the one hand, management and corporations are exposed to litigation by minority shareholders of a loss corporation if no reimbursement is made for use of such corporation's loss. If, on the other hand, management attempts to follow the obviously equitable route of making reimbursement, management is exposed to litigation by stockholders of a profit corporation if reimbursement is attempted. Court decisions involving these questions have reached inconsistent results on inconsistent premises. Compare *Case* v. *New York Central Railroad Co.* (232 N.Y.S. 2d 702, reversed, N.Y. Sup. Ct. App. Div. 1st Dept. (Oct. 29, 1963, reported 32 U.S.L. Week 2226, Nov. 19, 1963)); *Western Pacific R.R. Co.* v. *Western Pacific R. Co.* (197 F. 2d 994); *Alliegro* v. *Pan American Bank* (136 So. 2d 656). See also *Phillip-Jones Corp.* v. *Parmeley* (302 U.S. 233); *Koppers Co.* (8 T.C. 886); *In re Consolidated Electric and Gas Co.* (15 S.E.C. 161); *In re City Service Co.*, Holding Co. Act of 1935 Release No. 5535. However, two decided cases which have indicated that such arrangements may be improper have been in large part based on the failure of Federal tax law to recognize the propriety (and equity) of such arrangements in the situation described. It may be assumed that courts interpreting the validity and equity, from a corporate standpoint, of making payments which arise in connection with the tax liability of the corporations involved will be guided, in most cases, by the general principles recognized in the Federal tax law. Present Federal tax law fails to recognize and support the proper concept of such payments in the situation described, and litigation and ultimate liability may result whichever course management pursues. If present tax law is amended to support the proper concept of the transaction, it will permit management to enter into a proper reimbursement arrangement buttressed against possible corporate liability by the general principles then embodied in the Federal tax law.

The proposed amendment will not require reimbursement arrangements to be entered into, or require reimbursement to be made. It will, however, recognize the propriety of such arrangements, leaving the decision as to their use in the hands of management who are responsible to the security holders and share holders.

(*c*) *Proposed amendment*

Section 222 of H.R. 8363 should be amended to add a special rule for the allocation of earnings and profits as a new subsection to section 1552 of the code. Such an amendment would provide a rule for determining the effect on earnings and profits of transfers of funds pursuant to an "agreement to reimburse" which would be defined in the amendment. The amendment would not affect the allocation of the consolidated tax liability of the group which would continue to be allocated in the manner provided by section 1552(a), nor would the amendment change present law regarding the determination of earnings and profits of members of an affiliated group except with respect to the treatment of transfers of funds pursuant to an agreement to reimburse. Finally, under the proposed amendment, the total earnings and profits of the members of the affiliated group would be the same as under present law, and the earnings and profits of each member who actually had earnings and profits would be no less than if it had filed a separate return. Consequently, the proposed amendment would result in no loss of revenue to the Government. It would merely affect the distirbution of earnings and profits between the members.

The earnings and profits of members of an affiliated group would be reduced or increased, as the case may be, by payments or receipts pursuant to the agreement to reimburse. It should be made clear under such an amendment that the transfer and receipt of funds pursuant to the agreement have no effect on the taxable income or loss of the transferor or recipient, but merely increase or reduce earnings and profits as would the payment or refund of Federal income taxes. This is the logical treatment to afford transfers of funds which essentially represent transfers of potential or deferred tax funds or benefits.

2. FAILURE OF REGULATORY AGENCIES TO RECOGNIZE PROPER TREATMENT OF FEDERAL TAXES WHERE CONSOLIDATED RETURNS ARE FILED

The Federal Power Commission has under consideration questions relating to the computation of allowance of Federal income taxes and the cost of service of companies under its jurisdiction which, if resolved in the affirmative, would have the effect of reducing the tax benefits of nonregulated members of the affiliated group to the benefit of customers of the regulated companies who have not borne any of the burdens of the operations which give rise to the tax benefit. Several cases are now pending in which the staff proposes to reduce rates to the customers of regulated companies by the amount of tax benefits occasioned by losses of nonregulated companies who participate with the regulated company in a consolidated tax return, as permitted under section 1501 of the Internal Revenue Code. For example, Cities Service Co. is a holding company with 34 separate corporations involved in numerous diversified activities.

Only one of the subsidiaries, Cities Service Gas Co., is subject to regulation by the Commission, but the Federal Power Commission staff proposes to take the tax losses of the unregulated companies to reduce the regulated company's rates. The examiner who presided at the hearings on the *Cities Service* case has written a decision wherein he disagrees with staff contentions basically on the grounds that to so deprive the unregulated companies of the tax benefit of their loses would contravene the intent of Congress. The Commission, however, by a 3-to-2 vote, has overruled the examiner and adopted the philosophy of the staff, opinion 396, *Cities Service Gas Company*, docket No. G-18799. The effect of this decision will be to discourage regulated companies from engaging in other nonregulated activities in which the companies are authorized to engage, and will distort the resutls of their regulated business as compared with those of their unregulated business.

Where two regulated companies are included in a consolidated group and one company wants to pass on the benefit of its investment credit to its customers, the staff of the Commission would, in effect, give the customers of the other regulated member of the affiliated group having taxable income the benefit of all or a portion of the investment credit, even though the second compand is entitled to no investment credit.

H.R. 8363 should also be amended to prohibit a Federal regulatory agency in determining the Federal income tax component of the cost of service of a member of an affiliated group from using income, credits, and deductions which are not directly related to the regulated activities of the member. This would, in effect, permit separate return treatment for the regulaed business of an affiliaed group which also conducts nonregulated businesses. It would not increase rates to customers; it simply would not work to lower them at the expense of the nonregulated activity.

STATEMENT OF ROBERT E. REDDING, VICE PRESIDENT AND GENERAL COUNSEL, TRANSPORTATION ASSOCIATION OF AMERICA

I. INTRODUCTION

It has been evident for some years that Congress has been utilizing the American tax system as a potent force to encourage our economic growth through expansion in production. There is practical unanimity in that expansion in production is a prerequisite of full employment, of a rising standard of living, and of the greater fulfillment of domestic and foreign needs.

To encourage industry to meet this need for greater investment, Congress has enacted various tax incentive measures, among which are those sections of the Internal Revenue Code of 1954, as amended, which pertain to the investment tax credit, liberalized depreciation, and consolidated tax returns.

These tax incentives for expansion and diversification will be voided to a large extent in the transportation industry under the incompatible and unreasonable principles of regulation now in effect or proposed by regulatory agencies. In their efforts to regulate rates and police the general activities of regulated companies, these agencies are applying or proposing rules which will negate as to one of the largest segments of the American economy—the transportation industry—the intended stimulant to our national economy.

The most recent example of the Federal agencies imparting their own economic philosophy to nullify an act of Congress is their action respecting the investment tax credit. In 1962, Congress enacted the investment tax credit. The major purpose in the President urging and in the Congress passing the investment tax credit bill was to stimulate the economy by providing additional capital for investment.

In respect to certain regulated companies, Congress provided a direct tax credit of 7 percent of the investment in new property. The 7-percent credit was allowed to those companies which are subject to competition, e.g., the airline, freight forwarder, highway, pipeline, rail and water carriers, while a 3-percent credit was allowed those companies which are subject to less competition, such as the electric and communication industries. (Reference hereinafter to regulated companies means the 7-percent companies.)

In response to the action of various Federal regulatory agencies seeking to deny industries subject to their jurisdiction the incentives provided by the investment tax credit, the House of Representatives, on September 25, 1963, passed as part of the President's 1963 tax bill section 202(e) thereof, reaffirming its original intent to prohibit Federal regulatory agencies from so acting. In respect to this provision, first, it should be noted that it does not increase consumer rates but, rather, provided industry with additional capital to invest. Second, both the administration and Congress intended the investment tax credit as a stimulus to the investor and not the consumer. The consumer is being provided for by the proposed reduction in individual income tax rates as set forth in the 1963 tax proposals.

Third, although regulated industry could pass the entire tax benefit through to its stockholders in the way of dividends, this unrealistic contention applies equally to all corporations, regulated and nonregulated. Additionally, even if a corporation passes the benefits through to its stockholders, the purpose of the credit will have been achieved for the investment in new facilities will have already taken place. Fourth, the Treasury Department loses $1.08 in revenues for every $1 of the investment tax credit denied industry by these agencies, which is in addition to the planned loss in revenues resulting from the application of the credit. This additional loss takes place because to reduce income after tax of a regulated company by $1, it is necessary to reduce gross income by $2.08; therefore, the taxable income is reduced by $2.08 of which 52 percent is $1.08, i.e., the additional loss to Treasury. It is improbable that this double loss in revenues to Treasury was initially anticipated.

To deny certain major industries the additional capital provided by the credit (as the Federal regulatory agencies are attempting) is to reduce the effect of the tax credit as a stimulant to the national economy, obviously thwarting the intent of Congress. As long as the investment tax credit provisions are law and as long as it is desired to have the policy of the provisions consistently applied, regulated industry must retain these benefits as would other industries. To prevent the Federal regulatory agencies from denying this incentive to the transportation industry is as valid as a concept as is the investment tax credit itself.

With respect to those regulated companies in a competitive market and entitled to a 7 percent tax credit, H.R. 8363 provides that the tax incentives are to be kept for the utilization of those companies. In respect to those companies entitled to a 3 percent credit, the bill forbids Federal regulatory agencies from passing on all of the tax credit in the first year unless the taxpayer otherwise consents.

The House of Representatives also passed as part of H.R. 8363 a provision repealing the so-called Long amendment to the 1962 tax bill, which reduced the tax basis of property subject to the investment tax credit by the amount of the tax credit; the Long amendment had the effect of making the 7-percent credit about a 3½-percent tax savings. In conformity with the administration's original intent, the decision of the House allows all corporations the full effect of the investment tax credit for purposes of expansion.

The action of the House was stimulated by actions of Federal regulatory agencies which have denied or indicate denial to industry of the use of the investment tax credit and other tax incentives. The Interstate Commerce Commission has implied that it will deny the benefits of the investment tax credit to companies subject to its jurisdiction. On June 17, 1963, a Federal Power Commission hearing examiner ruled that the natural gas pipeline industry should not receive any of the tax savings provided for by the investment tax credit.

In respect to other tax incentives, the FPC has actually denied industry substantially all of the tax incentives provided for by liberalized depreciation; the ICC has indicated the likelihood of similar action. The FPC has also deprived regulated companies of the incentives resulting from the filing of consolidated tax returns.

In respect to liberalized depreciation, the regulatory treatment not only deprives industry of the incentives which would result from the deferment of taxes, but also current tax revenues to Treasury can be appreciably reduced by not permitting regulated companies to utilize the incentive. The effect of the regulatory treatment is to increase the deferral (and thereby decrease current taxes payable) resulting from the use of liberalized depreciation by 108 percent. Although the incentive arising from the use of liberalized depreciation is a tax deferral having no tax saving aspects like the investment tax credit, the methodology of the tax loss to Treasury is identical in both instances.

There remains a serious gap in not having the national economy stimulated by the full force of these other tax incentives enacted by Congress. The congressional purpose in passing section 167 of the Internal Revenue Code of 1954 relating to liberalized depreciation was the same as it was in passing the investment tax credit provision; that is, to encourage expansion of the Nation's productive facilities. Nevertheless, after having allowed industry to utilize this tax incentive for a period of 7 years, the FPC in 1961 devised a method to deprive industries subject to its jurisdiction of substantially all of the tax incentive provided by Congress. Prior thereto, on February 9, 1959, the ICC implied in its accounting order that immediate flowthrough of the tax benefits from liberalized depreciation might be required.

Inasmuch as the congressional intent in providing for liberalized depreciation was identical to its intent in enacting the investment tax credit, the statutory language of H.R. 8363 should be broadened to prevent Federal regulatory agencies from depriving regulated industry of the temporary tax incentive provided for by liberalized depreciation, including the use of the administration-sponsored guideline depreciation.

Another tax incentive, of which the congressional intent has been obviated by a Federal regulatory agency, is in respect to consolidated tax returns. Although the Internal Revenue Code specifically provides that a regulated company has the right to join with nonregulated companies in the filing of consolidated tax returns, the action of one Federal regulatory agency would operate to deprive regulated industry of a large portion of the incentive.

The effect upon the revenues of Treasury of the action of the regulatory agencies of depriving industry of the incentives resulting from the application of the consolidated tax return sections is to reduce Federal revenues by the full amount of the tax on the reduction of revenues. If the intent of Congress is to be upheld, Congress itself must enact a provision prohibiting this practice by any regulatory agency.

II. THE TRANSPORTATION INDUSTRY STAKE IN SUCH LEGISLATION

A. Size and scope of the transportation industry

Transportation is a common denominator of America's ingenious industry and commerce—the one indispensable factor present in all economic activities. And it is a foundation of our national defense.

As the President said in his 1962 transportation message to the Congress:

"An efficient and dynamic transportation system is vital to our domestic economic growth, productivity, and progress. Affecting the cost of every commodity we consume or export, it is equally vital to our ability to compete abroad. It influences both the cost and the flexibility of our defense preparedness, and both the business and recreational opportunities of our citizens."

Sound growth in production and wealth can take place only if our transportation system is strong and healthy. The American transport system must keep pace with the rest of the economy so that economic and social progress is stimulated, not held back.

Another vital consideration is that the users of transportation in America continue to enjoy the benefits of privately owned and privately operated transport facilities—the free enterprise transport system which has helped the United States to develop the most bountiful economy in history.

Total transportation expenditures by U.S. citizens during 1962, including outlays for both private and for-hire transport, reached an estimated $112 billion, a gain of 8.5 percent over 1961. Such outlays outpaced total national output, or gross national product, which rose by 6.8 percent. Thus, transport expenditures constitute more than 20 percent of GNP. In fact, such outlays have accounted for approximately a fifth of GNP for the last 5 years.

As further indicative of the unassailable fact that transportation is an important keystone of progress and a significant part of the U.S. economy are the following highlights:

1. Transportation is a heavy user of basic products; e.g., 62 percent of rubber, 50 percent of petroleum, 23 percent of steel, 40 percent of lead, 22 percent of aluminum, 24 percent of cement, 14 percent of copper, etc.
2. Transportation generates about 20 percent of all the taxes collected by the Federal Government.
3. Transportation provides 14 percent of the Nation's total civilian employment, or about 9.4 million jobs.
4. Transportation investment in privately owned and operated plant equipment and facilities—over $126 billion in 1962—represents over 9 percent of the value of the Nation's wealth in terms of tangible assets.

Transportation is, therefore, a vital factor to every businessman in the cost of doing business, and to every citizen in the cost of living.

B. Transportation Association of America policy position

The Transportation Association of America is a nonprofit research and educational organization made up of users (i.e., shippers), investors, and carriers of all modes which collectively devote their efforts to the development and implementation of sound national policies aimed at the creation of the strongest possible transportation system under private ownership and operation. Users comprise 45 percent of the TAA membership.

The policy positions developed by TAA are studied carefully by eight permanent committees, or panels, composed of representatives from users, investors, and air transport, freight forwarder, highway, oil pipeline, railroad, and water carriers. These panels make individual recommendations to the TAA board of directors which approves final policy positions.

The TAA 114-man board of directors, includes not only top executives of all carrier modes mentioned above, but also senior officials of leading banks, insurance companies, investment companies, manufacturers, suppliers, agricultural interests, and professional persons. A list of the directors is attached to this statement.

With specific reference to the subject tax incentive legislation, the TAA board of directors on October 15, 1963, voted to approve the following statement of policy:

"The purposes and intent of congressional legislation granting tax incentives to general and regulated industry for expansion and diversification should not be circumvented by any agency or instrumentality of the United States through interpretations and rulings by which the benefits of such legislation are denied or limited for regulated industries while fully enjoyed by all other industries."

Seven of the eight TAA panels; user, investor, air, freight forwarder, highway, pipeline, and domestic water carrier, support the proposal. The railroad panel does not oppose.

In the TAA discussions it was noted that Congress had made provision in the Internal Revenue Code for the types of tax incentives described in detail in this statement, in order to induce expansion of industry. It was felt, however, that these incentives for expansion and diversification were likely to be voided to a large extent in the transportation and utility industries under incompatible principles of regulation now in operation or proposed by regulatory agencies.

III. INVESTMENT TAX CREDIT

On May 3, 1961, Secretary Dillon testified before the Ways and Means Committee that a credit distinction between transportation companies and the monopolistic-type of regulated companies should exist because of the highly competitive nature of the transportation industry. The 1962 bill, as enacted, provided a 3-percent investment credit for "regulated monopoly companies" and a

7-percent credit for the transportation companies. The primary reason for the differentiation in the investment tax credit provisions between those regulated companies entitled to a 3-percent credit and those entitled to a 7-percent credit rests in their different competitive position. There is not a reasonable alternative source of service for electric lighting or the telephone, while it is obvious that there is substantial competition among the airlines, buslines, truckers, railroads, pipelines, water carriers, and freight forwarders.[1]

Both the FCC and ICC have taken the view, for accounting purposes, that the entire amount of the investment tax credit should "flow through" to income in the year it is received. Once the accounting procedure has been established, there is an inherent danger that the same treatment may be carried over to ratemaking proceedings. In FCC Order 63-744 38445, released July 31, 1963, the FCC ruled "that the proper accounting treatment with respect to the investment tax credit arising from both owned and leased property is to account for it as a reduction in income taxes and let such reduction flow through to operating income."

The ICC, in order No. 34173 decided February 1, 1963, took basically the same position as the FCC. For its regulatory treatment of the investment tax credit for accounting purposes, the ICC adopted its position of February 9, 1959, in docket No. 34178 wherein, in respect to liberalized depreciation, the Commission stated:

"After consideration of the views for and against normal income taxes, different in amount from the income taxes actually payable, it has been decided that the charge to income each year for that year's Federal income taxes should be the amount produced by application of the effective tax regulations to transactions within the year. *The present-day shipper should not be required to provide from current freight rates for possible increased taxes of the indefinite future.*" [Emphasis added.]

If the ICC had intended to rule only upon the method of accounting and did not intend to deprive the carrier of the effect of the tax incentives as a matter of determining rates, there would have been no need to include the last sentence of the above quotation.

Likewise, the Civil Aeronautics Board will shortly rule upon the regulatory treatment it will afford the investment tax credit. The CAB in 28 F.R. 10785 and by Notice of Proposed Rulemaking EDR-61, dated October 2, 1963, proposes to prescribe accounting requirements for the investment tax credit.

It has been contended before the Federal regulatory agencies[2] that if the tax savings resulting from the application of the investment tax credit were to "flow through" to the consumer, such would act as a stimulant to the economy. However, Senator Proxmire, who opposed the application of the credit to most regulated companies, on August 25, 1962,[3] had the following excerpt from the Senate hearing on the investment tax credit provisions introduced into the Congressional Record:

"INSIGNIFICANT EFFECT OF THE CREDIT ON CONSUMER DEMAND

"Some utilities have contended that if the credit were passed on so as to lower the cost of service to consumers, this would increase demand and therefore provide a basis for additional investments in production facilities.

"Estimates of the possible effect of passing on the entire amount of the benefit of a 3-percent credit in the form of lower utility rates suggest an average reduction of cost to electricity consumers of less than 1 percent * * * [or] about 7 cents a month."

The price reduction for natural gas could not be much more than 7 cents a month per customer, if that. The excerpt also stated that both the demand for electricity or gas would not be affected by a price decline. Thus, it is apparent that any appreciable stimulant to the economy from the use of the investment tax credit, as applied to competitive but regulated companies, will not result from

---

[1] The oil and gas industries, including the transportation of oil and gas by pipeline, are subject to considerable competition between themselves and from competing fuels, such as coal and oil. For example, in 1960 fuel oil was used for 30 percent of the household heating requirements, coal for 12 percent, liquid petroleum gas for 9 percent, and natural gas for 41 percent. For industrial uses, in 1960 coal was utilized for approximately 38 percent of the requirements, natural gas for 36 percent, petroleum for 21 percent, and natural gas liquids for about 5 percent. (See Landsberg, Fischman & Fisher, "Resources in America's Future," 190, 216 (1963); FPC release No. 12953 (Oct. 14, 1963).)

[2] FPC staff brief, *United Gas Pipe Line Company*, docket No. RP 63-1, p. 85 (1963).

[3] 108 Congressional Record 16561 (daily ed., Aug. 25, 1962).

giving the customer a few more pennies but rather must come from encouraging these companies to reinvest these funds in new productive facilities. Senator Proxmire freely admitted that "any flow through of this advantage to consumers which is called for by existing law means no incentive." [4]

Secretary Dillon has repeatedly made clear that the purpose of the investment credit is to stimulate investment spending, not consumer spending. The administration in its 1963 tax program places primary emphasis on consumer spending by lowering the individual tax brackets; the emphasis upon individual tax reductions and not corporate reductions is based upon the tax benefits provided last year to corporations by the enactment of the investment tax credit.

As mentioned previously, for every $1 of the investment tax credit required to "flow through" by the regulatory agencies, the Treasury Department loses $1.08 in addition to the $1 investment tax credit reduction in income. Under a cost-of-service basis, a regulated company is entitled to recover a rate of return upon its plant investment, and all reasonable expenses associated with its jurisdictional operations, including income taxes payable. In order to recover the expenses of income taxes, the regulated company's rates reflect a cost component of 1.08 times the corporate net income after taxes. Thusly computed, the income tax is paid to Treasury.

As the taxable income of the regulated company is reduced the taxes payable by the company to Treasury are reduced. Therefore, if the net income of the regulated company is reduced by the amount of the investment tax credit, it is obvious that the taxes payable by the regulated company to Treasury will be reduced by 108 percent of the reduction. This is an additional 108 percent or more than double the anticipated loss to Treasury by the enactment of the investment tax credit.

The best example of how the Federal regulatory agencies are depriving or attempting to deprive regulated companies of the various tax incentives is the Federal Power Commission.

In respect to the investment tax credit, pursuant to a Notice of Proposed Rulemaking issued January 15, 1963, the FPC is considering, inter alia, depriving regulated companies of any of the tax benefits resulting from the application of the 7-percent investment credit enacted by the 87th Congress.

The FPC staff has already taken the position in the *United Gas Pipe Line* case [5] that the benefits of the investment tax credit should be denied regulated industry, and one June 17, 1963, the hearing examiner in that proceeding ruled that the 3.36-percent tax saving resulting from the use of the tax credit should be denied regulated industry. The examiner permitted only the retention of the far less significant tax-deferral benefit. If the Long amendment, which reduced the tax basis of qualified investment tax credit property by the amount of the credit, is repealed, as recommended by the House, the credit will be a full 7-percent saving and not the present 3.36-percent saving.[6] In such a case, the examiner would allow nothing to regulated companies.

If a regulatory commission were to deny regulated industry the benefits of the investment tax credit, the intent of Congress would obviously be thwarted. In section 46 of the Internal Revenue Code Congress made a separate, specific allowance of 3 percent of the qualified investment (as therein defined) for certain public utilities. If any regulatory commission could lawfully deprive a regulated utility of the benefits therein provided, there would have been no reason for Congress to grant any allowance for public utilities. The 3-percent provision would have been useless, for its effect would be washed out by regulatory action. Likewise, if regulatory bodies can deprive public utilities of the benefits of the tax credit, there would have been no reason for Congress to differentiate, as it did in section 46(c)(3)(B), between property of a utility whose rates are subject to Government regulation and property of a utility whose rates are not subject to governmental regulation.

As clear as the intent of Congress is, as reflected by the actual statutory language concerning the investment tax credit, this manifest intent is even

---

[4] 108 Congressional Record 17385 (daily ed., Sept. 4, 1962).

[5] Note 2, supra.

[6] A 3.36-percent saving results because the tax basis of the property is reduced by 7 percent, thereby reducing the depreciation deduction by 7 percent which, at a 52-percent corporate tax rate, allows a tax saving of 48 percent of 7 percent, or 3.36 percent. The remaining 3.64 percent is a deferred tax which must be paid but which is paid over the lifetime of the depreciable asset; the companies do have the use of a decreasing portion of the money until the deferred tax is fully paid. In this respect the 3.64 percent operates in a manner similar to the tax deferral provided for by sec. 167 of the Internal Revenue Code of 1954, respecting liberalized depreciation.

further buttressed by the conference report recommending enactment of the 1962 tax bill, as finally adopted by Congress. There it was stated:

"It is the understanding of the conferees on the part of both the House and the Senate that the purpose of the credit for investment in certain depreciable property, *in the case of both regulated and nonregulated industries,*[7] is to encourage modernization 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 the new facilities over their productive lives." (H. Rept. No. 2508, on H.R. 10650, 87th Cong., 2d sess., p. 14.) [Emphasis and footnote added.]

Chairman Wilbur Mills of the Ways and Means Committee, by letter of November 26, 1962, to the Chief Counsel, said:

"* * * the investment incentive credit, as I understand it, was to be purely for the purpose of encouraging capital investment. This would clearly not be the result if any investment credit had to be passed on to the users by public utilities."

Chairman Oren Harris of the Special Subcommittee on Investigations of the Committee on Interstate and Foreign Commerce cited the Mills letter with approval and went on to state at the subcommittee hearing held February 28, 1963 (tr. 152):

"Thus we find the clear intent of the Congress was to conform with the President's recommendation and to give the 7-percent investment credit to firms for the purpose of encouraging economic growth. Nothing was said in the final legislative history to indicate that this tax credit was to be passed on to the consumer."

In view of the legislative history of the investment tax credit, any Federal agency which denies any part of the full incentive effect of the investment tax credit to regulated industry has in effect negated a congressional enactment. However, unless section 202(e) is enacted into law, it is reasonable to assume that the Federal regulatory agencies will substitute their judgment for that of Congress and deny the tax credit incentive to regulated companies.

IV. LIBERALIZED DEPRECIATION

In 1950 and 1954, respectively, Congress provided for the deferment of income tax payments by allowing greater initial deductions for accelerated amortization and liberalized depreciation (offset by lesser deductions in later years), than had been permitted prior to the enactment of these provisions.

The purpose of Congress in enacting such legislation was clearly stated. Its intent was to benefit carriers rather than users of transport.

The legislative history shows that Congress in 1954 enacted section 167 to encourage expansion of the Nation's productive facilities. In his annual address to Congress (100 Congressional Record 571), the President of the United States requested legislation authorizing liberalized depreciation in order to stimulate economic growth:

"A liberalization of the tax treatment of depreciation would have far-reaching effects on all business and be especially helpful in the *expansion of small business* whether conducted as individual proprietorships, partnerships, or corporations. At present, buildings, equipment, and machinery are usually written off uniformly over their estimated useful lives. The deductions allowed, especially in the early years, are often below the actual depreciation. This *discourages long-range investment* on which the risks cannot be clearly foreseen. It discourages the early replacement of old equipment with new and improved equipment. And it makes it more difficult to secure financing for *capital investment*, particularly for small business organizations.

"I recommended that the tax treatment of depreciation be substantially changed to *reduce these restrictions on new investment,* which provides a basis for economic growth, increased production, and improved standards of living.

* * * * * * *

---

[7] Certain isolated remarks made by the late Senator Kerr on the Senate floor in regard to the investment tax credit might indicate that he thought the regulatory bodies would deny the tax benefits to regulated industry. E.g., 108 Congressional Record 16795 (daily ed., Aug. 28, 1962). However, even at that time he indicated a contrary belief, in stating that the purpose of allowing utilities only a 3-percent credit was to assure that they retained the benefits of the investment tax credit, 107 Congressional Record 16684 (daily ed., Aug. 27, 1962). Subsequently, the Senator made clear that the benefits were to apply to "both regulated and nonregulated industries," 108 Congressional Record 20548 (daily ed., Oct. 2, 1962).

"Faster depreciation, it should be noted, will merely shift the tax deductions from later to earlier years. It will not increase total deductions. The change should, in fact, increase Government revenues over the years because of the stimulation which it will give to enterprise and expansion." [Emphasis added.]

The same purpose was stressed by the Secretary of the Treasury when he appeared before the Senate Committee on Finance in support of the bill which became the Internal Revenue Code of 1954:

"Another provision of this bill allows more flexible charges for depreciation. * * * Here, again, the purpose is to stimulate employment, plant expansion, and modernization." [8]

Although nowhere did Congress provide that the tax deferrals resulting from the use of liberalized depreciation were not to apply to all corporations alike, the Federal regulatory agencies nevertheless have sought to deprive regulated industry of these temporary benefits. Permitting the regulated companies to retain this benefit does not result in higher rates, it simply does not reduce them.

The effect of denying regulated companies the benefits of liberalized depreciation upon the current revenues of Treasury was succinctly stated by William F. Stanley in Public Utilities Fortnightly, September 10, 1959, page 407:

"* * * in addition to each $1 of deferred taxes, which Congress intended to defer to aid corporations in expansion for the benefit of our national economy, there will also be deferred (for the same period) an additional $1.08 (104 [should be "108"] percent of the intended deferral), thereby severely penalizing the Federal Treasury, and, indirectly, all Federal taxpayers, and substantially reducing current tax revenues."

Although the ICC in Docket No. 34178, issued February 9, 1959, indicated that for rate purposes the benefits of liberalized depreciation might be ordered to "flow through" in the year they were obtained, the best example of a regulatory agency stifling the intended tax incentive of liberalized depreciation is the Federal Power Commission.

The FPC treatment of the tax deferrals resulting from the tax provision applicable to accelerated amortization and liberalized depreciation[9] not only represents an outright refusal to give effect to the intent of Congress in granting these tax incentives to stimulate the economy but also is an excellent example of administrative inconsistency. FPC has recently adopted a method of rate regulation specifically designed to prevent regulated companies from retaining the tax benefits afforded them by Congress. Yet, until recently, the FPC had carried out the intent of Congress by permitting regulated industry to retain these benefits.

In 1954, the FPC allowed a natural gas pipeline[10] to retain the benefit of the deferral resulting from the application of the accelerated amortization provision.[11] The U.S. Court of Appeals in the *City of Detroit* case affirmed the FPC action, stating that "* * * the intent of Congress reflected in section 124A is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities." [12] In 1956, this principle was extended by the FPC to permit regulated industry to retain the benefit of the deferral resulting from the application of section 167, relating to liberalized depreciation.[13] And again in 1960 the FPC ruled that a major independent producer could retain the benefits resulting from accelerated amortization.[14]

However, in 1961 a newly constituted FPC took away substantially all of the benefits regulated companies had been receiving under sections 167 and 168 of the code[15] and, in effect, reversed its prior decision upon which the industry had been relying for 8 years. The device employed by the staff of the FPC was to include in the cost of debt as cost-free capital the reserves accumulated from accelerated amortization and liberalized depreciation. This caused the cost of debt to be lowered, which, in turn, caused the rate of return to be lowered. The FPC adopted the staff's method; however, it did allow a return of 1.5 percent

---

[8] Hearings on the Internal Revenue Code of 1954 before the Senate Committee on Finance, 83d Cong., 2d sess., p. 95 (1954). See also id. at 104 (statement of Under Secretary of the Treasury).

[9] Secs. 168 and 167, respectively, of the Internal Revenue Code of 1954.

[10] *Panhandle Eastern Pipe Line Company* (13 F.P.C. 53 (1954)).

[11] Sec. 124A, Internal Revenue Code of 1939.

[12] *City of Detroit* v. *F.P.C.* (230 F. (2d) 810, 822 (1955), cert. denied, 352 U.S. 829 (1956)).

[13] *Amere Gas Utilities Co., et al.* (15 F.P.C. 781 (1956)).

[14] *Phillips Petroleum Co.* (24 F.P.C. 537 (1960)).

[15] E.g., *Northern Natural Gas Company* (25 F.P.C. 431 (1961)).

upon the accumulated reserves, or less than one-quarter of the return usually allowed on other rate base items. The actual dollar effect of the FPC recent action is to deny regulated industry substantially all of the benefits of sections 167 and 168.

It is axiomatic that courts are loath to overturn agency decisions; however, in an opinion[16] devoted to this reversal of position on the part of the Federal Power Commission, a strong minority (four of nine) of the U.S. Court of Appeals for the District of Columbia, sitting en banc, as recently as March 15, 1963, stated in its opening paragraph:

"* * * The erroneous order now affirmed by the majority derived largely from two sources: (*a*) the mistaken notion that, as to industries regulated by it, the Commission has power to limit the effect of the plain mandate of Congress expressed in sections 167 and 168, and (*b*) the Commission's refusal, contrary to its own precedents and in defiance of our city of Detroit opinion to recognize that the statutory accelerated amortization and liberalized depreciation are essentially bookkeeping entries for Federal income tax purposes, in which the ratepayers have no interest."

In the Alabama-Tennessee Natural Gas Co. proceedings, the FPC on June 1, 1962, issued on order inviting interested persons to intervene therein as amicus curiae to participate in a general reconsideration of its position regarding liberalized depreciation and accelerated amortization. It is entirely possible that the FPO will order the full amount of the deferral to "flow through" to the ratepayer.

The history of the treatment afforded tax incentives by Federal regulatory bodies leaves little doubt that the agencies will seek to deprive regulated companies of the tax benefits resulting from the use of "guideline depreciation." Shorter depreciation schedules on specified plant and equipment were placed in effect by the administration in 1962. The President's statement of July 11, 1962, is explicit as to the purpose of the new guidelines:

"This is a permanent change in the light of technological advance. Until these longstanding and outmoded handicaps to modernization (that is, the prior depreciation schedules) were removed, it was difficult for American business to achieve its maximum productivity—and the highest possible productivity is urgently needed today * * * to expand our economy fast enough to provide jobs for all who want them."

For regualted companies to receive equal treatment, we urge Congress to reiterate its original intention by approving legislation which provides that any deferment of tax resulting from the application of any method of accelerated depreciation should remain with the investing company to provide funds for plant expansion, with no disability being imposed in the form of either an immediate flow-through to users or as a reduction in the return otherwise allowable with respect to the reinvestment of such funds.

V. CONSOLIDATED INCOME TAX ALLOCATION

Section 1501 of the Internal Revenue Code permits an affiliated group of corporations to file a consolidated income tax return, with the result that profits of one member of the group may be offset by the losses of another member or members of the group, so that taxes will be paid by the consolidated group only on the true net profit of all of the members combined. This provilson in the tax law encourages established companies to diversify and invest in new enterprises. In exempting regulated companies from the provision increasing the tax by 2 percent for companies filing a consolidated return,[17] Congress particularly sanctioned and encouraged regulated industry to engage in new businesses.

Where an affiliated group avails itself of this privilege and so reduces the total tax which would otherwise be payable for the current year and where the group includes one or more regulated companies with income, a regulated company, unlike a nonregulated company, will not be able to absorb the risk of engaging in a nonregulated enterprise through an affiliated company unless the regulatory agency applies a method of alocation under which the regulated company's income will be charged for an amount equivalent to the separate return tax. If any smaller amount is allocated to the regulated activity, users are favored by tax reductions which are unrelated to the furnishing of the service. Unlike

[16] *Panhandle Eastern Pipe Line Company* v. *F.P.O.* (316 F. (2d) 663 cert. denied Oct. 21, 1962.

[17] Sec. 1503 of the Internal Revenue Code of 1954.

the nonregulated profit company, the regulated company would receive no tax benefit to offset the loss resulting from engaging in a nonjurisdictional activity. Obviously, this seriously jeopardizes the competitive position of the companies associated with a regulated company, as compared with competing companies which do not have included in the consolidated return a regulated company.

Likewise, a special problem arises in that regulated competing carriers may have different amounts of tax cost entering into cost of service where one is a member of a consolidated group and one is not.

By permitting the offset of current year operating losses against current year operating profits, the consolidated return provisions allow an immediate tax benefit on the losses, to the extent that they operate to offset profits. The purpose of this policy is to encourage established industry to engage in new and possibly more venturesome enterprises; to achieve this end, Congress utilized tax incentives, although it could have applied direct subsidies as it has found necessary to support other policies.

Unfortunately, the Internal Revenue Code, perhaps through oversight, does not expressly permit methods of allocating consolidated tax in such a manner as to permit the allocation of the tax benefits among the companies as if each company had filed a separate return. Furthermore, it now appears that the regulatory agencies will attempt to impose methods of regulation designed to force the regulated companies to reduce their rates for consolidated tax benefits arising from joining in a consolidated return with the unregulated companies.

The effect of this regulatory treatment can be understood best by an example. Assume that company P is the parent of company R, a regulated transportation company, and of company D, which is engaged in aircraft research and development. Further assume that companies P, R, and D file consolidated tax returns. If, in 1 year, company R had a before-tax income of $1 million, and company D, due to research and development losses, had a $1 million loss, there would be no tax payable under a consolidated return. Under recommended accounting procedures, company R would be charged with such taxes as it would pay had it not filed a consolidated return, and company D would receive a credit for the amount of the tax benefits which it provided. However, the regulatory agencies would not charge any tax to company R, and would give no credit to company D for its loss.

The regulated company would bear 100 percent of the loss as a result of this regulatory treatment. However, if the profit company were not a regulated one, but a bank, factory, or foreign trading corporation, the latter investors would bear only 48 percent of the loss. Yet, both the regulated and nonregulated corporate enterprises took the same risks and invested the same amount of dollars. This regulatory treatment has a discriminatory adverse effect upon the competitive position of the regulated company with respect to nonregulated enterprises.

Although the regulated operations in no way contributed to the tax reduction, under the regulatory method, the entire benefit would fall into the hands of the user. The result of such discrimination may well be to force company R and company D to file separate tax returns, hoping that company D will be able to use a tax loss carryover if it earns a profit in future years. If separate returns were filed, the users of the regulated company would be charged those taxes payable at a full 52-percent tax rate. It is difficult to believe that Congress intended a company to forego the filing of a consolidated return in order to achieve fair and equitable results among the affiliated corporations.

A more drastic but very probable result may eventuate by reason of this regulatory treatment. A regulated company may refuse to take the risk of engaging in a new, nonregulated business. By the same token, a nonregulated company might forego the risks of expanding into a regulated venture. Certainly, this is precisely the opposite result desired by Congress. That Congress intended regulated companies to utilize the consolidated tax return provisions appears obvious from the fact that Congress exempted them from the 2 percent increased tax rate imposed on other corporations filing consolidated returns.

The likelihood of the Federal regulatory agencies adopting a regulatory method, the effects of which are discussed above, is shown by a decision of the Federal Power Commission issued on July 15, 1963.[15] Although the decision was couched in complex terms, the effect of the decision is to deny regulated companies, subject to the jurisdiction of the FPC, a considerable portion of the tax

[15] *Cities Service Gas Co.*, opinion No. 396, docket No. G-18799, F.P.C.

incentives resulting from the filing of a consolidated tax return. That is, the FPC utilized the tax losses on nonregulated companies to reduce the revenues of the rgualted company joining in the consolidated return. The impact of the FPC's method of regulation is exactly as has been discussed above. Two dissenting Commissioners commented forcibly as follows:

"Completely ignoring the fact that Congress has provided that taxpayers may lawfully use their tax losses to offset their taxable income in the manner provided by statute, the majority imports its own peremptory economic and regulatory philosophy to strike down an act of Congress."

Again, it should be noted that the Internal Revenue Code does not infer that regulated companies should be treated any differently than nonregulated companies, for nowhere is it provided in the Code that the tax benefits resulting from the application of the consolidated tax return sections should not be applicable to regulated companies.

VI. CONCLUSION

The fiscal wisdom of Congress, having enacted those provisions related to the investment tax credit, liberalized depreciation, and consolidated tax returns, is not herein in issue. The point is that Congress, having enacted these provisions into law, they should apply to all industries, regulated and nonregulated. If the purpose of Congress in enacting these tax incentives is not to be thwarted, then the full effect of these stimulants should be encouraged, and no Federal agency should be allowed to obstruct a national purpose by substituting its judgment for that of Congress.

The Transportation Association of America urges Congress to enact into law section 202(e) of H.R. 8363 and to pass legislation assuring that the tax incentives resulting from the provisions related to liberalized depreciation and to consolidated tax returns are not denied regulated companies by the Federal regulatory agencies.

Transportation Association of America

BOARD OF DIRECTORS

George P. Baker, chairman, dean and professor of transportation, Harvard Graduate School of Business Administration, Boston, Mass.
Harold F. Hammond, president, Transportation Association of America, Washington, D.C.
Frank O. Prior, chairman, board of governors, retired chairman of the board, Standard Oil Co. (Indiana), Palm Beach, Fla.
F. W. Ackerman, chairman of the board, the Greyhound Corp., San Francisco, Calif.
John M. Akers, president, Akers Motor Lines, Inc., Gastonia, N.C.
G. W. Albertson, general traffic manager, F. W. Woolworth Co., New York, N.Y.
A. G. Anderson, New York, N.Y.
Harold Angier, general manager, California Grape & Tree Fruit League, San Francisco, Calif.
W. J. Barta, president, Mississippi Valley Barge Line Co., St. Louis, Mo.
J. N. Bauman, president, the White Motor Co., Cleveland, Ohio.
Charles H. Beard, general traffic manager, Union Carbide Corp., New York, N.Y.
Harry O. Bercher, president, International Harvester Co., Chicago, Ill.
W. J. Bird, vice president, Chrysler Motors Corp., Detroit, Mich.
Richard M. Boyd, director of traffic and transportation, Pittsburgh Plate Glass Co., Pittsburgh, Pa.
Kenneth F. Burgess, Sidley, Austin, Burgess & Smith, Chicago, Ill.
J. L. Burke, president, Service Pipe Line Co., Tulsa, Okla.
Walter F. Carey, president, Automobile Carriers, Inc., Flint, Mich.
A. D. Carleton, San Francisco, Calif.
Braxton B. Carr, president, the American Waterways Operators, Inc., Washington, D.C.
Owen Clarke, vice president, the Chesapeake & Ohio Railway Co., Cleveland, Ohio.
Jack Cole, president, Jack Cole Co., Birmingham, Ala.
Ben Colman, president, Evans Equipment Leasing, Inc., Metamora, Mich.
Henry A. Correa, vice president, executive department, ACF Industries, Inc., New York, N.Y.

A. B. Cozzens, vice president, vessel operations, Columbia Transportation Division, Oglebay Norton Co., Cleveland, Ohio.
James K. Crimmins, Chadbourne, Parke, Whiteside & Wolff, New York, N.Y.
Neil J. Curry, president, California Cartage Co., Inc., Los Angeles, Calif.
Harry G. Fair, vice president, Supply and Transportation Department, Phillips Petroleum Co., Bartlesville, Okla.
Charles W. L. Foreman, vice president, United Parcel Service, New York, N.Y.
Morris Forgash, chairman of the board, Universal Carloading & Distributing Co., New York, N.Y.
Welby M. Frantz, president, Eastern Express, Inc., Terre Haute, Ind.
L. E. Galaspie, director of traffic, Reynolds Metals Co., Richmond, Va.
J. C. Gibson, vice president, law, the Atchison, Topeka & Santa Fe Railway System, Chicago, Ill.
Donald M. Graham, vice chairman of the board, Continental Illinois National Bank & Trust Co. of Chicago, Chicago, Ill.
Allen J. Greenough, president, the Pennsylvania Railroad Co., Philadelphia, Pa.
W. P. Gwinn, president, United Aircraft Corp., East Hartford, Conn.
James F. Haley, vice president and director, Tarffic and Transportation Department, Koppers Co., Inc., Pittsburgh, Pa.
Wm. Barclay Harding, Smith, Barney & Co., New York, N.Y.
B. W. Heineman, chairman of the board, Chicago & North Western Railway Co., Chicago, Ill.
J. W. Hershey, chairman of the board, American Commercial Barge Line Co., Houston, Tex.
Richard D. Hill, vice president, the First National Bank of Boston, Boston, Mass.
Hunter Holding, vice president, the Equitable Life Assurance Society of the United States, New York, N.Y.
Victor Holt, Jr., executive vice president, the Goodyear Tire & Rubber Co., Akron, Ohio.
Phelan H. Hunter, president, Humble Pipe Line Co., Houston, Tex.
A. C. Ingersoll, Jr., president, Federal Barge Lines, St. Louis, Mo.
C. W. Jacob, senior vice president and secretary, American Airlines, New York, N.Y.
Downing B. Jenks, president, Missouri Pacific Railroad Co., St. Louis, Mo.
William B. Johnson, president, REA Express, New York, N.Y.
Robert B. Johnston, vice president, the First National Bank of Chicago, Chicago, Ill.
W. A. Johnston, president and chairman, executive committee, Illinois Central Railroad, Chicago, Ill.
Loren F. Kahle, transportation coordinator, Standard Oil Co. (New Jersey) New York, N.Y.
A. M. Kennedy, Jr., vice president, purchases and traffic, Westinghouse Electric Corp., Pittsburgh, Pa.
Carter Kissell, president, National Castings Co., Cleveland, Ohio.
Jervis Langdon, Jr., president, the Baltimore & Ohio Railroad Co., Baltimore, Md.
Maj. Gen. E. C. R. Lasher, president and chief executive officer, North American Car Corp., Chicago, Ill.
Daniel P. Loomis, president, Association of American Railroads, Washington, D.C.
Karl D. Loos, Pope, Ballard & Loos, Washington, D.C.
Robert S. Macfarlane, president, Northern Pacific Railway Co., St. Paul, Minn.
Malcolm A. MacIntyre, president, Eastern Air Lines, Inc., New York, N.Y.
Sidney Maestre, chairman of the executive committee, Mercantile Trust Co., St. Louis, Mo.
Dwight M. McCracken, vice president, general manager, loss prevention, Liberty Mutual Insurance Co., Boston, Mass.
Wilfred J. McNeil, president, Grace Line, Inc., New York, N.Y.
E. Spencer Miller, president, Maine Central Railroad Co., Portland, Maine.
Raymond W. Miller, president, Public Relations Research Associates, Inc., Washington, D.C.
Chester G. Moore, honorary secretary for life, American Trucking Association, Inc., Washington, D.C.
R. Stuart Moore, chairman of the board, Los Angeles-Seattle Motor Express, Inc., Oakland, Calif.
D. H. Overmyer, president, D. H. Overmyer Warehouse Co., Toledo, Ohio.
Adrian B. Palmer, president, Rollins Burdick Hunter Co., Chicago, Ill.
W. A. Patterson, chairman of the board, United Air Lines, Chicago, Ill.

Alfred E. Perlman, president, New York Central System, New York, N.Y.
James F. Pinkney, chief counsel, public affairs, American Trucking Associations, Inc., Washington, D.C.
Frank A. Plummer, chairman of the board and president, Birmingham Trust National Bank, Birmingham, Ala.
Gregory S. Prince, executive vice president and general counsel, Association of American Railroads, Washington, D.C.
Alexander Purdon, executive vice president, United States Lines Co., New York, N.Y.
William J. Quinn, president, Chicago, Milwaukee, St. Paul & Pacific Railroad Co., Chicago, Ill.
L. D. Rahilly, president, Interstate Motor Freight System, Grand Rapids, Mich.
John S. Rice, president, Rice Truck Lines, Great Falls, Mont.
W. Thomas Rice, president, Atlantic Coast Line Railroad Co., Jacksonville, Fla.
W. Lyle Richeson, vice president and assistant to president, Westinghouse Air Brake Co., Pittsburgh, Pa.
Guy W. Rutland, Jr., vice president, the Motor Convoy, Inc., Hapeville, Ga.
Walter N. Saaby, director, railroad sales, Highway Trailer Industries, Inc., Chicago, Ill.
Stuart T. Saunders, chairman of the board, the Pennsylvania Railroad Co., Philadelphia, Pa.
John W. Scallan, president, Pullman-Standard, a division of Pullman, Inc., Chicago, Ill.
Harry G. Schad, president, Atlantic Pipe Line Co., Philadelphia, Pa.
Eugene A. Schmidt, Jr., vice president and treasurer, Metropolitan Life Insurance Co., New York, N.Y.
Henry E. Seyfarth, Seyfarth, Shaw, Fairweather & Geraldson, Chicago, Ill.
B. M. Seymour, chairman of the board, Associated Transport, Inc., New York, N.Y.
Samuel H. Shriver, chairman and chief executive officer, Alexander & Alexander, Inc., New York, N.Y.
Charles B. Shuman, president, American Farm Bureau Federation, Chicago, Ill.
Robert F. Six, president, Continental Airlines, Inc., Los Angeles, Calif.
Edgar W. Smith, Edgar W. Smith & Sons, Portland, Oreg.
F. Cushing Smith, executive vice president, American Oil Co., Chicago, Ill.
J. L. S. Snead, Jr., Rumson, N.J.
William I. Spencer, senior vice president, First National City Bank, New York, N.Y.
W. J. Sullivan, director of traffic, Allied Chemical Corp., New York, N.Y.
A. M. Thomas, director of traffic, General Mills, Inc., Minneapolis, Minn.
Robert E. Thomas, president, Mid-America Pipeline Co., Tulsa, Okla.
Stuart G. Tipton, president, Air Transport Association, Washington, D.C.
L. H. True, president, Magnolia Pipe Line Co., Dallas, Tex.
Kenneth L. Vere, vice president, traffic, United States Steel Corp., Pittsburgh, Pa.
R. C. Waehner, general manager, distribution division, Lever Bros. Co., New York, N.Y.
Giles A. Wanamaker, president, the Hertz Corp., New York, N.Y.
Hugo Waninger, vice president, traffic, Anheuser-Busch, Inc., St. Louis, Mo.
Donald G. Ward, general manager, Container Division, General American Transportation Corp., Chicago, Ill.
William W. Ward, president, Ward Trucking Corp., Altoona, Pa.
T. Carl Wedel, vice president, C.I.T. Financial Corp., New York, N.Y.
John L. Weller, president, Seatrain Lines, Inc., Edgewater, N.J.
William White, chairman of the board, the Delaware & Hudson Railroad Corp., New York, N.Y.
George K. Whitney, trustee, Massachusetts Investors Trust, Boston, Mass.
Francis R. Wilcox, general manager, Sunkist Growers, Los Angeles, Calif.
C. J. Williams, president, Hillside Transit Co., Inc., Milwaukee, Wis.
R. A. Williams, president, Stanray Corp., Chicago, Ill.
William W. Wolbach, president, Boston Safe Deposit & Trust Co., Boston, Mass.
C. E. Woolman, president and general manager, Delta Air Lines, Inc., Atlanta, Ga.
Elliott C. Youngberg, general traffic manager, Inland Steel Co., Chicago, Ill.

STATEMENT SUBMITTED BY MERTON STANLEY, CHAIRMAN, PUBLIC SERVICE COMMISSION OF INDIANA

The investment tax credit was authorized by Congress to stimulate the economy and to create new jobs by encouraging industrial expansion. In order to foster this industrial expansion, it is necessary to encourage and have available utility services. The Public Service Commission of Indiana strongly supports the provisions of section 202(e) of H.R. 8363, Revenue Act of 1963, except the consent provision.

It is our feeling that there should be a degree of uniformity with respect to the application of the investment tax credit in regulated industry and that the consent provision will destroy uniformity. We believe that the purpose of the Revenue Act of 1962, which provided for the investment tax credit, was to encourage economic growth through increasing the profitability of productive investment over its productive life. Earnings are generated through the use of the facilities during the life of the facilities and are not determined by the acquisition of the facilities. In our opinion, the provisions of section 202(e) of H.R. 8363 are consistent with this fact and therefore serve to insure a treatment of the investment credit in the manner which accomplishes the purpose of the credit.

We believe that any treatment of the investment credit which would permit "flow through" of the credit to earnings in the year in which facilities are acquired would result in misstatements of the results of operations and the financial position of companies, would make more difficult the proper regulation of utilities, and would not be in the public interest. Further, that "flow through" directed by a regulatory agency to the ultimate consumer would defeat the tax incentive provided by Congress for regulated as well as nonregulated industry.

It is the opinion of this commission that the purpose sought by Congress in its enactment of investment tax credit will be best achieved if this incentive is permitted regulated as well as nonregulated industries and that the denial of this incentive to regulated industries will have an adverse effect on achieving the full potential of economic growth.

The adoption of section 202(e) will, in the opinion of this commission, have no adverse effect on our ability to properly carry out our regulatory functions.

It may be of interest that this commission, on September 20, 1963, adopted accounting rules which provide that the investment credit be reflected in the income statement of utility companies over the service life of the facilities which give rise to the credit. We understand that this accounting has been adopted by the great majority of commissions which have prescribed accounting procedures for the investment credit.

(Whereupon, at 4:25 p.m., the committee was adjourned, to reconvene at 10 a.m., Thursday, November 21, 1963.)

REVENUE ACT OF 1963

THURSDAY, NOVEMBER 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, Douglas, Talmadge, McCarthy, Ribicoff, Williams, Carlson, and Bennett.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

The Chair places in the record a letter dated November 18, from Secretary of the Treasury Douglas Dillon, clarifying the position of the administration regarding the expansion of treatment presently accorded coal royalties to iron ore royalties, as discussed by Senator Williams during the interrogation of Mr. Dan Throop Smith, on page 773 of part 2 of the printed hearings on this bill.

(The letter from Secretary Dillon follows:)

THE SECRETARY OF THE TREASURY,
Washington, November 18, 1963.

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

DEAR MR. CHAIRMAN: In the course of reviewing the testimony given by Mr. Dan Throop Smith at the October 23, 1963, session of the Senate Finance Committee hearings on H.R. 8363, it was noted that Senator Williams expressed the belief that the administration recommended the expansion of the treatment presently accorded coal royalties to iron ore royalties so as to tax the gain realized from iron ore royalties as a capital gain.

I believe that the record should be corrected to indicate that the tax program originally proposed by the President recommended the elimination of the provision of current law which permits the gain realized from coal royalties to be taxed as a capital gain. However, this recommendation was not accepted by the Ways and Means Committee.

The extension of capital gains treatment to iron ore royalties was not recommended by the administration. As stated in my testimony before the Senate Finance Committee on October 16, 1963, this extension was adopted over the Treasury Department's objection.

I would appreciate the insertion of this letter into the record.

Sincerely yours,

DOUGLAS DILLON.

The CHAIRMAN. We will proceed now. Other Senators will come in a few minutes.

Our first witness is Mr. Charles A. Siegfried on behalf of the American Life Convention, the Life Insurers Conference, and the Life Insurance Association of America.

STATEMENT OF CHARLES A. SIEGFRIED, ON BEHALF OF THE AMERICAN LIFE CONVENTION, THE LIFE INSURERS CONFERENCE, AND THE LIFE INSURANCE ASSOCIATION OF AMERICA

Mr. SIEGFRIED. I have a statement I would like to present to you, Mr. Chairman and members of the committee.

The CHAIRMAN. Yes, sir. Will you just have a seat, sir, and proceed?

Mr. SIEGFRIED. Thank you, Mr. Chairman.

My name is Charles A. Siegfried. I am senior vice president and chief actuary of the Metropolitan Life Insurance Co. and am testifying today in behalf of the American Life Convention, the Life Insurers Conference, and the Life Insurance Association of America. In the aggregate, the 359 life insurance companies which are members of these three associations hold over 96 percent of the group life insurance in force in the United States. These associations oppose the Treasury's proposal to tax group term life insurance and recommend that section 203 of the bill before you be deleted.

We believe the proposal would disrupt an insurance system of major social and economic significance.

Today the beneficiaries of some 38 million employees enjoy approximately $200 billion of protection through group life insurance. This constitutes nearly a third of the total life insurance in force among all American families today. Roughly half of this protection is financed wholly by the employer; the rest by employees and the employer jointly.

One of the advantages of group life insurance is its combination of sound insurance principles with administrative simplicity and low cost. This is accomplished by not having to weigh all the characteristics of each individual in the group. Employees are insured without regard to physical condition. The insurance has no cash, loan, or paid-up values. Amounts of insurance are based on earnings (commonly one or two times annual salary), length of service, occupational classification, or some combination of these, with no individual right to elect a higher or lower amount. If employees contribute to the cost it is usually on the basis of a flat amount per $1,000 of insurance regardless of age, condition of health, occupation, or other special risk. The employer pays the balance of the cost.

Group life insurance occupies a unique position in our society. It it an important layer of protection related to employment and is additional to the insurance protection provided by the individual himself. It is a private enterprise answer to a social and economic need. The prevalence of group life insurance as a collectively bargained benefit demonstrates its acceptance by employees and employers alike. It blends with the survivor benefits under the social security system. In this connection it should be noted that the employers' contributions under social security do not constitute taxable income to the employees.

We feel that it is wrong to tax group term life insurance as employee income.

For the past 43 years, dating back to a ruling issued in 1920, it has been recognized that group term life insurance is not a proper subject for income taxation. This ruling has unquestionably been a factor which has favorably influenced employers to establish many group

life insurance plans. In an era characterized by social insurance measures, the ruling stimulated the private sector of our economy to adopt a system of insurance protection for employee beneficiaries, without Government intervention.

It is the sound principle behind the 1920 ruling rather than its age which commends it to us today. It holds that group term life insurance premiums paid by an employer, while constituting a proper business deduction for that employer, do not constitute taxable income to the employees whose lives are insured. In support of this finding, the ruling states, in part:

> The financial benefits under these policies do not move to the employees personally, but only to their heirs or dependents after their deaths, and the payment of the amount of the policy is, in case, contingent upon the employee's continuance until death in his present employment which may be terminated at any time, either by himself or by his employer, and upon the continued payment of the premiums by the employer. The employee has no option to take the amount of the premiums paid for the policy covering his life instead of the insurance. The policy has no paid-up value either to the employer or the employee. Such insurance creates no debt on the part of the employer, pays no debt to the employee, and discharges no legal obligation resting upon the employee. The premium paid therefore is in no sense "gain derived" or realized or capable of being realized by the employee in dollars and cents, but only in the feeling of contentment that provision has been made for dependents. It is paid by the employer not as compensation to the employee, but as an investment in increased efficiency. It is therefore not income to the employee.

We wish to emphasize and expand somewhat on the reasoning inherent in this ruling. The underlying purpose of group term life insurance, as it has developed over the past 50 years, is not to compensate the employee. It is rather to provide a means whereby an employer can recognize and discharge a responsibility to the widows and children of those dying while in his employ, and at the same time to encourage and promote continuity of service and job satisfaction.

The insurance is temporary in nature—it has no cash, loan, or other value which can be converted into current income by the insured employee. There are no values the employee can carry with him if he terminates employment, other than the right to obtain other insurance. Many plans provide for cancellation of a substantial proportion of the insurance when an employee reaches retirement age. A group term life insurance plan may be discontinued or changed by the employer without the consent of the insured employee. The employee does not have a choice in the amount of insurance set forth in the schedule or plan adopted by the employer.

In short, from the viewpoint of a particular employee the advantages associated with group term life insurance are not tangible and consequently cannot be measured satisfactorily for income tax purposes. Because of the various contingencies affecting this insurance, it may happen that no concrete benefits whatsoever are obtained either by the employee or by his beneficiary. The employee receives no immediate benefit beyond the expectancy created in favor of his heirs. The economic value of this expectancy is so uncertain that it would be wrong to treat it as taxable income to the employee.

We feel that section 203 of the bill would discriminate against group term life insurance.

The taxation of group life insurance plans, which would necessarily involve considerable complexity, would have an unsettling effect on the incentive to purchase or continue group life insurance. This would

work to the detriment of many millions of moderately paid employees, even those who would not be subject to the tax because of its exemptive features.

Another undesirable effect of the proposal might be to encourage provision for death benefits for beneficiaries of employees under uninsured arrangements as contrasted with life insurance. There exists today a delicate competitive balance among the various types of insured and uninsured plans which could be upset if the current proposal becomes law. Uninsured arrangements do not involve taxing the employee on the value of the protection during his lifetime. Death benefits paid under uninsured arrangements are, generally, not subject to estate tax, as is group life insurance. Moreover, under these uninsured arrangements, there are no burdens comparable to the Federal income taxes paid by life insurance companies. Finally, insured plans are also subject to State premium taxes.

The adoption of section 203 would impose an additional tax and administrative burdens that could conceivably swing many firms over to uninsured arrangements. It would be unfortunate indeed if the Treasury proposal ultimately led to withdrawal of the protection of State-regulated life insurance from large numbers of employees and to the substation of uncertain and unsupervised arrangements.

We feel that section 203 presents serious problems in valuation and administration.

Group insurance costs are low because of the wide utilization of averages and the avoidance of complex recordkeeping, complicated calculations, and burdensome administrative procedures. Wherever possible, the group is considered as a whole rather than as individual employees. This simplicity and low cost would be destroyed by the administrative complexities inherent in section 203.

To illustrate, this section provides for imputing income to the employee through the use of a single valuation table of term insurance rates based upon attained age. This necessarily creates inequities. The age of the individual alone cannot properly be used to reflect the true value of the life insurance coverage. A younger person in impaired health may well present a substantially greater insurance risk than an older person in good health. In fact, such a single valuation table will often misstate the cost of insurance both for the group and the individual.

In seeking to allow for this fact the bill provides for an alternative "policy cost" method of valuation—quoting from the bill—

> on the basis of the average premium cost under the policy for the ages included within the age bracket which would be applicable.

However, there are serious technical and practical difficulties in the way of obtaining costs by age brackets based on the actual experience of a particular plan. In the first place the usual administration records and procedures would not provide the data essential to determine such costs. Hence, it would be necessary to establish new recordkeeping and to make studies and analyses that are not now required.

Even if such data were available, their use for tax purposes would often produce incongruous results. For example, in many employer plans the number of persons in a particular age bracket may be small and no deaths may occur in such bracket in a particular year or over a period of years. Even with a large number of persons insured within

a bracket there would probably be sharp fluctuations in the death rates experienced from year to year. Thus a particular individual with a substantial amount of insurance could have little or no tax if he passed through a series of age groups where there were few or no deaths. On the other hand, the death of such an individual, who had paid little or no tax during his lifetime, would cause a sharp rise in the cost to others in his age bracket thereby shifting the tax burden to them. This system, marked by sharp fluctuations in cost, would cause much difficulty in recordkeeping and particularly since withholding is required.

Other kinds of unusual results could be cited. In brief, the procedure is highly uncertain and capricious in its operations and would not provide a sound basis for cost evaluation.

And so, in summary:

1. Group term life insurance is an important employee benefit providing needed protection for millions of American workers and their families. Its growth over nearly half a century reflects the low administrative costs resulting from its broad-scale approach.

2. The Treasury Department has recognized since 1920 that the financing of this benefit by an employer does not give rise to income taxable to employees. The facts underlying the operation of group life insurance support this conclusion.

3. Section 203 would constitute an unwarranted extension of the economic benefit theory.

4. Section 203 would present many difficult problems of tax equity and costly recordkeeping.

5. The alternative "actual cost" valuation procedure is unworkable.

6. Section 203 would discriminate in favor of unregulated uninsured benefit plans.

In sum, we strongly urge this committee to reject section 203 and thereby avoid seriously impairing a system of proven social value.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Siegfried.

Are there any questions, gentlemen?

Senator TALMADGE. Mr. Siegfried, I notice in your statement that you say:

> Today the beneficiaries of some 38 million employees enjoy approximately $200 billion of protection through group life insurance.

What is the average amount of those policies?

Mr. SIEGFRIED. $1,000 to $5,000 I would say would be a typical policy.

Senator TALMADGE. Now, what percentage of that $200 billion would be affected by this bill if taxation would begin at $30,000?

Mr. SIEGFRIED. Well, it is a very small percentage. My recollection is that probably fewer than one-half of 1 percent of the total number insured would have that amount, and the amount would probably be something less than 5 percent of the total—a small percentage.

SENATOR TALMADGE. What is the average cost of a policy of $30,000 in group insurance?

Mr. SIEGFRIED. Well, that could be answered in several ways——

Senator TALMADGE. Well, just an approximate value, taking into consideration everything—the age group, number of employees concerned and so forth—the best average that you can give, the best guess.

Mr. SIEGFRIED. Well, speaking broadly and having in mind a countrywide average, the cost of insurance of this kind would be about $8 to $9 a year for $1,000 of insurance.

Senator TALMADGE. You were talking of economic benefits, then, on the order of $200 to $300, is that right?

Mr. SIEGFRIED. Well, let's see. You say $30,000 and I said $8 [calculating]. That is $240, yes, sir.

Senator TALMADGE. It would be $240?

Mr. SIEGFRIED. That is for a $30,000 policy and applying an average value for that insurance, yes, sir.

Senator TALMADGE. I take it from your statement that in addition to problems of administration and other details, that the main thrust of your position is that it is not taxable income and should not be figured as such. Is that your position?

Mr. SIEGFRIED. I think so. The values that are associated with it are uncertain, they are subject to various contingencies that I feel are impossible to measure as applied to individuals, and there are so many uncertainties around it and such indefiniteness in these values that we think it is highly inappropriate to undertake to value them as current income to the employees.

Senator TALMADGE. I presume that most of these policies in addition to having the death benefits also carry hospitalization, do they not?

Mr. SIEGFRIED. Well, many employer plans, as part of the overall plan, will include hospital plans, yes, sir, hospital benefits. But we have tried to compartmentalize and keep the group insurance separate and distinct from the other benefits in the plans.

Senator TALMADGE. There has been no attempt, this bill makes no attempt, I don't believe, to attribute income to those that have hospitalization policies.

Mr. SIEGFRIED. It does not, no, sir.

Senator TALMADGE. And the only benefits, that would be taxed would be the——

Mr. SIEGFRIED. The bill seems to reach into the package and seems to reach only for the life insurance part of the package.

Senator TALMADGE. And it does not include assignment benefits or profit-sharing benefits?

Mr. SIEGFRIED. It doesn't deal with that, no, sir.

Senator TALMADGE. Thank you very much, Mr. Chairman. That is all.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Ribicoff?

Senator RIBICOFF. No questions.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mr. Siegfried, just one question. I believe the Treasury Department has estimated that this will produce about $5 million in revenue.

Mr. SIEGFRIED. I have seen that figure, yes, sir.

Senator CARLSON. Well, now, isn't it reasonable to assume, in view of the difficulties of administrating this program by the corporations themselves, that it would cost a substantial amount of money for these corporations to keep this new additional bookkeeping and that item would be deductible and in the final analysis there might be a loss of revenue instead of an increase?

Mr. SIEGFRIED. It is hard to measure but it has seemed that way to some of us, yes, sir. Even taking the $5 million and forgetting the additional costs and deductions of taxes that would result from those costs, just taking that, we do feel that the revenue involved is out of all proportion to the complications that are involved and out of proportion to what would be gained. It is a very highly destructive move as far as these plans are concerned and it works, as I see it, substantial inequities on the individuals affected, and for very little revenue and, as you pointed out, it may produce, on net balance, no additional revenue whatever.

Senator CARLSON. I think that you will agree, would you not, that there would have to be changes in bookkeeping in many corporations, if they are going to follow through with the provisions of section 203?

Mr. SIEGFRIED. It is very clear that that would follow, yes, sir. Group insurance, as I tried to say, is a very simple operation. Now, this would introduce procedures and complexities entirely foreign to this kind of business. In group insurance we make no effort whatever to put people in their proper risk classification. There is no need to do it.

But if this bill became law then, for the same time, it would seem that equity would require that you would have to have underwriting procedures and measurements to see that people were treated fairly according to the risk they present, and this is a very costly and troublesome development.

Senator CARLSON. It seems to me that, getting down to the individual employee's account, based on age and salary and so on, all of these various items, that would mean they would have to enter into bookkeeping records of an employee's account with a corporation or employer, and it certainly then is not a group program, it gets to be an individual program?

Mr. SIEGFRIED. Exactly, exactly. Individual insurance is naturally more costly than group insurance because you must go through all of that.

Senator CARLSON. That is all. Thank you, Mr. Chairman.

The CHAIRMAN. Any more questions, gentlemen?

Senator BENNETT. Mr. Siegfried, I would be interested in having you give the committee a little more information about what you call unregulated, uninsured benefit plans. Are you talking about a corporate determination that certain employees might, or the families of certain employees might be given a gratuitous gift by the corporation after the death of the employee?

Mr. SIEGFRIED. Well, group insurance is designed to provide the funds from which income benefits can be made available to widows of deceased employees, and this is the kind of benefit that could be associated with the uninsured retirement plans. So one of the possibilities open to an employer is to make these payments on an uninsured basis directly to the widow as part of the widow's benefit, or part of the retirement plan, and that would be uninsured.

Senator BENNETT. Paid out of current income?

Mr. SIEGFRIED. Well, it either could be paid out of current income or money could be set aside in advance, whichever way the employer chose. But it would not have the safeguards that are thrown around the typical group insurance plan.

Senator BENNETT. Well, apparently one of the reasons for the proposal in the tax bill that there should be a limit of $30,000 is that this is put in there to prevent the corporation from providing substantial, large benefits to its top executives. Under an uninsured, unregulated benefit plan, could not these substantially large benefits be provided?

Mr. SIEGFRIED. They could, sir—but first I would like to draw attention to the fact that even $30,000 provides, when it is converted to weekly income, would provide something less than $30 a week income and certainly many employers would seek to provide a larger level of income than that. So the end result would be that through these uninsured arrangements they would be providing benefits of values that go far above the $30,000.

Senator BENNETT. So passage of this particular feature of the bill would not solve this social problem of limiting the right of the corporation to give special benefits to special people; but on the other hand might faster programs which would widen the gap, tend to widen the gap or could tend to widen the gap?

Mr. SIEGFRIED. I would agree with that, sir. I think we should also recognize—one of the points that I tried to make is that the values associated with these amounts seem to have been misunderstood or distorted. The value depends on the man's expectation of dying. For a person in bad health, of course, it has a high value, but there would be many people who would have a considerable or very good expectation of life, so they would have a very small value.

So, unless you get down to analyzing the individual situation, it is not correct to say that just because a man has a $30,000 certificate, that he has something of great value. He might have something of substantially less value than the man who has $5,000 worth of insurance who is in impaired health.

Senator BENNETT. That is all, Mr. Chairman, thank you.

The CHAIRMAN. Thank you very much, Mr. Siegfried.

Mr. SIEGFRIED. Thank you, sir.

The CHAIRMAN. The next witness is Mr. Lewis C. Burwell, Jr., representing Plans, Inc.

The Chair is informed that Mr. Burwell will submit a statement, in lieu of appearing.

(The statement referred to follows:)

PLANS, INC.,
November 20, 1963.

MRS. ELIZABETH B. SPRINGER,
Chief Clerk, Senate Committee on Finance,
New Senate Office Building, Washington, D.C.

DEAR MRS. SPRINGER: Enclosed please find my prepared statement, to be read before the Committee on Finance.

Sincerely,

LEWIS C. BURWELL, Jr., *Chairman.*

PREPARED STATEMENT OF LEWIS BURWELL, JR.

Mr. Chairman and distinguished Senators, my name is Lewis C. Burwell, Jr. I am chairman of the board of Plans Inc. The principal business of Plans Inc., is estate planning, corporate financial planning, and employee benefit plans. We have been in this business a little over 30 years.

I appreciate the opportunity of testifying before you, with reference to the tax legislation being considered, and I assure you that my remarks will be brief. Witnesses, far more expert than I, have commented on the economic

implications of both a tax cut and tax reform. However, I do wish to make one observation on the economics involved.

The tax cut is a good thing, if we can afford it, and tax reform is a good thing without any qualification whatsoever. I realize that you cannot legislate expenditures in these proceedings, but the real partner to a tax cut should be a budget cut. In our complex society it is a very short step from economic considerations to political considerations, and I certainly do not intend to venture into this jungle. However, in the context of these observations, this is the point I wish to underscore. There has been so much publicity and debate and speculation about the 1963 tax bill, it is probable that the American public and American economy has already discounted a significant tax cut. If the cut does not materialize, or is unduly delayed, there is a very real chance that we could have a recession in 1964. Should this occur, the blame would rest squarely upon the Congress.

I am dead opposed to deficit financing as a way of life, but since the Congress has the ultimate power to control Federal expenditures, I believe that you should get on with the business of the tax cut as quickly as possible and clamp down later on expenditures. To wait for a show of faith by the administration that it will reduce expenditures is, I am afraid, wishful thinking and a fruitless posture.

The idea of reform is popular with everyone except those being reformed. We, in Plans, make our living by guiding people and companies to tax havens and sanctuaries. Often these journeys are tortuous and labrynthine, but no matter what you do they will always exist because an ingenious person will reconstruct his affairs and his operation to conform with the changes in the law or the regulations.

I would like to make two observations on this matter of reform: First, anything that you can do to simplify the statute and to minimize the options and exceptions will constitute a much-needed reform in itself; secondly, I am all for eliminating the breaks for the privileged few, but I strongly oppose anything that will discriminate against the unprivileged many. I would like to illustrate this last point.

Under date of August 12, 1963, the Prentice Hall Federal Tax Guide included the following paragraph:

"Loans to carry insurance: At present, some individuals get a tax break when they borrow tc pay life insurance premiums. This is because the interest on the loan is deductible while the interest buildup in the policy reserve is not currently taxed."

As we know, the House bill has set up certain tests which, if met, continues to permit the deductibility of this interest.

Another threat to deductibility was posed by the third circuit in an opinion which held that "Perhaps interest should not be deductible, because there is usually no real debt between the policyholder and the insurance company to create any enforceable liability against the borrower." However, this has now been reversed by the Court itself in the case of *William K. Carpenter* v. *Commissioner*, CA-3, August 29, 1963.

I want to spend a few minutes in this interest matter. In the first place, the Prentice Hall statement contains an incorrect assumption. Life insurance premiums are paid with after tax dollars and while the interest buildup is not currently taxed, it is eventually taxed if the insured cashes in his policy prior to death and gets back more than he paid. Any interest buildup on accumulated dividents is taxable each year. Only in the event of a gain by death is there no income tax. However, if the cash surrender value at the time of death exceeds the original face of the policy, the courts have ruled that the gain is taxable to the beneficiary. When we think in terms of death benefit (which is indemnity for the loss of a capital asset; i.e., earning power) there is no more tax break involved in deducting the interest on money borrowed to pay life insurance premiums than there is in deducting interest borrowed to pay fire insurance premiums.

There are three principal objections to the disqualification of interest deduction on life insurance loans.

1. *It will discourage the purchase of life insurance.*—There is nothing to prevent me from borrowing on my life insurance to pay my fire insurance premium, or to meet my house payment. Nor is there any reason why I should not borrow on my house to meet my life insurance premium. However, the young man who feels that he needs more life insurance to protect his family or his business and can afford to carry it only by utilizing the increase in cash value to help pay the

premiums is told he cannot deduct his interest. Presumably, though, it is all right if he uses the insurance loan to pay his doctor bill and pays the full insurance premium from his salary. So in actuality, there will be little hardship because everyone will borrow from Peter to pay Paul. The real damage arises, though, from the fact that such a measure will discourage the purchase of life insurance and this is, undeniably, a bad result and distinctly and directly affects the unprivileged many.

2. *It is discriminatory.*—In order to provide a higher national standard of living, increased employment and less reliance on the Federal dole, this Government for years has permitted corporations to deduct, from income tax, payments paid for employee group life insurance and pensions. Nor is the employee required to report these payments as constructively received income. If you want to be completely fair, you should permit the self-employed to deduct, from personal income tax, the amount of pure term insurance premium he pays in an amount equal to the deduction permitted the corporations. By no stretch of the imagination could you justify denying the right to deduct interest on loans necessary to enable him to carry sufficient insurance to partially indemnify his family for the loss of earning power, which would occur at his death.

3. *It is unenforcible.*—The provision as originally proposed and to a lesser degree as passed by the House will be absolutely impossible to enforce. IRS will have to search the origin and purpose of every loan of every taxpayer where a life insurance policy is part or all of the collateral. If I correctly read the intent of the Congress, it is to prohibit transactions for profit in life insurance where such profit is due in part to deductible interest. This should not be confused with the function of life insurance to indemnify against loss. The intended objective is, I believe, the same as the present provision in the code which prohibited the deduction of interest on loans made to purchase or carry tax exempt securities.

Recommendation

You could disallow all previous interest deductions any time a policy is surrendered. This would reduce the cost basis of the taxpayer and increase the taxable profits, but would again be almost impossible to trace. If the Congress wants to deal realistically with this matter, it should disqualify interest deductibility on loans made against any policy whose cash surrender value at any time exceeds the face of the policy and let it go at that. This is the only type of life insurance that gives rise to profits (as distinguished from indemnity) which could be generated in part by tax-deductible interest.

Except for the administrative difficulty of enforcement, I am not specifically opposed to any of the other reforms being considered, because they are mainly aimed at arresting the growth of wealth already accumulated and do not discourage the creation of new wealth in the hands of new people. This is a thing we must watch. Any law that destroys initiative or incentive or the desire to grow and excel is a bad law and inimical to the American tradition.

There is one measure which, if it has been considered certainly has not gotten much publicity, that I do strongly advocate. I refer to some sort of an income tax deduction or credit for the individual who is financing his own or his children's higher education. The greatest asset of any country, in the last analysis, is the knowledge and brainpower of its citizens. I do not believe in directly subsidizing educational costs, as I understand is done in Russia, but I do feel that some sort of an income tax credit that could be used currently or be "put in the bank" for future use by the student himself, would be an extremely wise national investment. The form and magnitude and detail of such a provision is a job for the experts and I will not attempt at this time to do more than raise the point.

Mr. Chairman, I greatly appreciate the privilege of making this statement before your committee.

The CHAIRMAN. The next witness is Archibald E. Mackay, representing the Financial Executives Institute.

STATEMENT OF ARCHIBALD E. MACKAY, FINANCIAL EXECUTIVES INSTITUTE

The CHAIRMAN. Would you have a seat, sir, and proceed?

Mr. MACKAY. Mr. Chairman and members of the committee, I am Archie Mackay and I represent the Financial Executives Institute. You have been furnished with copies of our statement.

The CHAIRMAN. You may proceed.

Mr. MACKAY. The Financial Executives Institute is a continuation of the organization formerly called the Controllers Institute of America, with a slightly broadened scope of membership. We have a membership of more than 5,600 financial and accounting officers of U.S. companies representing a wide cross section of American business.

The committee on Federal taxation, in general, limits its recommendations to administrative and technical matters of concern to the broad scope of business. On these matters which concern the day-to-day conduct and efficiency of business, we hope our experience as reflected in our recommendations will be of some substantial help to this committee.

In the nature of general comment we believe, whether corporate rates are considered an effecitve excise tax or an income tax on some people, the rates are too high. They encourage inefficiency, they discourage new business and enterprise, and they keep prices high.

We believe the quick reduction in these rates is so important, as suggested by President Kennedy, that they should not be delayed by tying reductions to structural changes, referred to as "reforms," many of which are of dubious merit as we shall hereafter discuss.

I seem to be here in an insurance group. However, our comments are on points other than insurance and with your permission I would like to proceed on that basis.

As to the acceleration of corporate tax payments: Twice in the post-World War II period corporations having estimated Federal income tax liability of more than $100,000 annually have been required to accommodate to new tax payment patterns. The reasoning given has been that these taxpayers, as a class, should be placed more nearly on the pay-as-you-go basis which has for sometime been effective for individuals. The fact that it has been an important factor in the budgetary situation, resulting in the shifting of a substantial proportion of corporate tax payments progressively into earlier fiscal periods, has of course also been important. We have opposed these changes in the past, for purely practical reasons, and we strongly urge that there be no further change at that time.

It has been stated that the purpose of the tax reductions is to stimulate business. The committee report states that increased revenues will result from the reductions proposed. Yet by the acceleration of corporate payments the benefits to the economy are to be deferred for 6 years.

Corporate earnings do not flow evenly during the tax year. Seasonal variations, the normal shifting of the economy, conditions induced by competition and many other factors make it impossible to forecast annual earnings with any consistency. In view of the necessity for inclusion of income from foreign sources and the taxable year scope of depletion, depreciation, inventory and other deter-

minations, it is obvious that no reasonably accurate estimate of tax earnings can be made early in the year.

If budgetary considerations are ultimately determined to demand that some further acceleration of corporate tax payments be now adopted, we would then propose that there be substantial changes in the scheduling at present reflected in section 122 of H.R. 8363. First, the filing and payment dates specified in paragraphs (a) and (b) should be moved to the close of the 4th, 6th, and 9th months of the tax year with the final payment of estimated tax being due on January 31 of the year succeeding the tax year, rather than on the 15th of a month. For any corporation of size it is not possible to ascertain earnings within 15 days of the close of any period. Thus the first installment deadline cannot be met and the alternate periods of 5, 8, and 11 months are meaningless because they cannot be used.

Second, an election should be provided whereby corporations which publish interim statements and those subject to regulation would be permitted to use the published or reported book net income as the basis for estimates and payments rather than requiring that such amounts be converted for these interim periods to a tax basis.

The problems of converting book income to tax income are substantial. It should be realized that there is no such thing as an interim tax basis. Finally, the penalty provisions contained in code section 6655(d) should be modified as to the April and June payments to provide that an estimate within 50 percent of the annualized amount on the basis selected would be acceptable. With these changes, the proposed further acceleration of corporate income tax payments might be workable. It is our basic position, however, that the entire proposal contained in section 122 and related provisions of the pending bill should be rejected.

Group term life insurance: The Committee on Federal Taxation of the Financial Executives Institute basically opposes the proposal contained in H.R. 8363 to tax employees for premiums on group term life insurance in excess of $30,000 furnished by their employers, since this provision (1) will discourage a highly desirable practice in employer-employee relations; (2) adopts an unrealistic method of computing the tax on the so-called income to be imputed to an employee from such arrangements; and (3) imposes substantial administrative burdens on employers, the cost of which is out of all proportion to the possible revenue gains.

Clearly, group term life insurance is an economically desirable arrangement, the tax consequences of which have been well known and understood for over 30 years. This is essentially a family type benefit of great value to our present day society, and is generally related to compensation and in line with the standard of living supported by such compensation. As noted by the Ways and Means Committee it does much to keep together family units where the principal breadwinner dies prematurely. It should be remembered that the high cost which is to be charged to older employees is a function of age and not the amount of salary. Such legislation can well result in the discontinuance of many highly desirable insurance programs.

It appears that the principal objection to the continuation of present policies with respect to group term life insurance arises from the fact that in some relatively isolated instances, certain highly paid employees have been afforded life insurance coverage in substantial amounts.

It is submitted that to attack this particular problem by taxing all employees covered by group term life insurance in excess of an arbitrary limit of $30,000 is an unrealistic program. Our committee recommends instead that, if some statutory change is believed to be necessary, a tax be imposed only on group term life insurance coverage in excess of an amount determined under a nondiscriminatory formula. One logical basis for such a formula would be a multiple of earnings. It should be noted here that this is, in fact, the basis for group term life insurance programs which have been adopted by many employers throughout the country.

Section 203 of the House bill proposes a highly unworkable method of computing the premium cost of group life insurance on employees. The use of the tables prescribed in the present bill ignores the fact that group term life insurance coverage is provided at a lesser cost because the group is composed of individuals of all ages. In almost all group life insurance plans which are on a contributory basis, employees are charged the same rate per $1,000 of coverage regardless of age. It is true that under such programs a younger worker may pay more than his proportionate share for his insurance coverage. But the situation is reversed as he grows older and thus enables him to recoup the earlier "excess" in payments in the later years. Moreover, by using a single rate per $1,000 of coverage, the rate is never so large as to be burdensome on the employee, whereas the rate prescribed under the House bill, which is dependent on age, becomes economically unfeasible in the later ages. Since those people now covered by insurance in excess of the proposed $30,000 limit did not receive the proposed benefit of a tax deduction during the earlier years when the actual cost at their age was lower than the premium paid, it is eminently unfair to tax them now when the premium is lower than age cost.

Another major objection to the method prescribed in the House bill for computing the cost of group term life insurance is the tremendous administrative problem involved for employers. The determination of the amount of income, the reporting (and explaining) of this item to employees, the withholding of tax on such income, the handling of inevitable adjustments resulting from premium refunds, changes in coverage and rates of contribution, the determinations of what portion of a premium paid is attributable to life insurance coverage where a package deal of group term life insurance and group hospitalization and other related coverages is involved—all add up to an almost insuperable administrative burden. The cost to employers of this burden will probably well exceed the estimate of $5 million additional income to be derived from the proposed change in the law.

Senator Carlson touched upon the administrative difficulties of handling this proposal, which is expected to raise no more than $5 million and we would like to reemphasize that point——

Senator Carlson. While you are talking about that, I presume that you endorse the position taken or presented by Mr. Siegfried?

Mr. Mackay. We do, sir.

If the Senate Finance Committee should adopt the plan of the House bill that some portion of group life insurance provided by an employer should be deemed taxable to the employee, then for the reasons cited herein, our committee would recommend that any taxa-

tion of group term life insurance be based on a single average cost factor, regardless of age.

On the item of dividend credit and exclusion: The revenue bill of 1963 provides for the repeal of the dividend credit in two annual steps and for an increase in the dividend exclusion from $50 to $100.

In this connection, the report of the Committee on Ways and Means states that the reduction in the corporate rate provided by the bill (1) probably does as much to remove any double taxation of corporate dividends as would continuance of the present dividend credit and (2) will have a more important impact on corporate investment than any reduction directed solely toward corporate income which is distributed. The increase in the dividend exclusion is intended to encourage a broader stock ownership among those with relatively low income.

The Financial Executives Institute Committee on Federal Taxation does not believe that the bill will produce the results assumed by the Committee on Ways and Means. Rather, it believes that with the enactment equity investment will be discouraged, the double taxation of dividend income will become even more intolerable, and an important contributing force to economic growth will be eliminated.

The recognition in the President's tax message that double taxation of dividend income does exist is significant and realistic. In like manner, recognition by Secretary Dillon and the Treasury of the fact of double taxation is made clear in Mr. Dillon's testimony before the House Ways and Means Committee on February 7, 1963, concerning the increased dividends which he would expect taxpayers to receive as a result of the corporate tax rate reduction. It seems clear, however, that any increase in dividends from this source in the next few years will be materially limited or will not exist at all in view of the restrictions on cash resources imposed by the acceleration of corporate tax payments as provided by the bill. Recognition by the present administration of the existence of the double taxation of dividends is in accord with the carefully developed view of Congress in 1954 when the principal emphasis of both tax-writing committees was on relief from double taxation. However, reduction in the corporate income tax rate from 52 to 48 percent would not result, as is contended by the President and the Secretary, in an equitable and effective reduction in the double tax burden. The double tax would still exist in significant degree. In our view the dividend credit and exclusion provisions offer a more realistic and effective approach to the problem of double taxation.

The dividend credit and exclusion were enacted originally to encourage equity investment and to provide partial relief from double taxation of dividend income. If these objectives have not been accomplished, it is not because they are not and are not worthwhile. Rather, the objectives have not been attained because the 4-percent dividend credit is minimal in amount and because of the tax rate structure within which the dividend credit and exclusion were forced to operate—in particular the high and steeply graduated individual tax rates. The proportion of corporate funds secured from new equity financing has not increased because taxpayers burdened with these high rates have not been willing to expose funds remaining after taxes, including those resulting from the dividend credit and exclusion, to the high degree of risk associated with new equity financing.

It is also not reasonable to contend that this relief gives the largest benefit to those with the high incomes. The dividend credit for most taxpayers is 4 percent of qualifying dividends regardless of income level. If this fixed rate of credit appears to provide a larger benefit to taxpayers with higher incomes, it is only because the income involved is being taxed at a higher rate of tax. In this connection, it seems anomalous to discriminate, as the House bill would do, against taxpayers with income in the middle and upper surtax brackets, at a time when there is increasingly general recognition of the harm done to incentives, capital formation, job creation, and economic growth by discriminatory taxation of income at these levels.

The FEI Committee on Federal Taxation requests the Congress to retain and increase the dividend credit and exclusion in the Internal Revenue Code. With adequate individual rate reform, we are convinced that these provisions will accomplish the original objectives established when they were enacted in 1954 and thereby contribute to the overall objectives of the President's program to stimulate economic growth.

Now, referring to section 202—repealing the requirement that the basis of section 38 property be reduced by 7 percent, this requirement has produced almost an accounting nightmare in actual practice. The actual credit turns out to be somewhat less than 7 percent, approximately three and a half percent.

The investment incentive credit plan has become widely accepted as having generated the stimulative effects to the economy that were hoped for when the plan was adopted by the 87th Congress.

Natural skepticism as to the benefits to be derived from the new and untried plan resulted in the inclusion of section 48(g) which over the life of the asset at current tax rates reduces the initial benefit of the credit by about one-half.

Hence, the credit which has been generally construed as 7 percent (3 percent in the case of most public utilities) is more in the nature of three and a half percent for business generally and one and a half percent for most public utilities.

Besides being difficult to interpret and almost impossible to explain understandably to anyone except the most sophisticated in the art of accounting and finance, there is widespread difference of opinion as to how and when the benefit should be reflected in income and financial statements. The eight largest public accounting firms are equally divided in the matter of treatment and presentation.

The detailed accounting for proper treatment of the requirements imposes such a burden on many businesses as to not make the credit worth the effort; yet for tax purposes, the taxpayer has no alternative but to adjust the basis of eligible assets whether or not the benefit of the credit is taken.

Further complications arise in connection with State tax returns for which the depreciation deduction is the same as allowable under Federal law without offsetting benefits against the State tax.

Public utilities are confronted with the important problem of determining whether for ratemaking purposes the cost of facilities are to be reduced by the investment credit. Furthermore, some public utility regulatory bodies have shown an inclination to flow the benefit of the credit through to the public utility customer thus depriving the utilities of the benefit originally intended for them by the Congress.

In order to provide greater stimulus to the economy and relief from recordkeeping and accounting difficulties, enactment of section 202 of the revenue bill of 1963 is most urgently recommended.

Now, dealing with stock options and section 214, we feel that section 214 of H.R. 8363 contains many significant changes in the stock option provisions.

We feel basically that the 3-year provision is highly objectionable and that the extension of the 6 months' holding period to 3 years will be of particular hardship to younger men and those who must borrow to finance stock purchases.

The June 11, 1963, cutoff date for issuance of "restricted stock options" should be changed to the date on which the President signs the bill.

In granting stock options, as in any other day-to-day decision, business must be able to rely upon the law in effect at the time decisions are made. If taxpayers were to withhold taking action until final enactment of all tax proposals, the wheels of business would grind to a halt. These managerial decisions having been made, should not be disturbed by giving retroactive effect to changes in the tax law.

The proposed 5-year option life for "qualified stock options" is too short and should be changed back to the 10-year life presently permitted for "restricted stock options."

Options are normally granted to give the employee a proprietary interest in the business and to retain existing key men or to attract new talent. Adoption of the shortened 5-year period would seriously reduce the effectiveness of stock options to achieve the corporate objective. Shortening of the option life would also work hardships on the young executive who hasn't had sufficient time to accumulate funds to purchase the stock. If assets have to be sold which are shares of stock in the company granting the option, the major purpose for granting the option would be defeated.

In the event the effective date of the new stock option provisions cannot be changed from June 11, 1963, to some later date; that is, the date on which the President signs the new tax bill, the modification provisions ought at least provide that any amendment to options granted prior to the date the President signs the bill would not constitute the issuance of a new option, provided such amendments are made within 18 months from such enactment date (in order to provide adequate time where shareholder approval is required) and such option thereafter meets the requirements of a "qualified stock option."

The extension of the 6-month holding period to 3 years will be a particular hardship to younger men and those who must borrow to finance stock purchases. A general decline in stock prices could wipe out all their capital overnight. The loss provisions would be of little help where all is loss. This long holding period will cause employees to dispose of their stock sooner than would a shorter period.

In an effort to assure that new options at a lower price will not replace older options at a higher price, the new law (proposed sec. 422(b)(5)) provides that new options may not be exercised until older restricted options are exercised (or terminated before January 1, 1965). This will deny new options to those holding restricted options and thus will penalize those employees whose financial situation prevents them from exercising outstanding options. In many instances it will have the effect of retroactive legislation destroying the value of existing options.

For the future, this provision will also deny a corporation the ability to use qualified options to retain valued employees if the company's stock has declined in value. This is not to the best interest of our economy or the health of corporate enterprise. We respectfully suggest that this provision is punitive and should be eliminated.

New provisions for employees' moving expenses are very helpful. However, they don't go quite far enough.

A major problem which requires legislative solution, and which the House bill has not come to grips with, faces employees who are transferred to a new place of employment. Internal Revenue Service has taken the position that any moving expenses reimbursements which go beyond the bare cost of transporting the employee, his family, his household goods, and his personal effects to the new location represent taxable income to a transferred employee.

We do not see the justification for this position when the move is initiated by the employer for its own convenience, the expenses involved are unavoidable and are incurred to further the business interests of the employer, and the employee realizes no financial gain from the reimbursements but is merely protected against loss.

An employee who is transferred by his company to a new place of employment cannot get by with merely a mover's bill and one-way transportation for members of his family. If he owns his home, he must incur a broker's commission and legal fees, as well as possible loss because of the forced sale. If he has a long-term lease on a rented apartment, there is a penalty for early termination. He must locate suitable housing at the new place of work, and this usually involves travel expenses for both himself and his wife and legal fees and other expenses related to the purchase. Generally, because of the short notice received from his company, he finds it necessary to start work at the new location before he can complete arrangements for moving his family. This entails transportation, meal, and lodging costs away from his place of residence. After the family arrives at the new location, it may be necessary to put them up in a hotel or motel until the household goods arrive and the new home is ready for occupancy.

Most companies recognize these costs as a company responsibility and agree to reimburse them. If employees must pay taxes on these reimbursements, which do not differ fundamentally from those covering lodging and meals while traveling on business, it will be difficult for industry to maintain the level of manpower mobility which is required by an expanding economy.

The Ways and Means Committee considered this question but decided to leave the tax status of such reimbursements to judicial interpretation under existing law. However, even if the courts were to rule favorably on such reimbursements, which is by no means a certainty, the controversy could drag on for years before a binding judicial determination is obtained. Furthermore, during all this time, Internal Revenue Service would undoubtedly continue its newly intensified campaign to collect taxes on such reimbursements.

We strongly urge, therefore, that the Senate Finance Committee amend the House bill as follows:

1. Provide an exclusion from gross income for all moving expense reimbursements, except expenses related to sale of the employee's principal residence.

2. Provide that reimbursements of expenses related to sale of the employee's principal residence, plus any reimbursement to cover a loss attributable to forced sale of such residence, be treated as part of the proceeds of sale.

It would be highly desirable for these amendments to the code to be characterized as clarifications of existing law and given retroactive effect. Such action would not be impractical from a revenue standpoint, because only recently has Internal Revenue Service instituted widespread efforts to enforce a narrow interpretation of its ruling (Rev. Rul. 54-429) which allows employees to exclude moving expense reimbursements from gross income.

The reimbursement that they receive is not, we feel, taxable income or income at all, it merely restores the capital depletion which he has suffered through the wishes of his employer. He has no right to enjoy income in the sense that one ordinarily thinks of income.

Now, as to the $25,000 surtax exemption for corporations, section 223 seems to us to assume that the multiple corporation setup is a tax avoidance device. If this were so, the present Internal Revenue, sections 269 and 482, seem to afford the Commissioner all of the authority that he needs to correct these abuses.

Section 223 of the new bill proposes the addition of sections 1561, 1562, and 1563 to the Internal Revenue Code. Section 1561 provides that only one surtax exemption will be allowed to an affiliated group of corporations, whether or not a consolidated return is filed by such a group. Section 1562 provides that corporations in an affiliated group may elect to claim a separate surtax exemption at the cost of paying a penalty tax equal to 6 percent of each corporation's taxable income up to a maximum of $25,000.

This provision should not be enacted. Competition and the requirements for various business operations are the primary factors—and not surtax exemptions—which dictate the need for organizing separate corporations. The mere fact of common ownership, no matter how simply or well defined, should not result in the imposition of a tax penalty. The extension of stockownership and attribution rules to the question of surtax exemption is inconceivable. Present laws and court decisions thereunder give adequate protection to the revenue against the proliferation of corporate entities in order to secure primarily the benefits of surtax exemptions.

There are other factors which would prevent the equitable application of the proposed change. Certain affiliated groups of corporations, which include banks, are not permitted to file consolidated returns. Further, where different methods of accounting, as dictated by the business needs of various members of an affiliated group are used, consolidated returns may not be filed.

For these reasons, section 223 of the present bill should not be enacted.

As to the intercorporate dividend deduction, the bill makes no change in section 243 of the Internal Revenue Code which provides for a deduction equal to 85 percent of dividend income received by a corporation from other domestic corporations. This committee has repeatedly supported a 100-percent deduction on such intercorporate dividends in order to eliminate a double or triple tax before such dividend income is received by the corporate stockholders. Favorable consideration of this proposal is urged.

And, concerning the 2 percent consolidated return penalty tax, favorable action is recommended also in the enactment of section 222 of H.R. 8363 which amends section 1503 of the present Internal Revenue Code and thereby eliminates the 2 percent penalty tax on consolidated returns. This forward step in taxation of corporate entities has long been urged.

Section 215 of the proposed bill dealing with interest on certain deferred payments, causes us some concern in the area of contracts which are entered into, the performance of which and the payment for which is indeterminable at the time of the execution, the date of execution of the contract.

That is to say, the sale price may be based on the quantity of minerals or barrels of oil extracted and there is just no way to determine at the outset just what that price will be.

In general, the proposed section 483 provides in the case of any contract for the sale or exchange of property occurring after June 30, 1963, there shall be treated as interest a portion of the deferred payments where little or no interest is stated.

While the bill makes provision for certain exclusions from the application of section 483, it will apply in the case of a seller only if some part of any gain from the sale or exchange of property would be considered as a gain from a capital asset or as gain from depreciable property.

This proposed section 483 will disrupt many ordinary business contractual methods.

For example, natural resources are often bought with non-interest-bearing notes having maturity dates roughly matching the expected production from the property. Whole businesses are sold with future payments dependent solely upon earnings or other future factors.

Certainly one of the worst features of this proposed legislation is the uncertainty of the interest rate to be determined by the Internal Revenue Service. This uncertainty will apply to all contracts whether they state interest or not. The interest rate may be changed from year to year and presumably from taxpayer to taxpayer dependent upon the Internal Revenue Service appraisal of the risk involved.

The exception for sales or exchanges of patents under proposed section 483(f)(4) would apply only to transfers of patents by individuals. It is questioned whether the legislators intended to exclude from this exeption corporate sellers of patents or other intangible property such as trademarks, know-how, and the like.

We strongly recommend that this section be eliminated from the bill.

Now, the 5-year carryover of charitable contributions:

The substitution of a 5-year carryforward period pursuant to section 209(b) of the revenue bill of 1963 in lieu of the existing 2-year period provided by section 170(b) of the Internal Revenue Code of 1954 for the deduction of charitable contributions by corporations in excess of the 5-percent limitation would constitute a significant advance in a highly commendable policy previously adopted by the Congress.

The change is in accord with recommendations made previously by this committee, and the reasons for it are so adequately stated in the general explanation of the bill by the Committee on Ways and Means as not to require repetition or restatement in this presentation.

On the item of disallowance of certain travel and entertainment expenses, prior to 1962, the deduction for travel and entertainment expenses was governed historically by the code section permitting the deduction of ordinary and necessary expenses. Because of the broad terms of the pre-1962 statute, the Commissioner had been restricted in his regulatory powers. In many cases where the Commissioner contended that the taxpayer abused the right to take such deductions, the courts decided in favor of the taxpayer. As a result, the Internal Revenue Service pressed for and was successful in getting more restrictive legislation; namely, section 274 of the code, adopted in 1962.

The new code provisions (sec. 274) attempt to define what constitutes good business practice, with the result that the Commissioner was limited in issuing reasonable and workable regulations. Even though the final regulations under section 274 are not as severe as those first proposed, they are nevertheless excessively burdensome and unfair to business.

The effect has been that section 274 curtails the exercise of good business judgment by denying certain deductions deemed proper expenses by business. As a result of section 274 and its regulations, there has been an adverse impact on certain businesses.

Latest reports for the first 8 months of 1963 indicate that food and beverage sales by hotels and restaurants were 6.7 percent below the corresponding period in 1962.

By adopting the concept, "reasonably designed to further the taxpayer's trade or business," with respect to both the deductibility and recordkeeping of travel and entertainment expenses, Senator Long's amendment retains the broad intent of Congress under the present section 274 (which is designed to eliminate abuses) but permits more flexibility by recognizing varying established legitimate business practices. The proposed amendment also leaves more room to interpret the distinction between business and personal expenses in the light of particular circumstances of the taxpayer.

In the area of substantiation, the proposed amendment leaves broad enough powers to the Commissioner to write reasonable regulations without being straitjacketed by the code. The proposed amendment also empowers the Secretary to write regulations which would exempt particular types of expenses and expenses below certain limits from its provisions. The amendment, therefore, in effect leaves to the Commissioner discretion to recognize established legitimate business practices in writing his regulations.

The Internal Revenue Service will still be able to carry out the intent of Congress by its normal audit procedure under the proposed amendment.

We feel that in recognizing the need for corrective legislation in the area of abuse cases and without unduly burdening legitimate business, Senator Long has proposed a practical solution to the problem.

Mr. Chairman, that is all we have to offer.

The CHAIRMAN. Thank you very much, sir. Any question, Senator Williams?

Senator WILLIAMS. Mr. Mackay, one question. I have listened to your recommendations and they will certainly be taken into consideration by this committee.

But just in the event that none of your suggestions are incorporated in the bill and the bill is left as it passed the House, are you for it or against it?

Mr. MACKAY (after pause). Oh, I would have to say I am against it because of some of the inequities.

Senator WILLIAMS. Well, that is the reason that I asked, because I noticed in your statement you said that you believed that—

* * * the quick reduction in these rates is so important, as suggested by President Kennedy, that they should not be delayed by tying reductions to structural changes.

And I want to be sure whether you are recommending—and I am not saying that your recommendations should or should not be taken into consideration, because they will be taken into consideration by the committee and maybe some of them will be accepted, and maybe not—but I wanted to get it clear what your position would be on the bill itself, assuming it was acted upon in the Senate as it passed the House of Representatives.

Mr. MACKAY. Well, let me clarify this, Senator——

Senator WILLIAMS. You oppose enactment of the bill, is that correct?

Mr. MACKAY. Let me clarify that. We are in favor of the tax reduction. We see no necessity to tie this other aspect, the structural reform part, to it.

Senator WILLIAMS. Well, I don't know that I agree with you, if I heard you correctly, but——

Mr. MACKAY. But as to the total impact of this bill, as to the reduction of taxes, we are in favor of it.

Senator WILLIAMS. I know that. I just want to be clear that I get your position. H.R. 8363 as it passed the House of Representatives may not be amended by this committee. It may be acted upon by the Senate, there may not be votes enough here to amend it. Now, assuming that the bill is to be voted on in the committee and in the Senate in the form in which it passed the House with no changes, are you for it or against it?

Mr. MACKAY. We are for it.

Senator WILLIAMS. You are for the bill. Well, that is what I wanted. First you said that you were against it, but you meant to say that you were for the bill, assuming that none of these changes that you have recommended were included in the bill, you are still for it?

Mr. MACKAY. Yes, sir; still for it.

Senator WILLIAMS. Thank you.

The CHAIRMAN. Are there any more questions?

(No response.)

The CHAIRMAN. All right, you are excused, sir.

Our next witness is Mr. Richard N. Foulk, of the Insurance Brokers' Association of the State of New York, Inc. Will you please come forward, sir, and take a seat and proceed?

STATEMENT OF RICHARD N. FOULK, INSURANCE BROKERS' ASSOCIATION OF THE STATE OF NEW YORK, INC.

Mr. FOULK. Thank you, Mr. Chairman and members of the committee.

My name is Richard N. Foulk, I am vice president of Brown, Crosby & Co., Inc., in New York, and I appear in behalf of the Insurance

Brokers' Association of the State of New York, Inc., whose members are responsible for a large portion of corporate insurance plans written throughout the United States and, indeed, the world. While no statistics are available of the total number of insurance plans purchased or administered by our members, conservatively it affects a high percentage of the American working force. Since this insurance is also important to their dependents the number of citizens affected by group life insurance handled by our members for their clients can easily be in the tens of millions.

The proposed plan could disrupt the present pattern of group life insurance development which currently provides protection to millions of wives and children by making available the equivalent of half pay for a 3- to 6-year period at the death of the employee. This necessary protection could not have been developed to its present significant level had it not been for its attractiveness to all classes of employees and its sometimes deliberate special attractiveness to higher management levels. We believe the proposal, even as amended, will create more problems and produce adverse consequences which will be all out of proportion to the tax objectives.

Our association is opposed to the Treasury Department's proposal to tax group term life insurance for two primary reasons.

First, the proposed maximum is a limitation imposed after almost 50 years of development of a system which has operated under a favorable Federal tax climate. It could reverse the evolution of one of the earliest forms of employee welfare benefits. The continuing increase of average incomes could well result in the immediate future in the reversal of the trend to provide two or three times salary because of the proposed maximum and, therefore, group term insurance could cease to be as significant as it has been up to now.

Second, in requiring that, solely for the purpose of tax calculation, an otherwise unnecessary system of median age and quinquennial groupings be superimposed, the tax proposal does violence to the principles of economical administration and simplicity that have done so much to promote this socially beneficial system. The use of an average premium without regard to physical condition or special underwriting considerations for individuals has resulted in a desirable simplicity. This proposal would impose a burden of more detailed recordkeeping, a burden which will have to be borne not only by policyholders but by the Treasury Department—all for a possible trivial revenue gain, indeed, more probably for a revenue loss.

We believe that a fixed maximum is unnecessary particularly since the insurance underwriting techniques generally make proportionately higher maximums available only as the total size or volume of the policy increases. Seldom, however, is it possible for the larger corporations with their proportionately higher salaries to make available to the top classifications the same ratio of insurance to income as is available to lesser-paid employees. We feel, then, that the present practices are quite satisfactory.

A predominant characteristic of plans, large and small, has been the relationship of benefit to salary and the use of an average premium.

Gentlemen, if, notwithstanding these remarks, which presumably follow the pattern of testimony made by other members of the industry, it is still felt that a proposal for taxing group life insurance must be adopted, we would urge you to consider that the present proposal

could in fact be inequitable to the employees taxed because the use of a mortality table with or without a quinquennial grouping and the median age, still could result in imputed taxes which are unrelated to the true cost of the protection afforded.

While it is possible that the alternative policy cost method can reflect the true cost, the bill's description of this alternative is so vague that it is impossible to determine how it would be applied. Group insurance in almost all instances is on a cost-plus basis; in other words, claims plus insurance company's administrative charges—in a sense it is similar to a checking account where the total checks written plus the service charge may result in a balance which is, of course, returnable. Under group insurance the only exception is that the claims are all paid if they exceed the premiums.

Now, a mortality table for group life insurance is used initially to approximate the dollars required to underwrite for a year the anticipated claims produced by the specific plan of benefits. An average premium is computed from this table. The table is generally accurate as far as the insurance carrier is concerned or the table for all of its group life exposure, but it is seldom accurate, particularly in any one year, for an individual group because the tables are based on mortality for hundreds of thousands rather than a single group which may have an entirely different mortality than the overall insurance company's experience. For this reason, the mortality tables become academic as a case grows in size or in years of exposure and usually discounts are applied to the manual premium until an amount sufficient to support the average losses of the group is produced. This could mean then, and often does, that the life claims for a particular group in one year are very small—even 5 percent or 10 percent of the premiums paid, and that over a period of time the individual group case will tend to develop an average mortality of its own supported by its own average premium, which may or may not follow the pattern of the overall experience.

The use of a mortality table, then, should not, in our opinion, be the basis for determining possible tax for one individual.

Therefore, in order that any law adopted should not—

(1) Adversely affect the acceptability of group insurance, and

(2) Result in inequitable tax treatment, we strongly suggest that you consider the following:

(*a*) The maximum should be based on a ratio to salary. We would suggest up to three times as a reasonable limit because continuing a man's salary to his family for a few years after his death is not an unreasonable objective to provide a meaningful widow's benefit to all classes of employees. Any amounts in excess of the ratio would be subject to a tax.

(*b*) The tax would be determined by using the average billed premium less the employee's contribution, if any, and approximately three-fourths or half of all group insurance is contributory. This average approach would eliminate the complicated quinquennial premium grouping and could, indeed, produce a revenue gain instead of a possible revenue loss we feel the proposed legislation will produce. Indeed, it might even be desirable to include an automatic forgiveness of the first $2 a month or $24 a year since in many instances the amount subject to tax will be so small.

(c) Eliminate the proposed return of excess contribution since this would become meaningless if the average premium approach is used.

(d) Eliminate the highly controversial and almost impossible to administer alternative policy cost method.

(e) Instead of withholding, simply compute taxable value once a year for addition to the W-2 form.

A tax law based on these principles would, we believe, be easier to administer and more favorably accepted.

Thank you for the privilege of appearing before you.

I am leaving a couple of examples with the committee, with one example of how it could produce a revenue gain instead of a loss. Again I thank you for the privilege of appearing.

(Examples referred to are as follows:)

ILLUSTRATIONS OF PROBLEMS PRODUCED BY THE BILL

Some of the administrative nuisances the bill produces or which will require clarification, are the following:

1. A separate record in the quinquennial age grouping will be required for all employees who, in general, are over age 47 and who are approaching $30,000 of life insurance.

2. Since withholding on a monthly basis is implied in the bill, and if the alternative policy cost method is, as some people interpret it to be the net cost of coverage; i.e., claims paid plus administrative charges, the employer will not know what the net cost actually is for several months following his policy anniversary. This would then require retroactive adjustments, generally, on withholding and necessitate the following up of each employee who is terminated.

Some questions are—

(a) What age is used, the age at the beginning of the calendar year or the date of birth change, anniversary of policy, etc.? If this produces a new age classification, is it retroactive to the first of the year, tax year?

(b) If, as the bill says, an employer may elect either the basis "value" or the policy cost method with respect to any employee for any period, does this mean the employer only has the right to determine which is the most advantageous basis for the employee involved? If so, does he need to keep another set of records for comparison?

(c) Dependents insurance is available in many States and the law implies that the employer is responsible for such withholding. How about the wife of an employee who insures him as a dependent with just enough to go over the proposed maximum? Who is responsible for withholding?

(d) There are many association plans in effect which while on the assessment type could presumably have some sponsorship or cost implication for other than the member. Are these eligible too for imputed values; how?

(e) What or how do you control situations where an employee works for several employers? Which one is responsible for withholding?

(f) If under the alternative policy cost method the experience has been so favorable that a reserve for fluctuation of claims is established instead of the return of total dividend, what is the net rate in that specific year (assuming the interpretation of the alternative cost method allows such a choice)?

TAX EXAMPLE

An employee age 50, earning $30,000 a year, insured for $100,000, whose employer pays $9.60 per year per $1,000 for the coverage and the employee pays $7.20 per year per $1,000—

Under the bill's provision the employee's contribution of $7.20 exceeds the table's value of $70,000 or $552.30, and thus no taxable increment remains.

Under our proposal the payable premium on the portion of insurance in excess of 2½ times salary, or $25,000, is $240 and the employees' contribution is $180, thus $60 is available for taxation.

The CHAIRMAN. Thank you, sir, very much. Any questions?

Senator WILLIAMS. Mr. Foulk, I appreciate your suggestions and some of them, many of them, certainly do merit consideration and cer-

tainly will be considered by the committee, but I will ask you the same question that I asked of Mr. Mackay.

Just in the event that none of them, none of your suggestions are accepted by the committee and the vote comes on H.R. 8363 as it passed the House, are you for or against it?

Mr. FOULK. I am against it.

Senator WILLIAMS. Against it. Thank you.

The CHAIRMAN. That is a straightforward answer, all right. Thank you.

Mr. FOULK. Thank you, Mr. Chairman.

The CHAIRMAN. The next witness is William F. Leach, Associated Industries of New York State, Inc. Will you come forward, sir, and take a seat and proceed?

STATEMENT OF WILLIAM F. LEACH, ASSOCIATED INDUSTRIES OF NEW YORK STATE, INC.

Mr. LEACH. My name is William F. Leach, a partner in Benefits Counsel of New York, a consulting actuarial firm with principal offices in Buffalo, N.Y. Associated Industries of New York State, Inc., a nonprofit membership corporation composed principally of manufacturers within New York State, is one of our clients.

Associated Industries of New York State sponsors a group term life insurance program for participation of member companies with five or more eligible employees. The essential aim of the program is to make available to smaller member companies this desirable coverage, at costs comparable, through pooling, to the favorable cost available to the industrial giants independently. The successful and economical operation of the program has resulted in widespread acceptance by large and small employers alike.

In the best interest of this program, Associated Industries of New York State, Inc., is unalterably opposed to the principle inherent in the proposal for taxation of group term life insurance presently under consideration by the Senate Finance Committee. Our discussion reflects not only the judgment of Associated Industries but the expressed opinion of many employers and employees participating in their program. Our stated opinions also reflect a reliable consensus of employers maintaining similar plans independently and apart from such a pooled facility and the major insurors underwriting these independently administered plans.

Among the reasons that this proposed legislation appears objectionable are the following:

(1) It is clearly discriminatory in that the tax impact falls upon larger earned incomes already burdened by disproportionately high direct personal taxes.

(2) It can become another serious irritant to employer-employee relations in that another employer sponsored benefit becomes diminished and adulterated by the impact of taxes, thus opening the employer's door to further wage demands.

(3) It will add substantially to the constantly advancing administrative expenses imposed upon industry by governmental agencies by making the employer responsible for the cost of computing and reporting another element of taxable income.

(4) It may compromise the social values of group life insurance by limiting its effective range, thus adding a greater burden to the necessary Government support of dependents.

(5) The $30,000 exclusion under consideration seems arbitrary and unrealistic in that it is unrelated to the economics of earning capacity or the human life value.

If, in the judgment of the Senate Finance Committee, it is essential to impose some tax at certain levels of employer maintained group term life insurance we strongly urge that the committee consider utilizing a base related to earnings rather than an arbitrarily selected dollar level. We also suggest that the death benefits under the public pension system (social security) be taken into consideration in arriving at a proper formula related to earnings. In determining the exempt status of certain employer maintained private retirement plans the Internal Revenue Service requires that such plans be properly integrated with the public pension system to avoid possible discrimination. This reasonable and intelligent approach has for many years had the acceptance of both Government and industry and has established a precedent which should be examined in the light of the pending legislation regarding the taxation of group life insurance. Retirement benefits under the public pension system emphasize replacement of a greater ratio of earnings for lower paid employees than for higher paid employees and we believe this to be proper. Current regulations allow exempt status to properly integrated private retirement plans designed to provide a similar ratio of replacement of earnings in respect to higher paid employees. It appears reasonable that similar treatment should be extended to death benefits provided under the public and private systems. We therefore submit the following example for your consideration:

Employee dies leaving wife and two children ages 2 and 4. The maximum death benefit from the public pension system is the approximate equivalent of $50,000 of insurance. This results in the replacement of more than 10 years' earnings for an employee earning $4,800 per annum while it results in a replacement of only 1 year's earnings for an employee earning $48,000 per annum.

Since death benefits under the public pension system will vary with the number of children and their ages, it is not our intention to suggest that a full 10 times earnings formula including the maximum social security benefit should be considered as a yardstick. State insurance laws coupled with underwriting practices of insurors will automatically control the issuing of excessively large amounts of group term insurance as related to earnings. Some compromise position similar to the three times earning formula set forth in exhibit A attached hereto might provide an adequate solution.

Group term life insurance maintained by the employer is provided to replace the loss of earnings through untimely death. Such coverage has been essentially related to earnings to more realistically capitalize the economic value of the human life, as is the death benefit under the public pension system.

If after further exploration of the procedure suggested herein, the committee arrives at a reasonable exclusion level based on a multiple of earnings, we suggest that the method of assessing any such resultant taxable increment should be closely examined to avoid discrimination between employees and costly administrative problems to the employer. The use of any manual rate component related to the attained age of

the employee could sharply discriminate against the older employee at the same earnings level as a younger employee. This discrimination is illustrated by the following excerpts from a current manual group life annual rate table:

Attained age of employee:	*Manual rate per $1,000, insured*
40	$5.28
50	12.51
60	29.72

Established group insurance accounting procedures utilize an average annual rate established by the total amounts of insurance at all ages insured. It seems to us that the use of this average annual rate which is so widely accepted in the insurance industry would be a far more meaningful way of determining the value of the group life insurance.

We suggest that it is in the interest of the public and in the interest of social welfare to encourage through favorable tax legislation maintenance of adequate amounts of group life insurance in relation to earnings by American industry. We recommend that the section of H.R. 8363 relating to taxation of group life insurance as presently conceived be deleted from the bill until a depth study of all of its implications, both social and economically can be fully appraised.

On behalf of Associated Industries of New York State, its member companies, and their employees, we wish to thank this committee for the opportunity of appearing here today. Should you desire further information in connection with our suggestions we will be most happy to provide it.

(The information referred to follows:)

The purpose of this exhibit A is not to develop a complicated and costly procedure of valuing the social security benefit, but to merely justify a level of exempt group term life insurance that is a reasonable multiple of earnings.

EXHIBIT A

Three times earnings formula integrated with social security

Annual earnings	Death benefit, social security[1]		Group insurance 3 times earnings	Death benefit, social security plus group insurance	
	Amount	Multiple of earnings		Amount	Multiple of earnings
$4,800	$49,000	10.2	$14,400	$63,400	13.2
$6,000	49,000	8.2	18,000	67,000	11.2
$8,000	49,000	6.1	24,000	73,000	9.1
$10,000	49,000	4.9	30,000	79,000	7.9
$15,000	49,000	3.3	45,000	94,000	6.3
$20,000	49,000	2.4	60,000	109,000	5.5
$30,000	49,000	1.6	90,000	139,000	4.6
$50,000	49,000	1.0	150,000	199,000	4.0

[1] Approximate amount of insurance necessary to provide an aggregate benefit equal to the death benefit under social security in respect to deceased employee leaving wife and 2 children age 4 and 2.

Mr. LEACH. I would like to briefly review with you the exhibit A, "Three Times Earnings' Formula Integrated With Social Security."

The purpose of this exhibit A is not to develop a complicated and costly procedure of valuing the social security benefit, but to merely justify a level of exempt group term life insurance that is a reasonable multiple of earnings.

The left-hand column shows earnings starting with $4,800 per annum up to $50,000.

The next column shows the expected death benefit under the public pension system, in other words, social security, and it shows that $49,000 of replacement income with 10 years or more of earnings and we see at the bottom of the line that $50,000 is one times earnings. When this is integrated with the middle column, showing the life insurance and the amounts of three times earnings, running from $14,400 to $150,000 and added to the social security death benefit of $49,000, the result then would be that employees earning $4,800 a year receive a total benefit of $63,400, or 13.2 times his earnings, while an employee receiving $50,000 a year on a three times earnings will receive $199,000, or four times earnings, approximately.

The CHAIRMAN. Have you completed your statement?

Mr. LEACH. Yes.

The CHAIRMAN. Thank you very much. Any questions?

Senator Carlson?

Senator CARLSON. No questions.

The CHAIRMAN. The next witness will be John K. Dyer, Jr., of Towers, Perrin, Forster & Crosby, Inc. Will you please come forward and take a seat, sir, and proceed?

STATEMENT OF JOHN K. DYER, JR., VICE PRESIDENT AND ACTUARY, TOWERS, PERRIN, FORSTER & CROSBY, INC.

Mr. DYER. Thank you, Mr. Chairman.

1. My name is John K. Dyer, Jr. I am vice president and actuary of Towers, Perrin, Forster & Crosby, Inc., an organization of employee benefit plan actuaries and consultants with headquarters in Philadelphia and with over 500 clients located through the United States. I have been connected with this organization for more than 26 years.

2. I am a fellow of the Society of Actuaries, a member of the Conference of Actuaries in Public Practice, and an associate of the British Institute of Actuaries. I am also a member of the Pension Research Council of the University of Pennsylvania, and of other professional organizations. My entire actuarial career of over 30 years has been in the field of employee benefits, especially pensions and group life insurance.

3. I should like to submit my views and comments regarding section 203 of H.R. 8363, which section would impose an income tax on the imputed cost of group term life insurance purchased by employers for their employees. Nearly all of the companies for which my organization is consultant maintain group life insurance plans for their employees. Most of these plans have been in effect for many years. It is my considered opinion that the usefulness and acceptability of a large proportion of these plans would be seriously impaired if section 203 were to become a part of the tax law. Many—perhaps most—of the plans would have to be modified. While this would mean more work for consultants, we would greatly prefer to concentrate our efforts upon the development of constructive changes and improvements in our clients' plans, rather than repairing damage resulting from tax legislation.

4. Subsection (a) of section 203 of the bill would require an employee to include in his taxable income an imputed "cost" of group term life insurance coverage in excess of $30,000, if this cost exceeds the employee's own contributions toward the group insurance plan. Such "costs" would be determined either by a "uniform premium table method," using a standard table of rates by 5-year age brackets to be prescribed by regulations, or by a "policy cost method" which would use a table of rates by age brackets, based upon the actual premium cost under the group insurance policy. Terminated employees who have either reached retirement age or become disabled, would be exempt from the requirement.

5. Subsection (b) of section 203 provides that if an employee's own contributions toward group term life insurance in excess of $30,000 exceeds the imputed cost of such insurance as determined under the uniform premium table method, the employee may claim a tax deduction in the amount of such excess.

6. I should like to offer my comments and recommendations in three areas, as follows:

First, I should like to summarize briefly the reasons why I believe your committee should delete section 203 from the bill, leaving unchanged the existing income tax-free status of group term life insurance.

Second, in the event that you are not persuaded that section 203 should be eliminated, I should like to suggest reasons why it is logical and equitable that the part of an employee's group term life insurance which continues to enjoy full tax exemption should be determined on the basis of annual earnings, rather than as a maximum dollar amount as proposed in the bill.

Third, also still assuming that section 203 is retained in principle, I should like to demonstrate that simplicity, equity, and actuarial soundness call for the use of a single average cost factor, independent of age, rather than the proposed tables of factors by age groups.

7. The following are, in my considered opinion, the significant reasons why Congress should not disturb the longstanding principle of permitting group term life insurance to be provided by an employer, on a wholly income tax-free basis:

(*a*) The principle dates from 1920; nearly as long as the income tax itself has been in existence. For over 40 years the availability of group term life insurance benefits on an income tax-free basis has been a factor in the establishment and maintenance of many important employer-employee relationships. Partial elimination of this long-standing feature of the tax law will, I am sure, have a seriously disrupting effect upon many of these relationships; an effect disproportionate to the tax revenue that might be involved.

(*b*) The concept of taxing the value of contingent benefits, especially those which involve no significant real cost unless and until they are in fact paid, involves far-reaching implications. If this is a sound concept in one situation where the benefits are free of income tax, it could well be extended to other benefits having similar characteristics, such as health insurance, workmen's compensation, and even social security.

(*c*) Administrative burdens adding significantly to employer operating costs would result from the legislation. Employer payroll offices rarely maintain records of employee ages, and in the case of non-

contributory plans often do not even record amounts of group insurance, both of which would be necessary in order to carry out the requirements of section 203. Individual determinations of imputed income or tax deduction, as the case may be, would have to be made for each employee, reported for tax purposes, and included in the basis for withholding taxes. Changes in group insurance coverage, often related not only to earnings but to length of service, the employee's position, his family status, and other factors, would have to be recorded and the resulting changes in taxable income or deduction calculated and reported. Changes affecting the tax liability often would not conform to payroll periods, so prorating would be necessary. The receipt of premium refunds reducing the employer's cost retroactively would, of course, compound these problems. All of these things would add significantly to administrative costs, and complicate the tax structure, in the face of universal agreement that the tax structure should be simplified. The amount of tax revenue estimated to result from section 203 simply does not justify the cost of its collection.

(*d*) The estimated gain in tax revenue of $5 million was presumably determined on the assumption that group insurance plans will generally be left unchanged in the face of this new tax. I believe that many plans would be changed, generally in the direction of substituting tax deductible employer contributions for employee contributions now paid out of taxed income. Such changes would doubtless apply to all levels of insurance. Thus the aggregate and result could well be a loss rather than a gain in tax revenue.

(*e*) The tax treatment of employer-provided death benefits already involves many inconsistencies. Noninsured death benefits, widows' pensions under qualified pension plans, and group insurance plans using permanent forms of insurance, are all treated differently. The proposal adds a further complication. If legislation in this area is felt to be necessary, such legislation might well be deferred until there is opportunity for careful study, preferably by a special committee appointed by the Congress, of the subject of employee death benefit taxation in all of its ramifications.

DETERMINATION OF AMOUNT OF INSURANCE EXEMPT FROM TAX

8. If, notwithstanding these arguments, it is your decision to retain section 203 in principle, I feel that some changes must be made in the House version if the new tax is to be reasonably workable and equitable. First, I should like to suggest careful reconsideration of the question of exempt amount. The imposition of a $30,000 limit, or of any flat dollar limit, is essentially arbitrary and discriminatory. In effect it confines the tax advantage of group term life insurance to those for whom the wholly tax-free social security survivor benefits provide the greatest benefit in relation to earnings.

9. I submit that it would be entirely reasonable to permit full tax exemption of amounts of group term life insurance up to at least 2 years' salary, preferably retaining the $30,000 limit of the bill as a minimum exempt amount. This would permit sound, long-established, and nondiscriminatory plans to continue operating as they have in the past, but would still prevent the rare abuses of highly discriminatory plans.

10. In support of this suggestion, I refer to a recent study made by the actuarial staff of the Social Security Administration, Actuarial Study No. 54, Division of the Actuary, Social Security Administration, indicating that the value of survivor benefits provided under the Social Security Act averages over $7,000 per covered individual, an amount probably in excess of 2 years covered earnings. The social security survivor benefits are wholly tax free, both as to the employer's share of the social security taxes when paid, and as to the benefits when received. It would seem entirely reasonable to permit employers to make a corresponding provision, on a similar tax-free basis, in respect of all or any part of an employee's earnings not covered by social security.

USE OF SINGLE AVERAGE FACTOR TO DETERMINE IMPUTED COST

11. My second recommendation, if section 203 is to be retained, is that the imputed cost of group term life insurance be determined on the basis of a single average cost per $1,000 of insurance, such average to be based upon the experience cost of the plan, and applied uniformly for all ages. The proposal to require the use of factors varying by age groups would not only greatly complicate the application of this new requirement, but would, in my opinion, introduce serious elements of unsoundness and inequity into the plans affected by the new tax.

12. One of the main reasons why group term life insurance has developed as successfully as it has is that from the very beginning it has been underwritten on the principle that individual employees should not be affected by the normal increase by age in the cost of term insurance. Failure to observe this principle led to the bankruptcy and virtual disappearance of assessment insurance which was popular in the latter part of the 19th century. The principle of level employee cost for group term life insurance is in effect required by the regulations of many State insurance departments, limiting employee contributions to group term insurance generally to 60 cents per month per $1,000 of insurance.

13. The tax imposed by section 203 does violence to this sound and firmly established concept of level employee cost. On the graded by age basis, employees with group term insurance in excess of the exempt limit would be subject to an increasing cost, in the form of periodic increases in income tax, even when the amount of taxable insurance remains unchanged. With increases in amount of insurance, probably reflecting higher earnings and higher tax brackets, these increases in tax cost would be compounded. Under such circumstances it would probably be necessary for employers to give the employees affected an opportunity to refuse the insurance, even under noncontributory plans. This would bring about the unsound underwriting situation which the insurance and underwriters and State supervisory authorities have so carefully tried to avoid.

14. Under a contributory group term insurance plan, younger employees generally pay more than the cost of comparable individual term insurance. This has been acceptable to younger employees, so long as they can rely upon the situation being reversed when they become older, and their own contributions are less than the cost of comparable term insurance. The employee's attitude is that he is buying

level premium insurance; not increasing premium term insurance—the same attitude that motivates individual buyers of insurance to choose level premium policies under which premiums in the early years are greater than the term cost of current protection. Thus to impute as taxable income a theoretical "employer's share" of the cost of group term insurance protection, measured by 1-year term cost factors, has the effect of taxing the employee on values created by his own contributions in earlier years.

15. Inclusion in the tax regulations, as would be required by section 203, of a table of cost factors suggesting to younger employees that they are contributing more than the value of their current insurance, could well create dissatisfactions forcing employers to assume all or a larger share of the cost of group insurance. This would, of course, increase the employer's deductible expense and thus reduce tax revenue, with only a minor offset resulting from the added tax on insurance over $30,000.

16. Section 203(b) seems to be an attempt to mitigate the inequities resulting from taxing the value of group insurance on the basis of factors increasing by age. The tax deduction device of section 203(b) fails to accomplish this purpose, however, except to a very minor extent. It fails completely in the important case of employees who are now old, and who never had the advantage of a special tax deduction when they were young. A single average factor, reasonably representative of the average value of each individual's term insurance over his working lifetime, is the practical and logical solution to the problem of equity.

17. Still another anomaly inherent in the cost-by-age basis arises under contributory plans toward which the employer's contribution is relatively small, or sometimes nonexistent. Such plans are, in effect, mutual assessment arrangements, whereby the employees themselves pool the cost of claims on the basis of a uniform rate of contribution, independent of age, sex, race, occupation, or state of health. Such arrangements succeed, where the assessment societies failed, because the covered groups preclude self-selection, and because the employer stands ready to contribute whenever the employees' contributions are insufficient to meet claims. From this viewpoint, to tax the older employees on imputed cost is not to tax an employer contribution, since there is none, but rather to tax that part of the value of the benefits of the older employees which is paid by the younger employees. As previously pointed out, such an arrangement is acceptable to younger employees only because of the assurance the plan gives them that they too will, in later years, be entitled to insurance having a value in excess of their own contributions.

18. Section 203(b), the tax deduction provision, would automatically become unnecessary by the adoption of a single average cost factor for determination of tax liability under 203(a). The fact that the 203(b) deduction is a complicated makeshift is clearly brought out by an illustration. Using a computer, one large employer made detailed calculations for his over 25,000 employees of the estimated taxes and tax reductions that would result from section 203. He found that over 4,200 of his employees had group insurance coverage in excess of $30,000. Of these nearly 1,900 would have an increase in taxable income, averaging $247 per employee. About 1,500 of them would have a deduction from taxable income under section 203(b), averaging

$11. For the remaining employees there was neither a tax nor a deduction. These results demonstrate the disproportionate amount of administrative detail required to produce relatively insignificant taxes and tax deductions.

19. Thus to summarize, a single average cost factor would produce taxable income on a uniform basis for all employees with insurance coverage above the exemption. It would produce taxable income only in connection with plans where the employer contributes toward the cost. It would avoid destroying the sound underwriting principles upon which group term life insurance is based. It would avoid inequities among employees in different age brackets. It would eliminate any need for a new type of tax deduction. Finally, but importantly, the use of a single average would be a far simpler and more practical arrangement from the standpoint of administration.

Thank you.

The CHAIRMAN. Thank you very much, sir. Any questions? Senator Williams?

Senator WILLIAMS. Mr. Dyer, your constructive suggestions certainly merit the consideration of the committee and they will be considered, but I would like to ask you the same question that I have asked the previous witnesses.

Just in the event that none of your suggestions should be acted upon by the committee and the vote comes on the bill as it passed the House, would you be for it or against it?

Mr. DYER. It is very difficult for me to answer that objectively, because I am not an expert on many of these technicalities. But from what I know about this total bill, I believe I feel personally there is good in it and that the good, at least slightly, outweighs the bad in it.

Senator WILLIAMS. Well, I appreciate your answer. It may boil down to such a decision having to be made by Congress and I wondered what your position was. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Dyer.

The next witness is Mr. John O. Todd, of the Association for Advanced Life Underwriting. Will you please come forward, sir, and take your seat and proceed?

STATEMENT OF JOHN O. TODD, ON BEHALF OF THE ASSOCIATION OF ADVANCED LIFE UNDERWRITING; ACCOMPANIED BY LEONARD L. SILVERSTEIN AND GERALD H. SHERMAN, COUNSEL

Mr. TODD. Mr. Chairman and members of the committe, my name is John O. Todd. I am a CLU, a member of the National Association of Life Underwriting, a former chairman of the Million Dollar Round Table, and I reside in Evanston, Ill. I appear before you today as president of the Association for Advanced Life Underwriting. I am accompanied by counsel, Leonard L. Silverstein and Gerald H. Sherman.

The membership of the Association for Advanced Life Underwriting is national in scope, having members in nearly every State of the Union. These are men who are leading agents representing more than 60 life insurance companies. Collectively, we have countless years of experience in the field, directly coming in daily contact with thousands of life insurance policyholders, and have been involved,

in one capacity or another, in putting in force literally billions of dollars of life insurance. The welfare of the life insurance policyholder is quite obviously of major concern to us. More importantly, we believe that our knowledge, experience, and "feel" for the subject might very well be of help to the committee in its assessment of section 213 of H.R. 8363, as it was passed by the House of Representatives.

In general, may we identify section 213 as the section of H.R. 8363 which would eliminate the deduction for "interest paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract"—if the loans were made pursuant to a systematic plan of borrowing. The provision also contains certain stated exceptions to the proposed general rule of nondeductibility.

We have experienced extreme difficulty in determining the purpose which is intended to be served by this provision. The Treasury, in its original proposal, gave a round figure estimate of only $10 million as possible revenue gain, but has never indicated any conviction that even this modest amount would be realized. It is always difficult to refute Treasury estimates, but we have been advised by competent actuaries that there is strong reason to believe that the revenue losses, direct and indirect, could exceed the gains by several times. Actuaries foresee these losses in the form of reduction in taxable transactions set in motion whenever new life insurance premiums are brought into being, whether by borrowing or otherwise.

Since even on Treasury estimates, the revenue potential is too small to be material, we cannot find the revenue aspects to be adequate reason for further complicating of the code with this complex and difficult to administer addition, nor for taking the risks that I will point out hereafter, of creating some seriously adverse effects on the whole institution of life insurance.

If the purpose of section 213 is not to increase revenue, we presume it must be designed to eliminate an "evil" which is deemed to exist. Without such an "evil," it is quite clear that there would be no reason for the passage of the section. We have sought, without success, to find a description of the "evil" in the statement of Secretary Dillon before the House Ways and Means Committee and in that committee's report accompanying H.R. 8363, as well as in his statement before your committee.

Secretary Dillon before the House committee based upon an illustrative financed annuity situation, concluded:

> Thus it can be seen * * * that, solely because of the interest deduction, a taxpayer in the 60-percent bracket can make a $12.50 profit for every $1,000 of outstanding loan on the policy.

As we demonstrated in our testimony presented to the House Ways and Means Committee, it is not possible to effect the profit that Secretary Dillon professed to see in the financing of annuity premiums.

With the committee's permission I would like to depart for a moment from the prepared statement, to say that we are filing for your record the same answer to Secretary Dillon's conclusion that we filed with the House committee.

We note that in his testimony to your committee Secretary Dillon has abandoned his annuity illustration and based his contention that there is an abuse on a comparison between the insurance bought on a

term basis with insurance bought on a financed basis. With the committee's permission we would like to file for the record an analysis of the Secretary's conclusions and I would like to present here orally the gist of his analysis.

Briefly, the Secretary in his example filed proceedings demonstrates that if a young man aged 35 and in the 50-percent tax bracket buys $100,000 of 20-year term insurance as compared with the same amount of permanent insurance on a minimum-deposit basis, that his term insurance will cost him approximately twice as much as the minimum deposit insurance, solely because of the tax saving on the interest deduction—this is the gist of the Secretary's contention.

It is hardly necessary, in front of this body, to observe that nearly every financial transaction entered into by any taxpayer must under our current tax law always be examined by its transactions. There are countless examples of clearly legitimate transactions which depend upon the tax effects inherent in the method of execution.

But perhaps the most perfect analogy in the matter of this insurance comparison is one which is familiar to virtually every taxpayer in the Nation. I refer to the decision that each such taxpayer must make when he considers whether to rent or to buy his home. The heavy trend toward home buying instead of renting is obviously caused by the fact that interest and real estate taxes are deductible and rent is not. Since 90 percent or more of home buyers could not buy without borrowing, the deductibility of interest becomes a vital consideration in making the decision to buy or to rent.

Now, obviously, a taxpayer in the upper figures 50-percent bracket would be able to pay interest at only half of the net cost of rent. The analogy to the term insurance versus the minimum deposit method is almost exact in every regard.

The term buyer rents his insurance. At the end of the term his position is identical to the home renter whose lease has expired. The permanent insurance buyer owns his insurance and if he borrows the money to pay for it, there is no more reason that we can see why he should not be allowed to deduct the interest charges than for the man who buys a home. Furthermore, just as the home buyer, because he owns his home, can keep it, while the renter cannot, so also the permanent insurance buyer never reaches the end of the term when he no longer controls his right to retain the insurance.

Our filing for the record is designed to show the exact details of the foregoing analogy based upon the use of the example included in Secretary Dillon's testimony before your committee.

Having failed to elicit an "evil" from the Secretary's statement, we then turned to the Ways and Means Committee report. The committee did not adopt the Secretary's reasoning. In its report it described the "evil" as follows:

> The annual increase in the cash value of an 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 [after deduction] interest charges the taxpayer pays. Thus, for taxpayers in higher brackets, where the annual increment in the value of the 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.

The Ways and Means Committee appears to be saying that the payment of insurance premiums with borrowed funds somehow re-

duces the cost of the insurance to the taxpayer and may, in some cases, result in a profit to him. This, we unequivocally state, cannot be so. So long as the income tax rate is less than 100 percent, this is patently impossible. Not only can there be no cost savings through financing of the premiums, but there must, in all events, be an additional cost.

Men do not buy life insurance with the primary motive of making a profit. It is bought to indemnify someone for a loss that will be suffered in case of death, or to provide retirement funds when the insured reaches the end of his or her working lifetime. If a policyholder survives long enough so that cash values ultimately build up to a sum greater than the sum of the premiums he has paid, the gain is taxed not as a capital gain, but as ordinary income if he surrenders the policy during his lifetime.

This gain is an inherent part of the policy. Whether the premium money was borrowed or not will not influence by 1 cent whether or not there is a gain over premiums. If the money is not borrowed, the policyholder will have no interest cost. If the taxpayer does borrow the premiums, he must pay an interest charge which, no matter how small, adds to his cost and hence decreases rather than increases any potential profit. We are submitting for the record a simple arithmetic illustration of this inescapable conclusion.

Since no one has been able to show an "abuse" that can withstand this kind of close scrutiny, we must respectfully suggest to this committee that there is no supportable reason for the passage of section 213.

In the past there have been concededly sham transactions in which a true debt situation did not occur. However, the Supreme Court has clearly stated that the alleged interest paid on the sham borrowing may not be deducted. Legislation is not needed to correct this situation, nor is section 213 directed toward such a correction.

Section 213 would not only serve a socially useful purpose, it would in fact be socially detrimental. By pointing a finger at cash value life insurance as being in some way a "bad" commodity, it will cause a perhaps unintended, but nevertheless very real discrimination. I think we can all agree that life insurance serves a desirable function of after-death family protection or postretirement independence. There is no good to be served by limiting its use through the passage of legislation which is intended to correct an abuse that no one has been able to define.

Aside from the fact that section 213 in its broad application seems nowhere to fit within the scheme of so-called reform legislation, it also has serious defects with regard to the particulars of its application. For example, when a young man seeks a medical education, he must spend 10 to 14 years before he can start to earn a living. During this long period, the need for life insurance is very urgent, to cover the cost of his education, which often must be borrowed, and also to protect his young family. It is common practice for such young doctors to borrow from insurance agents and from insurance companies to finance the premiums needed to carry this insurance until they can earn enough to repay. Should these young men be penalized by not being allowed a deduction for interest just because they have the integrity to try to secure their creditors with a life insurance policy?

Another example of how this section would threaten a great hardship is the case of the homeowner who seeks to cover his life with

insurance enough to pay off the mortgage on his home. Insurance coverage to secure the payment of debt in case of death is one of the classic purposes of life insurance. If interest is to disallowed for money borrowed "directly or indirectly," then any premiums paid for life insurance by anyone who has a mortgage on his home could easily subject the borrower to disallowance of a part of his interest.

The subjective tests imposed by the section put every insurance borrowing situation under unnecessary and unfair scrutiny. Taxpayers will be made to defend transactions which were not envisioned to be within the scope of the section. For example, who can determine with any certainty whether borrowing is pursuant to a systematic plan, or whether the borrowing is directly or indirectly for the purpose of financing insurance premiums? Every individual who owns cash value life insurance and happens to borrow against other collateral for purposes wholly unrelated to the insurance, stands in danger of losing the deduction for the interest paid on such borrowings. There will be imposed upon taxpayers a burden of proof that is difficult to distinguish from harassment. We do not intend to state that the Treasury Department will deliberately administer section 213 in a way that constitutes harassment. However, enforcement of the section in the manner that is clearly required by the very language of the section will by itself border on harassment, through no fault of, or specific design by, the Treasury Department.

Section 213 would permit the deductibility of interest where the borrowing is made to meet unexpected economic hardship. However, what of anticipated economic strains? For example, the proposal does not take into account situations in which childrens' education costs are foreseeable, as they invariably are. What possible abuse can there be in the use of insurance policies to finance education?

In the light of all of these factors, it seems that the inclusion of section 213 will have no appreciable effect on revenue and will cure no significant abuse or evil in the current tax structure. At the same time, as we have shown, it carries a serious risk that it will seem so discriminatory against cash values of life insurance as a form of property that it will discourage many from buying permanent insurance, to the great detriment of the individuals, the institution of life insurance and the whole economy of the Nation.

The Association for Advanced Life Underwriting has great difficulty, therefore, in finding any social utility in section 213. There is obviously greater moral value in life insurance than in gambling, vacations, fur coats, and like luxuries. There is no disallowance of the interest deduction where amounts are borrowed to finance these frivolous activities. Certainly life insurance should receive equal, if not more favorable, treatment.

We urge the committee to delete section 213 in its entirety when, and if, the committee reports H.R. 8363 to the floor of the Senate. We do not mean to be presumptuous, but feel certain that millions of American policyholders would echo this request.

I should like, with your permission, to file in addition to the previously filed document, an article recently published in the Insurance Field about 2 or 3 weeks ago setting forth our views where we feel that section 213 would adversely affect permanent regular life insurance, wholly aside from finance insurance.

The CHAIRMAN. Without objection, it will be received.

(The article referred to is as follows:)

[Reprinted from the Insurance Field, Oct. 25, 1963]

WE, THE SALESMEN—INTEREST DEDUCTION CLAUSE COULD HURT

(By John O. Todd, CLU, Evanston, Ill.)

If your living is directly or indirectly dependent upon the sale of life insurance, I sincerely hope you will read what follows carefully and thoughtfully. If, when you have done so, you find yourself in agreement with the basic tenets, I hope you will immediately send this copy to the president or such other officer of your company as you think may be most concerned. Finally, if you are that top officer of a life insurance company, I earnestly believe that your reaction to the message here could be of the utmost importance to the future of the great and wonderful thing we know as legal reserve life insurance.

The subject is legislation. Specifically, it is the proposed legislation now included in the House Ways and Means Committee version of the 1963 tax bill respecting disallowance of the interest deduction on certain loans against life insurance.

INCORRECT ASSUMPTIONS

Unfortunately many life insurance people, both in the field and the home offices, have been given the impression that this legislation is only directed at and will only affect so-called minimum deposit or bank financed types of transactions. Perhaps equally unfortunate is the common assumption that an abusive tax profit is made available to high bracket taxpayers when they borrow the money to pay premiums on life insurance. It can be conclusively proved that any tax profit involved in buying a life insurance policy is inherent in the policy itself, and hence is available to anyone, whether he uses his own capital or borrowed capital. The Treasury has constantly implied that the profit ability in the purchase of a level premium legal reserve cash value life insurance policy is greater if the money used to pay the premiums is borrowed than if it is bought with the policyholders own money. The fact is, of course, if there is a cost of a profit in the purchase of any policy, it is not altered one iota by virtue of where the money comes from.

However, the real problem is not even concerned with the "borrow to buy" argument. Let us set this aside entirely. Let us assume neither you nor your company has ever approved of or sold a dollar's worth of minimum deposit or bank financed insurance. Let us assume even that you feel that such sales should be somehow curbed if it could be done without adverse effect to the basic sale of ordinary level premium cash value insurance. The question then becomes: "Does the proposed amendment to section 264 of the Internal Revenue Code accomplish a reasonable possibility of curbing the sale of any financed insurance which might be thought a tax abuse, without any serious potentially adverse effect on the sale of regular, nonfinanced, ordinary life business?"

SEVEN GOOD REASONS

My fear is that the language proposed constitutes a major threat to the whole life insurance industry. May I outline briefly my reasons:

1. Cash value life insurance, bought by men who seek to combine their savings for future lifetime purposes with protection against death, is of utmost importance as an anti-inflation influence. If a substantial percentage of the savings dollars now being accumulated by the U.S. public in the fixed dollar values of life insurance is diverted into equity investment, it will create added dangerous inflationary pressures.

2. The mobility of cash values is threatened by subjecting the policyholder to a possible disallowance of interest deduction on account of money borrowed "directly or indirectly to purchase or maintain such a policy," even policyholders who have no intention of borrowing money at the moment of purchase, may well dissuaded from using a form of policy which combines cash value with protection.

3. Even the existence of such a threat, places in hands of mutual fund and savings and loan representative tool to help persuade prospective policyholders to "buy term and invest the difference."

4. A classic use for life insurance is to permit men to insure their lives as a protection for their heirs against debt. Under the language of the proposed law, any man who owes any money, on a mortgage or otherwise, to the time

he buys a new cash value life insurance policy, could have part of his interest deduction on his loan disallowed because he bought the policy. Even if the Treasury disavows any intent to be this rigid in its enforcement, it opens the door to something that could approach harassment.

5. The real danger of this is that it will almost certainly create a buying trend away from permanent insurance and toward term insurance. Even though term insurance has its place, no one who lives to 65 or after (and 4 out of 5 life insurance buyers do live this long) is ever as well served with term insurance as he would have been with permanent coverage.

6. The proposal to single out life insurance in this manner as opposed to all other forms of property constitutes an unfair economic and social discrimination against life insurance, and makes of it a form of "second-class property" when in fact the social service of life insurance is so beneficial to the U.S. economy that it should be encouraged in every way.

7. It seemed quite clear that the House Ways and Means Committee meant the language excepting "any loan in connection with a trade or business" to be so broad as to make it perfectly plain that such loans would be unaffected by this revision. However, in the report of the committee, perhaps inadvertently, it is quite possible that the groundwork has been laid for the Treasury to disallow interest even in such a situation, because in that report this gratuitous explanation is made: "Thus, if the taxpayer pledges his insurance contract as part of the collateral for a loan to finance capital improvements for his business, no part of the interest on such loan would be disallowed as a deduction under the new paragraph." This is typical of the danger that in the administration, even the clear-cut intention of Congress may not be relied upon by the taxpayer.

TAKING A CHANCE

As you can see, these things are basic—they have nothing to do with life insurance bought with the intent of being financed by borrowing. They pertain rather to the nuances that will control the young man as he plans his financial future. It could very well cause a gradual shift away from permanent insurance which in 5 years could easily double the percent of insurance being bought on a term insurance basis, at the expense of permanent insurance, to the everlasting disadvantage of the policyholder, the economy, and the insurance industry.

Is it really necessary to take such a chance with the future? Will the proposed legislation accomplish enough restraint of whatever may be considered the abuses to justify these risks of damage to the basic services of life insurance? Does the potential revenue or even the contention of "equity among taxpayers" justify the downgrading of life insurance by sheer complication of the tax bill, if nothing else? If some revision of the Internal Revenue Code must be conceded to satisfy the Treasury, does the current proposal have adequate safeguards for policyholders to prevent unintended damage to them?

Even more to the point, if Congress really knew the risks of damage to life insurance, would it feel this amendment was needed? Or if the life companies, both individually and through ALC or LIAA continue to join with NALU and AALU in opposition to its inclusion, could we have reasonable grounds to suppose that the Senate Finance Committee might either discard the provision adopted by the House committee or amend it further to make sure that we are not unintentionally accepting provisions which will damage the whole structure of life insurance?

The boards of NALU and AALU have both voted to oppose any revision of section 264 with all the means at their disposal. This speaks solidly on behalf of the agents in the field. Congress is much more likely to be impressed however if there is clear evidence of solidarity between the field and the home offices.

Hearings before the Senate Finance Committee are now underway, and it seems of great importance that the unanimity of the opposition be made perfectly clear. This means at the very least that the companies be strongly represented when the opportunity for public hearings is offered.

Finally then, this is what we in the field can do about the matter. Let us each request our own company to make its voice heard, both at the level of its association board of directors, and, if necessary, with the Senate Finance Committee members themselves.

The president of your company is certainly concerned with your views. Be sure to express them to him. If this article expresses views with which you agree, clip it, and send it to him in case he may not have seen it.

Mr. President, if you are inundated with copies, please forgive me. You only need to read it once, but if you do, I hope it will bring you additional

thoughts with which you will agree. The men in the field and the companies working together could just possibly prevent this discriminatory legislation from passing—not only now, but for all time.

Mr. TODD. The Association for Advanced Life Underwriting appreciates the opportunity it has been given to present its views to the committee. We stand ready to answer any questions or to work with the committee and its staff in any manner that the committee desires.

Thank you.

(The tables submitted with statement are as follows:)

ANALYSIS OF ADMINISTRATION'S EXAMPLE CONCERNING THE USE OF CASH VALUES AS COLLATERAL

(Submitted by the Association for Advanced Life Underwriting)

The example utilized by the administration did not take into account the facts that earnings on cash values are subjected to tax, when cash values are received from sale of the annuity policy. Assuming the same tax bracket as utilized by the administration, the net profits to the borrowers of $12.50 and $8.75 are converted into losses of $4 and $5, respectively.

Insured's tax bracket	Administration's figures				Additional figures	
	Interest expense per $1,000 of loan (3¾ percent)	Net interest expense after tax deduction	Annual increase per $1,000 of cash value (2¾ percent)	Net profit from borrowing	Income tax on receipt of cash value increase	Net cost resulting from borrowing
60 percent	$37.50	$15.00	$27.50	$12.50	$16.50	($4)
50 percent	37.50	18.75	27.50	8.75	13.75	(5)

ANALYSIS OF INCREASED COST INCURRED THROUGH FINANCING OF INSURANCE CONTRACT

The table below illustrates the additional cost that will always be incurred when a taxpayer pays his insurance premiums with borrowed funds. The figures are based upon a 20-pay life policy taken out by a man age 45. The annual premium is $1,000 and total insurance coverage at maturity (age 65) is $31,000. No matter how small the interest rate, an additional cost is incurred through premium financing. On the figures utilized, where the net interest rate is as low as 2 percent, the additional cost $4,297.

1. Cash value after payment of all premiums	$24,000.00
2. Total premiums paid	20,000.00
3. Gain taxable as ordinary income on surrender of policy	4,000.00
4. Interest cost, 5 percent, if premiums are financed	13,066.00
5. Interest cost, 2 percent rate, if premiums are financed	4,297.00

ANALYSIS OF SECRETARY OF TREASURY'S EXAMPLE COMPARING PURCHASE OF TERM INSURANCE TO PURCHASE OF WHAT IS DESCRIBED AS "TYPICAL MINIMUM DEPOSIT INSURANCE PLAN"

The Secretary sets forth, in his example, the obvious fact that an item of deductible interest costs a 50-percent-bracket taxpayer a net of only one-half as much as any nondeductible item, such as a premium for term insurance. He then concludes that a tax "abuse" results because the policyholder "has been able to cut his insurance cost in half."

Every financial transaction must always be examined by any prudent taxpayer so that the manner of execution will produce the legitimately available tax economy. The deductibility of interest, whether for business or personal purposes is a major fact in our basic economy. There are countless examples in which the stimulus for individuals to buy instead of rent such items as houses, cars, and other goods both hard and soft, is based primarily upon the tax saving due solely to the deductibility of interest from income tax.

Comparative costs to taxpayer in a 50-percent bracket of renting of home versus borrowing the money to buy one provide nearly an exact analogy to comparing the acquisition of term insurance versus minimum deposit, as set forth in the Secretary of the Treasury's example.

Let us illustrate this analogy in order to evaluate the allegation that there is an abuse only when the purchase involved is life insurance.

Assuming a 35-year-old taxpayer is in a 50-percent bracket. He is faced with the decision as to whether to rent or buy a $30,000 home. He sets down the following figures to analyze:

	If he rents—	If he buys—
Annual rental	$3,200	
Annual interest at 6 percent		$1,800
Annual real estate taxes		600
Estimated annual upkeep		800
Total gross annual outlay	3,200	3,200
Annual tax saving at 50 percent on deductible interest and taxes		1,200
Net annual cost of the house	3,200	2,000

In 20 years he saves $24,000, i.e., (20×$1,200) by borrowing to buy instead of renting, solely because of tax saving. Is this, per se, a tax abuse? If his tax bracket is more or less his saving would be proportionately increased or decreased.

Now suppose the same taxpayer, having decided to buy the home with borrowed money, wants to be sure that if he dies his widow will own the home free of any debt and that she will have enough income from capital at least to keep the family together in their home. He decides therefore that he needs $100,000 of life insurance, to provide $30,000 to pay off his debt on the home and $70,000 to give his widow about $350 per month of income. He is faced with the decision as to whether to use term insurance (comparable to renting) or to use permanent insurance (comparable to buying). He sets down the figures shown in Secretary Dillon's example to analyze:

	If he rents (term insurance)	If he buys (permanent insurance) or (minimum deposit basis)
Average annual premium outlay	$938.00	$58
Average annual gross interest at 4.8 percent		857
Total annual outlay	938.00	915
Tax saving in 50 percent bracket		428
Net cost of coverage per year	937.50	487

Just as with the figures he made when deciding whether to rent or buy his house, he finds it is cheaper to buy. In 20 years by borrowing to buy he saves $8,560, i.e., (20×$428) solely because of tax saving. Why is it an "abuse" when the purchase is life insurance to protect the house he buys but not an "abuse" when the purchase is a house?

The CHAIRMAN. Thank you very much. Any questions?

Senator WILLIAMS. Mr. Todd, you have made an excellent statement here and you have given us some good reasons in support of your position. But, as you know, the committee is confronted with an effort that is being made by the administration to push this bill through without any amendment. And just in the event that we are confronted with the situation of accepting H.R. 8363 as it passed the House without any changes, without any amendments, and without incorporating any of your suggestions, will you give this committee what your position then would be?

Mr. TODD. Senator Williams, I would be very regretful to think that a committee of this significance could be pushed by the administration or anyone else into taking something lock, stock, and barrel.

Senator WILLIAMS. Well, I can assure you as one member of the committee, that I am not going to be pushed into it, but, collectively, we may not have the votes.

So, therefore, it may very well be that this bill will be voted upon without any amendments—I certainly hope that it will not be. I certainly join you in the hope that it will be changed.

But just in the event that it is not changed and the question comes up on the acceptance or rejection of the bill as it passed without amendment, as has been requested by the administration, then would you care to give your position?

Mr. TODD. May I qualify it this way by saying that for 15 years or more I have had the privilege of appearing on many platforms discussing subjects having to do with taxation.

It has been my public position during this entire period that a need for tax reduction as a reform was the greatest single essential in the country today—not for the same reasons that the President gives at the present moment, but simply on the basis of my belief that it is improper for any nation to be operating on wartime tax rates in a peacetime period. So that any form of tax reduction that has had the serious consideration that this one has had is better to have than not, in my opinion.

But these reforms of this sort, which have little or nothing to do with any revenue purpose, seem to me to be an unfortunately very high price for a few people to be required to pay in order to accomplish the objective of getting a tax reduction.

Senator WILLIAMS. Well, I appreciate your answer, but I was merely trying to clarify your position because if the administration has its say; that is, the manner in which the bill will be submitted to the Senate, as you know, without amendment. I join with you in that hope that there will be enough support in the committee to make some constructive changes in the bill before it goes out, but it may not happen that way. And I do thank you for the position you have taken.

Mr. TODD. Thank you, Senator.

The CHAIRMAN. Thank you very much.

Our next witness is Francis G. Bray of the National Association of Life Underwriters. Will you come forward, sir, take your seat, and proceed?

STATEMENT OF FRANCIS G. BRAY, THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS; ACCOMPANIED BY CARLYLE M. DUNAWAY, GENERAL COUNSEL

Mr. BRAY. Thank you, Mr. Chairman.

I am Francis G. Bray and I am the chairman of the committee on Federal law and legislation of the National Association of Life Underwriters, as well as a member of the association's board of trustees. I am accompanied today by our general counsel, Mr. Carlyle M. Dunaway.

For your further information, my organization is a trade association with a membership of more than 82,000 individuals—principally

life insurance agents, general agents, and managers—located in all 50 States, the District of Columbia, and Puerto Rico.

My primary purpose in appearing before your committee today is to make known to you my association's opposition to section 213 of H.R. 8363 (the proposed Revenue Act of 1963), which would disallow the deduction of interest paid on loans incurred to purchase certain life insurance and annuity contracts. In addition, however, I would like to avail myself of this opportunity to express our support of S. 2068, which has been introduced by Senator Russell B. Long, a member of your committee, and 19 other Members of the Senate, and which we understand Senator Long plans to offer as an amendment to H.R. 8363. Then, in conclusion, I will make a brief mention of my association's position on the subject of tax reduction.

1. Deduction of interest on loans incurred to purchase certain life insurance and annuity contracts (sec. 213):

Subject to various exceptions, section 213 of H.R. 8363 would disallow the deduction of interest paid or accrued—

> on indebtedness incured or continued to purchase or carry a life insurance, endowment, or annuity contract * * * pursuant to a plan 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).

The avowed purpose of this section is to disallow the deduction of interest paid in connection with life insurance and annuity contracts purchased on the so-called minimum deposit or bank loan plan. Both the Treasury Department and the House Ways and Means Committee have made it clear that the section is not intended to affect the "normal" use of life insurance and annuity contracts as collateral for loans.

We certainly commend the Treasury Department and the Ways and Means Committee for their efforts to word section 213 so that it would not adversely affect the deduction of interest paid on "normal" policy loans. Nevertheless, we still feel strongly that this section is wrong in principle even if it could be limited in its application only to the types of transactions at which section 213 is intended to be aimed.

We find it difficult to understand why the Treasury Department and the Ways and Means Committee seemingly take the position that the deduction of interest paid on loans obtained for the purpose of initiating and maintaining life insurance coverage invariably results in "tax abuse" but apparently do not question the propriety of the interest deduction in the case of loans obtained for virtually all other purposes, even where such purposes may be of the most frivolous nature. Perhaps the principal argument advanced in support of this position is to the effect that since taxpayers are presently denied the right to deduct interest on loans obtained to purchase tax-exempt bonds, they should similarly not be permitted to deduct interest on loans obtained to purchase financed life insurance because of the so-called tax-free inside buildup characteristic, which is essential to all level premium, legal reserve life insurance policies of a permanent nature.

We submit that such an analogy is highly inaccurate and misleading, for whereas interest on tax-exempt bonds is never subject to taxation, this is by no means true of any profit resulting from the interest increment on the increasing cash value of a life insurance contract. For example, when a life insurance policy is surrendered, any gain realized by the policyholder which is attributable to the interest incre-

ment clearly becomes taxable to him at that time. In this connection, it should be kept in mind that close to 60 percent of all benefits paid under life insurance policies are paid to the policyholders themselves (that is, as the result of surrenders and maturities). Therefore, we feel that it would be much more accurate to compare the interest which accrues on the cash value of a life insurance contract with the interest which accrues on the Federal Government's series E bonds and which is also tax exempt until such bonds are cashed in.

Prominent among those who would be adversely affected by the enactment of section 213 would be the young business or professional man. Frequently, such an individual, with a currently low income but with bright prospects for substantially increased earnings in the future, cannot presently afford to pay out of his own pocket the full premium for the amount of permanent life insurance protection that he wants his wife and children to have. As a temporary expedient, therefore, he buys his insurance on the minimum deposit plan, under which he borrows against the cash value of his policy to help pay the premiums for several years. Later, after his earnings have increased, he not only begins to pay the full annual premium out of current income but also liquidates his loan as rapidly as possible. By following this procedure, he has been enabled to secure a plan of permanent life insurance in an amount adequate to the needs of his family and at a much younger age and lower premium than would have been possible had he purchased term life insurance and later converted it to permanent insurance at his then attained age.

Since the type of person referred to is, as I have indicated, normally in a relatively low income tax bracket in the years during which he uses borrowed money to finance his life insurance, we do not believe that it can be seriously contended that the transaction involves any element of tax abuse. Nevertheless, by disallowing the interest deduction in situations of this type, section 213 would clearly discourage such individuals from buying permanent life insurance and the guaranteed lifetime protection that it would provide for themselves and their families.

There is also another type of situation to which section 213 apparently could apply, and which, again, does not involve any element of tax abuse. As a matter of fact, it does not even involve the use of the bank loan or the minimum deposit plan, as those terms are understood in the life insurance business and, presumably, by the Treasury Department and the Ways and Means Committee. I have reference to the type of situation in which a person has several life insurance contracts, the relatively large annual premiums on which fall due at different times during the year. He finds that if he himself were to have to pay each of these premiums as it falls due, it would have an unsettling effect on his budget. Accordingly, in order to provide a more convenient method of meeting the premium payments, he obtains a personal loan from his bank each year. The bank applies the proceeds of each year's loan to the payment of the premiums as they fall due, and the policyholder repays the loan in 12 equal monthly installments.

It would seem to us that if the interest paid by the insured in the foregoing example exceeded $100 annually, section 213 quite conceivably might be construed to preclude him from taking the interest deduction in connection with this perfectly normal credit transaction,

particularly if it could be shown that the "plan of purchase" under which he bought his life insurance policies contemplated the use of annual bank loans for the purpose of paying premiums.

In addition to our conviction that section 213 is wrong in principle, we have grave doubts that the section would be susceptible of either effective or equitable enforcement. For example, if a taxpayer, in the face of section 213, nevertheless chose to finance the purchase of life insurance with money borrowed from a bank and secured by collateral other than life insurance, it seems obvious that the Internal Revenue Service would be unlikely to discover—let alone prove—the real nature of the transaction. In such event, his interest deduction, although illegal, would escape challenge.

On the other hand, we are deeply apprehensive that virtually every policy loan obtained from the issuing insurance company would be "red flagged" in the eyes of the Internal Revenue Service if the interest on the loan exceeded $100 a year, and that even if the loan transaction were a completely "normal" one, the policyholder would be required to prove that he had borrowed the money for a purpose other than the systematic financing of premium payments.

Thus, enactment of section 213 would open the door to unwarranted, even though unintended, harassment of life insurance policyholders and would have the result of seriously impairing the use of life insurance cash values as collateral security. To put it another way, section 213 would have a marked tendency to make such cash values "second-rate" collateral. This would clearly constitute an unjustified discrimination against permanent life insurance and the millions of people who seek to provide economic security for themselves and their families through this particular form of private thrift. A likely result might be that many people who otherwise would be desirous of investing their savings dollars in permanent life insurance because of the guaranteed security that it offers would divert these dollars to other uses which, in many cases, might be less suited to their needs.

In conclusion, I would like to make it abundantly clear that in opposing section 213, and, for that matter, any other proposal that would change the pressent tax treatment of interest paid on life insurance loans, my Association does not agree that the deduction of interest on loans obtained for the purpose of financing premium payments results in "tax abuse" in any event. Furthermore, I wish to repeat—and stress—that we feel that section 213 would constitute and unwarranted discrimination against and impairment of the collateral value of a form of propery that is vital to the well-being of almost every family in the Nation. Any such impairment of the quality of permanent life insurance would, in our opinion, also have a distinct tendency to impair the incentive of the individual to provide for those dependent upon him for their economic security. Finally, even the Treasury Department and the Ways and Means Committee concede that section 213 would produce no significant additional revenue; and, in our opinion, the expense of administering this section would more than offset any additional income to the Federal Government.

For the reasons which I have given, we strongly urge your committee to reject section 213 or any other proposal that would change the present tax treatment of interest paid on life insurance loans.

The second subject about which we wish to speak is the deductibility of expenses of business entertainment, travel, and gifts, and S. 2068,

which would amend the existing provisions of the Internal Revenue Code relative to this subject.

In 1962, as your committee is well aware, Congress added section 274 to the Internal Revenue Code. The purpose of this new section is to eliminate alleged abuses in the deduction of expenses incurred for business entertainment, travel, and gifts. As commendable as this purpose may be, we feel that the provisions of section 274 and the implementing regulations issued by the Internal Revenue Service go far beyond what is necessary to accomplish the basic objectives of Congress and, in the process, have imposed undue limitations upon the deductibility of business expenses of the type referred to and unreasonable requirements with respect to the proof of such expenses even where otherwise deductible.

To cite just one example, under section 274 a taxpayer cannot deduct the expense of business goodwill entertainment unless such entertainment is in the form of the so-called quiet business meal or unless it immediately precedes or follows a substantial and bona fide business discussion.

Now, I am sure that your committee must recognize that the creation and maintenance of goodwill and the confidence that it engenders is essential to the successful conduct of almost every business including, of course, the sale of life insurance. We think that it is both necessary and proper that a businessman be permitted to deduct expenses incurred for the goodwill entertainment of customers or clients or prospective customers or clients so long as such expenses are ordinary and necessary and are reasonably designed to further the taxpayer's trade or business. As I have already indicated, under section 274 the taxpayer is not permitted to deduct expenses of this type except in the two limited situations referred to above.

Again, even where business expenditures for entertainment, travel, and gifts are otherwise deductible under section 274, the elements of such expenditures must be substantiated in minute—and sometimes practically impossible—detail. These substantiation requirements subject taxpayers to unnecessarily burdensome recordkeeping. This burden is particularly onerous in the case of small businessmen such as life insurance agents.

For the above and other reasons that we could give, we are extremely gratified that Senator Russell Long, together with 19 other Members of the Senate (including four other members of your committee), has introduced S. 2068. In our opinion, this bill would establish far more reasonable and understandable rules than now exist under section 274 with respect to both the deductibility of expenses incurred for business entertainment, travel, and gifts and the substantiation of such expenses. At the same time, the bill would tend to eliminate much of the confusion and uncertainty that have beset the business community generally since the enactment of section 274 and the issuance of the regulations thereunder.

We understand that Senator Long intends to offer S. 2068 as an amendment to H.R. 8363. We strongly support—and earnestly hope that your committee will accept—such an amendment.

The last subject is that of tax reduction: As I indicated at the beginning of this statement, I will close with a brief mention of my association's position on the subject of tax reduction. I might add that

it will be a brief mention for the reason, among others, that I doubt that I could say anything on this subject that you have not already heard from the many knowledgeable witnesses who appeared before you earlier in these hearings.

Nevertheless, we believe that you may be interested in knowing where we stand on this highly important issue. Therefore, I will now read to you the following official policy statement that we published on February 15, 1963, pursuant to action of our board of trustees:

> The National Association of Life Underwriters urges a prompt reduction in taxes, which, in fact, will produce sufficient net relief to individual and corporate taxpayers to provide a currently needed stimulus to the national economy.
>
> In the interest of sound fiscal policy, however, any projected reductions in Federal revenues must be accompanied by timely elimination or curtailment of nonessential Federal spending.

In concluding this statement, I wish to express to your committee my own sincere appreciation and the appreciation of my association for having been given this opportunity to appear before you. If you feel that we can be of further service or that you would like additional information regarding the subjects covered in this statement, please call upon us at any time.

The CHAIRMAN. Thank you very much, Mr. Bray.

Any questions? Senator McCarthy?

Senator MCCARTHY. Thank you, Mr. Chairman. Do you know, sir, how much life insurance is being carried in borrowings of the kind that your proposal is directed to?

Mr. BRAY. I do not know any specific figures, and these would be very difficult to gather, I believe, Senator. However, we have made some investigations in a limited area, that is, with a limited number of companies and, as far as we have been able to determine, it is an insignificant amount.

Senator MCCARTHY. You do not think that this case is comparable to the disallowance of the interest or the deductions when the borrowing is for the purpose of buying tax-exempt bonds?

Mr. BRAY. No, sir, because as we said in our statement, in the case of the interest on a tax-exempt bond, there is no tax ever paid, whereas in the case of life insurance any increase in cash value resulting from interest earnings is inevitably paid in terms of a tax when the policy is surrendered or when it matures, if there is a gain.

Senator MCCARTHY. Mr. Bray, could you tell us what amount of the portfolios of the life insurance companies is in tax-exempt bonds?

Mr. BRAY. I am sorry, Senator, I could not hear you.

Senator MCCARTHY. I asked you about what percentage of the portfolios of the life insurance companies do they invest in tax-exempt bonds?

Mr. BRAY. I could not answer that question.

Senator MCCARTHY. You do not know?

Mr. BRAY. No, sir.

Senator MCCARTHY. Of course, it varies from company to company. There are some where that is not substantial and in others it is a rather large investment.

Mr. BRAY. Senator, this is an area in which I have never made an investigation, as to what percentage of the portfolios were in tax-exempt bonds.

Senator MCCARTHY. Thank you.

Mr. BRAY. You were referring to tax-exempt bonds and things of that kind?

Senator MCCARTHY. Yes, sir, that is right; held by the insurance companies.

Mr. BRAY. I thought I understood you correctly. No, I have no specific information on that.

Senator MCCARTHY. All right. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Bray. The committee will recess until 10 o'clock tomorrow morning.

(By direction of the chairman, the following is made a part of the record:)

BUFFALO FORGE CO.,
Buffalo, N.Y., November 14, 1963.

Subject: H.R. 8363.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SIR: The above bill under study by the Senate Finance Committee contains provisions for taxing employees on the current value of amounts of employer financed group life insurance in excess of $30,000.

We wish to register our strong disapproval of such legislation without being prejudiced by its effect on our employees, of whom we have about 1,500 and none of whom are insured in that range. It would seem that all employees in any income bracket are now heavily taxed, and the principle of reaching out to tax minor items of fringe benefits is untenable. The accumulated miseries of employers and employees alike in calculating and reporting this additional tax could not possibly justify the relatively small increase in revenue to the Government, even though the additional revenue were justified.

This move represents a further encroachment of the Federal Government into an area that has been and should remain the direct responsibility of the States to regulate.

No doubt the lower limit of $30,000 was incorporated merely to minimize the objections to the principle, but the principle is still there, and it's inconceivable that this limit would not be gradually lowered in future legislation. Furthermore, the principle being once established could easily be applied to many other areas of fringe benefits, the susceptibility of which to taxation would be even less justifiable.

May we count on your vote against this provision of the bill?

Yours respectfully,

W. R. HEATH, *President.*

STRATHMORE PAPER CO.,
West Springfield, Mass., November 15, 1963.

Hon. HARRY F. BYRD,
Chairman, Finance Committee of the U.S. Senate,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I would like to record our company in opposition to the Treasury proposal to tax group life insurance as provided in H.R. 8363. Our company is a group life insurance policyholder and feel very strongly that the proposed taxation is an unfair discrimination against a small group of group term life insurance holders.

Furthermore, the tax revenue to be raised under such a proposal seems insignificant and it is evident to us that the Treasury is attempting to place limitations on group life insurance available to executives. As such, this action encroaches on the area of insurance regulation which we believe should remain the responsibility of the States.

The calculations and recordkeeping would result in an increased administrative burden for our company far out of proportion to the small amount of revenue anticipated.

We respectfully recommend to you that you oppose H.R. 8363 if and when it comes before the Senate for a vote.

Sincerely,

H. D. JOHNSTON, *President.*

ALLEGHENY POWER SYSTEM, INC.,
New York, N.Y., November 15, 1963.

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

DEAR SENATOR BYRD: H.R. 8363, which your committee is now studying, contains a provision (sec. 203) making taxable to officers and employees in active service, the "cost" of group term life insurance over $30,000 made available by their employers.

On my own behalf and on behalf of the 20 or more other officers and employees of our system whose taxes would be substantially increased by this provision, I urge your committee to drop it from the proposed tax bill.

My principal reason for saying this provision should be dropped is that it is a case of changing the rules in the middle of the game. For more than 30 years our companies have stressed group life insurance as an important social and family advantage of employment in our system, all with the support and encouragement of the Federal tax law. Most of the people who have come to have the higher amounts have spent many, many years getting to that point and have relied on this insurance in their financial planning. Undoubtedly it has been paid for with money they would otherwise have had as current compensation. Now should they be asked to sacrifice much of what they have attained in paying taxes on imputed income which they don't have?

When the rules are to be changed in matters of this sort, they should be changed prospectively to apply to new commitments which can be made with full knowledge of the consequences.

I understand the gain to the revenues from this change would not be important. On the other hand the complicated computations and withholding arrangements would be another substantial burden on employers. There must be better ways of arriving at an equitable distribution of our necessary tax load.

Very truly yours,

J. LEE RICE, Jr., *President.*

CRAVATH, SWAINE & MOORE,
New York, N.Y., November 14, 1963.

Re group term life insurance purchased for employees.

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

DEAR SENATOR BYRD: For many years, employees have not had to include in their income for Federal tax purposes premiums paid by their employers for group term life insurance protection. Now, however, section 203 of H.R. 8363 would for the first time include such premiums in the employees' gross income to the extent that they represent the cost of insurance protection over a certain exempted amount.

In my judgment, adoption of section 203 would be unwise, since the relatively small amount of additional revenue (about $5 million) which it is estimated might result from the adoption of section 203 does not justify upsetting the thousands of group insurance plans negotiated by employers and employees over many years in reliance upon the historic tax exemption of such insurance. Furthermore, such a small amount of additional revenue does not appear to justify complicating the income tax law any further.

My brethren at the tax bar and I are becoming increasingly concerned over the growing tendency of the legislature to pass income tax legislation during each Congress which is somewhat more complicated than the legislation enacted by the previous Congress. At one time, simplicity in our income tax laws, although not always achieved, was at least a desired result. I fear that is not the case today. Complicated legislation, such as that proposed by section 203, should not be enacted unless a substantial amount of needed revenue would result therefrom or some major social ill corrected. I submit that section 203 does neither.

The basic purpose of group insurance plans is to provide insurance protection in amounts related to an employee's earnings. Section 203, in providing a flat dollar exemption from gross income for the cost of $30,000 of insurance protection, regardless of the earnings of the particular employee, is contrary to this purpose. Imputing varying amounts of income to the employee dependent upon his age—by determining the cost of protection by reference to a uniform table

of premiums based on the age bracket of the employee—is also contrary to this basic purpose because it fails to recognize the fact that group insurance, like ordinary life insurance, is based on a level premium.

Section 203 recognizes to a limited extent the fact that adoption of the section, which rejects the level premium concept, would discriminate against older persons. It does so by providing an income tax deduction for the younger employee to the extent that his contribution exceeds the cost of his insurance protection; thus, deductions in early years may roughly equal imputed income in later years. However, the section discriminates unfairly against present senior employees for whom the rules are now changed, because they will now be taxed at the high premium rates applicable to their current ages without having had the benefit of any deductions for contributions previously made in their younger days.

The extensive scope of proposed section 203 is illustrated by the fact that even where the entire cost of the insurance protection is borne by employee contributions, the section operates to impute income to the older employee by basing the cost of protection on the employee's age bracket, and the employer is required to treat the imputed income as wages subject to regular tax withholding. Since there has not been any payment made by the employer for the benefit of the employees as a group, this result does violence to traditional tax concepts.

Consequently, if statutory changes are to be made, it is respectfully suggested that:

(1) There be no tax consequences to any employee where the entire premiums paid for the group insurance are paid by the covered employees;

(2) Where the employer does pay all or a portion of the premiums, the amount of the exemption should be based on the employee's earnings, say 1½ to 2 times such earnings; and

(3) If the amount of coverage exceeds the exempted amount, the amount of income imputed to the employee, regardless of his age, should not exceed the excess of the single average premium cost for all employees covered by the group insurance over the amount of any contribution which the employee makes for his own insurance protection.

Faithfully yours,

ROSWELL MAGILL.

STATEMENT OF J. MILTON EDELSTEIN, WESTERN DIVERSIFIED SERVICES, INC., CHICAGO, ILL.

Mr. Chairman and members of the committee, I am a member of the National Association of Life Underwriters and the Association for Advanced Life Underwriting, major life insurance agents' associations. I submit this statement to you, respectfully requesting that you eliminate from the proposed 1963 tax bill (H.R. 8363) any limitations upon the right of life insurance policyholders to deduct interest for loans made for the purpose of financing premiums on life insurance or loans made against the collateral of life insurance for any purpose whatsoever.

The Treasury Department has requested a number of changes to increase Government income. The changes suggested generally apply to situations where it is felt that benefits to taxpayers were either not intended, or where improper advantage was accruing to the taxpayer.

I respectfully point out that this committee saw fit to delete from the Technical Amendments Act of 1958 (H.R. 8381) a similar request for limitation of interest deductions.

The facts leading to the current request by the Treasury are based upon the same facts that existed in 1957. It is a matter of general information that many life insurance companies have withdrawn policies from their portfolios where they felt that high early cash values represented a point of attack by the Treasury in influencing buyers to borrow against their policies for the purpose of maintaining adequate life insurance coverage. This would lead me to believe that the proposal requested by the Treasury would at this time be somewhat academic, since the tools which seemed to have been objectionable to the Treasury have been somewhat blunted. Some policies issued by over 1,500 life insurance companies in the United States are designed to give the policyholder a larger proportionate share of equity during the term of the policy. The policyholder pays more for the privilege of owning higher cash values by depositing with the insurance company a larger premium in order to develop his "savings account." This shortens the period of time during which premiums

are paid. This is not a new practice and has been with the life insurance industry for over 100 years. What is wrong with this procedure now, and why cannot the frugal buyer utilize his funds as though they were the same good property his father and grandfather owned when they sought to safeguard their families against the hazards of death and financial anemia?

Is a planned program wrong? A fruit farmer plants his trees, fertilizes and sprays them, and harvests his crop with great care and planning. Ocassionally, a worm is found as a tenant in an apple—this does not call for destruction of the orchard. He may police it a bit better but to amputate is final, destructive, and to be avoided.

Disallowance of the interest deduction on a loan taken against any collateral if the proceeds are used to pay life insurance premiums is amputation—complete and destructive—of every principle upon which permanent life insurance, and along with it inbred savings, has been weaned.

Rather than discuss the makeup of the proposed change as suggested in the bill passed by the House of Representatives, I should like to state categorically that any inclusion of restrictive legislation pertaining to the deduction of interest where the purpose of the loan is, upon subjective test, to pay premiums for new life insurance be eliminated from the bill as being harmful to the life insurance industry, to over 100 million policyholders now owning life insurance and to the millions of young people who will become policyholders in the future.

It has been proposed that this legislation will increase revenue. I don't understand how this is possible, since policies in existence would not be subject to the proposed restrictions. Therefore to obtain increased revenue, it would be necessary to secure a source of income from new policies which, if the present proposal were effective, would eliminate the deduction of interest and thus restrict the sale of policies where borrowed funds are used to pay the premiums. This is a negative approach falsely assuming that the same amount of life insurance will be written despite the fact that the property itself has been relegated to a lower grade of property. Why invest "savings" in contracts restricted as to collateral value yet showing no income return or capital enhancement?

When a lesser amount of insurance is written, revenue is reduced as commissions, medical fees, credit reports, home office employees, insurance company investment yields and profits would be nonexistent on business "not written," thus reducing the revenue, rather than increasing it. Additional loss of revenue would result from smaller estate and gift taxes. It is impossible to gain revenue by denying deduction of interest on a loan a taxpayer does not make.

In conclusion, I ask that this committee reject any changes in section 264 of the Internal Revenue Code. Such proposals as have been requested by the Treasury Department are subjective in nature, discriminatory, nonrevenue producing, and administratively unfeasible.

METHODIST HOSPITAL OF SOUTHERN CALIFORNIA,
Arcadia, Calif., November 18, 1963.

Senator HARRY F. BYRD,
Chairman of the Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The board of directors of this hospital has recently revised the group life insurance benefits for the protection of the dependents of its employees. While the employee pays some of the premium, the hospital makes the substantial contribution toward the cost.

It has now come to my attention that there is a proposed tax bill (H.R. 8363), passed by the House of Representatives and currently under study by the Senate Finance Committee, which would provide that employees should be taxed on the current value on amounts of employer-financed group term life insurance in excess of $30,000.

There are several reasons why we seriously object to this kind of legislation. However, for the purposes of this letter, we will limit our discussion to but two:

1. The additional income to the employee would be treated as regular income and would be subject to withholding tax. The calculations and recordkeeping will result in increased administrative burdens in our accounting department. It is my opinion that this will be completely out of keeping relative to the extent of the tax revenue anticipated.

2. We anticipated that the concept of imputed income might be extended to other areas of employer-financed benefits such as health insurance and workmen's compensation with far reaching and serious complications.

Please consider these facts before a decision is made on H.R. 8363.

Very truly yours,

WALTER R. HOEFFLIN, Jr.,
Administrator.

STATEMENT BY ALUMINUM CO. OF AMERICA REGARDING GROUP-TERM LIFE INSURANCE, SECTION 203, H.R. 8363, REVENUE ACT OF 1963

Section 203 of H.R. 8363 requires the inclusion in the gross income of an employee of an amount equal to the cost of group-term insurance provided under a policy carried directly or indirectly by the employer, to the extent that such cost exceeds the cost of the first $30,000 of coverage plus any amounts paid by the employee toward the purchase of such insurance. Cost is to be determined on the basis of uniform premiums computed on the basis of 5-year age brackets.

A companion provision, section 218, amends existing section 3401(a), relating to the definition of wages for withholding tax purposes, to provide that the excess cost determined in the foregoing paragraph constitutes a wage item and, as such, income tax must be withheld from the employee's pay.

House Report 749 of the 88th Congress states that the present 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; namely, individual life insurance or group permanent life insurance which carries a loan or surrender value. It is obvious that group-term life insurance is different from insurance which carries a loan or surrender value and for over 40 years, the Treasury Department regulations and rulings have recognized this difference and have held that no income is realized by an employee covered by a group-term life insurance plan.

An employee cannot borrow on group-term insurance and he cannot take it with him, as such, should he leave the company. In effect, during his lifetime, the only benefit derived is the dollar savings in cost of insurance when covered by an employer-financed plan.

The proposed provision is particularly objectionable in the case of plans such as that which Alcoa employs, which we believe not to be uncommon throughout industry, wherein substantially all of the cost of the insurance is fully paid for by the employees. Alcoa's life insurance program is divided into two main parts. Under the first, the company provides $5,500 of group-term life insurance to every employee with the cost of this life insurance paid for entirely by the company. The second part of our company's life insurance program is a voluntary plan. Under this part of the program, the company merely provides the vehicle (group) through which employees may purchase additional term life insurance at group rates based on the single average premium method. Participation by the employees in this part of the plan is entirely voluntary and any participating employee is free to withdraw from the plan at any time.

Over a span of years, the employee's cost as compared with purchasing comparable term life insurance coverage outside the group should average out. In his younger years the rate he pays as a member of the Alcoa group will be greater than would be required for term life insurance outside the group, but in his later years the rate paid as a member of the Alcoa group life insurance plan will be less than for term life insurance outside the group. Under the provisions of H.R. 8363, the imputation of income will obviously fall on older employees in spite of the fact that these same employees most likely have paid higher rates in their younger years under the Alcoa plan than would have been required had they purchased term life insurance outside the group. Under this voluntary part of our company's group-term life insurance program, the total cost thereof, except for necessary administrative expenses, is paid for by the employees, with dollars which have already been taxed. Therefore, we fail to see any sound justification for such life insurance plans being included under the changes proposed in H.R. 8363.

House Report 749, in its revenue estimates of H.R. 8363 (p. 12), notes that this provision is estimated to increase tax revenues by approximately $5 million a year. Although the stated purpose of this provision is to correct existing "abuses" and is not a revenue-producing measure, we believe that consideration should be given by the committee to the cost to employers to determine the amount

of imputed income per employee. We are not aware of the factors that have been considered in arriving at the $5 million amount, but our own insurance department has estimated that, with respect to Aluminum Co. of America, our annual administrative cost to determine the amount of imputed income for the affected employees will be very substantial. We estimate that the added cost to the company would reduce the company's tax liability at least in an amount equal to, if not in excess of, the added tax obtainable from individual employees required to pay tax on the amount of imputed income. If, as we believe, ours is a typical case, we fail to see how the $5 million revenue increase can be achieved, and we further feel that a great number of employees will be unjustly penalized.

On the basis of the foregoing, we strongly recommend that the Finance Committee delete section 203 from H.R. 8363 and endorse the continuation of the present tax treatment of group-term life insurance.

However, should the committee conclude that some change is desirable in the group-term life insurance area, we submit the following proposals for consideration:

1. Retain present tax treatment for voluntary group-term life insurance plans paid for by after-tax dollars of the covered employees.
2. If a ceiling limitation on the amount of coverage is required, such limitation should be in terms of multiples of compensation (perhaps two times annual compensation) or the proposed $30,000 exemption, whichever is greater.
3. In any event, if the House version of taxation of the excess cost of group-term life insurance premiums is retained, we respectfully urge that such taxation be based on a cost determined by use of the single average premium method.

YORK & CO.,
San Francisco, November 27, 1963.

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

DEAR MR. BYRD: It is my understanding the Senate Finance Committeee is conducting hearings on the new tax bill and that one of the items being considered is whether or not to include in an employee's income for tax purposes the cost of amounts of group life insurance in excess of a specified amount. I would like to take this opportunity to register an objection to this proposal.

Our small firm with 50 employees has always been a great believer in group life insurance, and we provide insurance for our most successful employees in amounts up to $75,000. We do this because we feel it is not only a wise investment in personnel, the lifeblood of our industry, but also, at reasonable rates, provides protection and contentment for the families these men have to support.

While the amount they might pay taxes on is minor, I feel sure the adoption of this proposal would have a decided adverse effect upon our relations with valued employees. It would also mean additional bookkeeping expenses and so confuse things that it is hard for me to believe the small amount of additional revenue derived by the Treasury would make it worthwhile. With this in mind, I respectfully suggest this item be eliminated from the new tax bill which, in general, I highly favor.

Sincerely yours,

PALMER YORK, Jr.

ELI LILLY & CO.,
Indianapolis, Ind., November 22, 1963.

Re group-term insurance, section 203 of H.R. 8363.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We have studied fully section 203 of H.R. 8363, which would tax "the cost" of employer-financed group-term life insurance in excess of $30,000 per person. It would serve no useful purpose for us to restate the numerous objections to this proposal expressed before the Senate Finance Committee and the House Ways and Means Committee. We respectfully submit that section 203 be rejected by the Senate Finance Committee for the following reasons:

1. We do not believe that there is any fair and equitable way to tax "the cost" of group-term life insurance.

2. The flat limitation of $30,000 is unreasonable and inequitable. While this limit has been increased from the initial amount of $5,000 to $30,000, this merely moves the beginning point of the inequity to a higher level. If any limitation is to be imposed, we submit it should be related uniformly to the employee's compensation, the best measure of his value to the employer; i.e., two or three times his annual compensation.

3. We believe section 203 by upsetting the favorable tax treatment accorded group-term life insurance for many years would serve to disrupt the establishment and maintenance of employee benefit programs.

4. Section 203 would establish a new precedent in the field of taxation by attempting to tax "the cost" of a benefit which may never produce any cash benefit to the employee, his family, or estate. We submit this is fundamentally unsound.

5. Section 203 would establish a principle which would have equal application in employer provided pension plans, medical expense insurance plans, sickness and benefit plans, and other related plans. If enacted, it would disrupt the continuing attempts by this company to develop better solutions to the problems affecting employees' security.

6. Section 203 with regard to the amount to be taxed to the employee if term life insurance exceeds $30,000 is unduly complex. It requires calculations employing complicated formulas to allocate the cost of insurance on the basis of age brackets. Each calculation must be made for each employee of the company and must be repeated each year. If it be held to be in the public interest to enact section 203, the burdensome and expensive method of calculation should be remedied. We suggest that insurance costs be computed on a level premium basis; i.e., without regard to age groupings. It would seem logical to us to use only that rate in computing to the employee a portion of the premium cost. 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 employee, some of whom might not be able to secure any life insurance outside the group.

It is requested that this letter be made a part of the committee's record on H.R. 8363.

Very truly yours,

J. E. MARMON,
Group Vice President, Manufacturing and Administration.

GENERAL TELEPHONE CO., OF THE NORTHWEST,
Spokane, Wash., November 26, 1963.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I am writing to you concerning the group term life section of H.R. 8363, which would require an employee to include as taxable income the cost of his group term life insurance over $30,000 and would require employers to furnish him with such cost.

We are strongly opposed to this measure for the following reasons:

1. The provision appears to be more an attempt to limit group term life insurance than to produce revenue since little tax income will result.
2. For the employer a computation and withholding for each individual employee concerned would be a complex, costly, and cumbersome procedure.
3. This proposed legislation would have a definite disrupting effect upon many long established group term life insurance plans.

I would urge you and your committee to seriously consider the impracticability of this provision and eliminate it from H.R. 8363.

Will you please make this letter a part of your committee's record.

Very truly yours,

A. J. BARRAN, *President.*

VAN NUYS, CALIF., *November 26, 1963.*

Re section 213 of the 1963 tax bill, amending section 264 of the 1954 Revenue Code.

HON. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SIR: Both as a private citizen and on behalf of hundreds of my personal clients who own life insurance, may I express my strong opposition to section

213 of the 1963 tax bill, amending section 264 of the 1954 Revenue Code, as it applies to the deductibility of interest on moneys borrowed to pay certain life insurance premiums.

I, personally, have made loans on the cash values of my life insurance policies to provide funds for my business, to take care of financial emergencies and to pay premiums when there were no funds available from other sources. In the future, I will no doubt find myself in a similar situation where I have substantial premiums due and no funds available to pay them. If I made a loan from some other source to obtain funds to pay my premiums, I would no doubt be able to deduct the interest charge. It is legislative discrimination against life insurance as property to disallow the deduction of interest charged on life insurance policy loans used to pay premiums or for any other legitimate business or personal matter.

I trust that you will use your influence to defeat section 213 of the 1963 tax bill, amending section 264 of the 1954 Revenue Code.

Sincerely yours,

JAMES S. O'BRYAN, CLU.

CITY OF STANTON, CALIF., *November 26, 1963.*

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

DEAR SENATOR BYRD: We, the undersigned mayor and certain employees of the city of Stanton, Calif., understand that the Senate Finance Committee is considering a Treasury proposal to tax employees on the "cost" or "value" of their group term insurance.

The city of Stanton will soon be participating with the employees in a group decreasing term insurance policy. Its maximum insured value will be in the area of the limit we understand is contemplated in the Treasury's proposal.

The decreasing term insurance policy was first designed to cover our "high risk" employees, defined broadly as policemen, firemen, and field public works employees. It is now designed to cover all employees, but with an 80 percent participation for the "high risk" people and lower percentages for others conditioned on their length of service to the city.

We have found that a sizable majority of our "high risk" employees do have very little insurance to cover their dependent families as beneficiaries. Most of these same employees, basic patrolmen, firemen, etc., are in the low end of the salary scale. This insurance is supplementary to workmen's compensation and social security death benefits which are not sufficient, in our judgment.

Our objections stem from these principal things: (1) Opposition to any income tax levy on group term insurance; (2) opposition to income tax levy on group term insurance with a limit under $50,000; (3) the implications with respect to social security, unemployment compensation, and workmen's compensation, in the future; and (4) the burden and expense to the employer in making the computations for value and cost of this category of insurance and making the necessary salary reports.

In view of the fact that this proposal would change the situation viewed in 1920 in Law Opinion 1014, it is our view that the Treasury's proposal should be opposed. This is a small city (population 17,000), which has an unfavorable competitive standing in competition in the labor market with other larger cities, because of our size, despite the fact that our salary scale is more than competitive. Fringe benefits, such as life insurance, offer inducements which help us attract qualified personnel. This Treasury proposal would tend to lessen these inducements.

The undersigned earnestly solicit your support to defeat this proposal.

Very truly yours,

RICHARD F. MCCARTHY, *Mayor.*
STANLEY J. LAVERY, *City Administrator.*
WILLIAM G. GOWER,
President, Stanton City Employees' Association.
JOHN L. YOUNG,
Sergeant, P.D., Chairman, Employees' Life Insurance Committee.

A STATEMENT BY R. R. PIPPIN, TREASURER, E. I. DU PONT DE NEMOURS & CO. ON CERTAIN PROVISIONS OF H.R. 8363

The purpose of this statement is to submit to the members of the Senate Committee on Finance the views of E. I. du Pont de Nemours & Co. with respect to certain provisions of the proposed tax legislation (H.R. 8363) which is now the subject of public hearings by your committee. We ask permission to file this statement for the consideration of your committee.

The Du Pont Co. believes that many of the provisions of the proposed tax legislation would represent constructive and worthwhile steps toward improvement of the income tax structure. However, we believe that the provisions of H.R. 8363 with respect to taxation of group term life insurance premiums, the dividend credit, and tax treatment of stock options would be highly inequitable and would not be in the national interest. These three particular provisions of H.R. 8363 are discussed in this statement.

1. Taxation of group term life insurance premiums.—We believe it would be a serious mistake to discard the longstanding principle that an employee does not derive taxable income under a nondiscriminatory group life insurance plan, even though financed by his employer. The arguments for exemption expressed in the 43-year-old Treasury Department Law Opinion 1014 are still valid and group insurance provided for employees on a nondiscriminatory basis cannot properly be regarded as compensatory in nature.

In any event, even if it be assumed that the furnishing of insurance protection by an employer may properly be treated as taxable compensation to the employee, we see absolutely no justification for taxing an employee on any amount which it not, in fact, paid by the employer. We do not see how it can be said that an employee receives compensation under a group insurance plan where he and his fellow employees finance the plan entirely out of their own pockets. Obviously, there can be no compensation beyond what the employer pays.

In his statement before the Finance Committee, Secretary Dillon described section 203 of the bill as a provision which would tax an employee on "the cost of group term life insurance protection provided by his employer to the extent the protection exceeds $30,000." In the description of H.R. 8363 prepared by the staff of the joint committee, it is stated that section 203 would tax employees on "amounts paid by their employers to purchase group term life insurance protection." These statements are misleading. The fact is that section 203 or H.R. 8363 would tax the employee whether or not the employer pays any part of the cost of the insurance. In our case all of the income taxed to an employee under this section would be payments made by other employees. Such is the necessary result of computing the amount subject to tax according to age groups—a method which we may refer to as the step-rate method. By imputing taxable compensation to employees where there has been, in fact, no payment made by the employer, this method will establish a new and dangerous precedent. If this principle is to be enacted into law we see no end to its application in distorting the amounts of taxable income imputed to taxpayers. We cannot believe that this result is intended. If any part of group insurance premiums is to be taxed we suggest the average premium method under which no employee compensation would be imputed unless there should be a corresponding payment on the part of the employer.

In addition, we object to the step-rate method because we believe—

1. It will be self-defeating in that it will not only fail to produce the anticipated revenue on a net basis but may well bring about a decrease in tax revenues.
2. It could make continued participation in contributory plans so unattractive to employees that they would cancel their coverage with destructive effect on their financial planning and jeopardy to the financial security of their families. Sufficient cancellations would force abandonment of the plans for the entire group.
3. It will complicate not "simplify tax administration and compliance," a stated objective of the proposed tax revision.

If any part of group life insurance premiums is to be taxed we suggest and would support use of the average-cost method of taxation because—

1. It would tend to preserve existing benefits for all employees.
2. It would be more likely to produce whatever revenue it may be forecast to produce.
3. It would be less onerous than the step-rate method from the standpoint of tax administration and compliance.

Employees covered by many contributory group life insurance plans pay as a group all or substantially all of the cost. Employees recognize that the probability of death increases with age; nevertheless, they regard group insurance as a long-term undertaking just as is their personal individual life insurance. Group life insurance has a career aspect, and employees accept as logical and equitable that the cost of providing the benefits for th eentire group be spread over their careers—a fact ignored by the step-rate method. Moreover, the overall average rate method of determining appropriate levels of employee contributions promotes a high percentage of continuing membership in the group which is a requisite for group sharing of death claim costs. The average premium method of taxation would therefore coincide with employee (taxpayer) views as to proper and practical cost allocation.

Any employee can understand that if his employer pays the group insurance premium the employee has received an economic benefit. (Whether this economic benefit should be taxed as income is another matter.) However, the employee certainly would find it beyond comprehension that he had received taxable income in a case where the employer had made no payment. From an employee's concept the amount of taxable compensation, if any, would be his reduction in pro rata premium payments resulting from the employer's payment. Taxation of income is less vigorously opposed when the provisions of the tax statutes coincide with the taxpayer's concept as to what constitutes income. We, therefore, believe that the average premium method of taxation would more nearly secure employee acceptance and compliance. The step-rate method on the other hand would be confusing, if not incomprehensible, and would tend to stimulate the development of schemes by which such tax could be minimized or avoided entirely.

The step-rate method may be expected to exert pressures which will make it not only self-defeating from a revenue standpoint but actually a cause of loss of tax revenue. By ignoring the career aspect of contributory group life insurance, it requires that in equity younger employees receive credit currently (rather than in later life) for their "overpayment" of cost. This is accomplished in H.R. 8363 by allowing younger employees to deduct on their tax returns a portion of their premium payments on their insurance coverage in excess of $30,000; the resulting benefit to the employee is the product of his tax rate times the deduction. This so-called equity adjustment could, however, stimulate these and other younger employees to seek lower actual payments on all of their group insurance—including amounts up to $30,000. However, if an employer agreed to lower payment rates for younger employees he would find it difficult, if not impossible, to shift the resultant cost burden to older employees and pensioners who not only would be unable to pay the extremely high premiums based on their advanced age levels but would find difficulty in understanding why they, who had paid a level premium throughout their careers, should suddenly be regarded as underpaying. Accordingly, the employer would be faced with the necessity of picking up the additional group insurance cost which action would result in increased expense and a decreased corporate income tax payment. In our own case, if premium payments by the participants in the group insurance program were adjusted along these lines we estimate that the potential reduction in corporate tax would be six times the maximum increase in tax paid by our older employees. We have no way of relating these estimates to the forecast $5 million tax revenue, but they certainly suggest that the anticipated revenue gain might well turn out to be a revenue loss.

The alternative to employer acceptance of the increased cost referred to above would be curtailment of the benefits offered to employees and pensioners. Such curtailment could make an insurance program so unattractive that it would have to be abandoned by reason of lack of sufficient participation by employees. Hence, many employees could lose part or all of their life insurance protection due to inability to replace group life insurance with individual policies, either through lack of funds or because as individuals they would be uninsurable. Financial security of surviving family could thereby be jeopardized—or destroyed—potentially adding to the burdens of Government.

In addition to the more fundamental points discussed above, the foreseeable complexities of administration are pertinent when a revenue measure is under consideration. The step-rate method would be both complex and expensive to administer. In contrast, the average-rate method applied to the employer payments would present no difficulty in determining whether an employee had taxable income and how much it was. The satisfactory experience in Canada is in point.

In summary, we oppose section 203 in its entirety. Moreover, we believe that the step-rate method would serve no revenue purpose and would exert pressures which could seriously impair the financial planning of a large number of taxpayers. We are of the opinion that if the taxation of group life insurance premiums is deemed appropriate, the average-rate method applied to the employer payments may not only serve a revenue purpose but will tend to preserve group insurance plans on which many taxpayers have based the financial security of themselves and their families.

2. *Repeal of the dividend credit.*—We feel that repeal of the 4 percent dividend credit is moving in the wrong direction. We are in favor, however, of the increased dividend exclusion from $50 to $100, provided this increase is not contingent upon a concurrent repeal of the dividend credit. This credit, although much too small, is a step in the direction of eliminating the inequity of double taxation on corporate profits. It encourages more investment in equity capital, which is the basic source of economic growth. Instead of being repealed, the 4-percent dividend credit should be enlarged. It was only after careful consideration and study of this subject by Congress, the Treasury and other groups for many years that this small step was taken in 1954 toward the elimination of double taxation on corporate profits. At that time, it was anticipated that the credit would ultimately be increased in ensuing years.

Aside from the equity of continuing the 4-percent dividend credit and its encouragement for investments in equity capital, we are convinced that over a span of years repeal of such credit would be costly to the Government. The 4-percent dividend credit is a substantial inducement to individuals to invest in equity securities. Without such inducement many investors would be inclined to shift away from equity securities to corporate obligations. Thus, if the 4-percent dividend credit were repealed, corporations needing new capital would find it more difficult to obtain funds through the issuance of capital stock. Accordingly, more of the new capital would be in the form of bonds, notes, or other interest-bearing obligations. Since interest paid on corporate obligations is deductible in full in computing taxable income of a corporation, the resulting tax paid by corporations which issue such obligations will be smaller than would have been the case had they issued equity securities. For instance, under the current corporate tax rate of 52 percent, a corporation issuing a $1 million 6-percent bond would pay interest of $60,000 per annum, but in so doing would reduce its Federal income tax payment by $31,200. In contrast, if capital stock were issued and a $60,000 dividend paid thereon, there would be no reduction in its corporate income tax. While the individual stockholder's tax would be reduced by $2,400 by virtue of this dividend credit, the use of bond financing in lieu of stock would bring about a net reduction in revenue to the U.S. Government of $28,800. It can thus be seen that only a modest shift from equity financing to bond financing would completely wipe out any additional revenue the Government might realize from repeal of the 4-percent dividend credit.

3. *Stock options.*—We are in agreement with the action of the House Ways and Means Committee in retaining provision for capital gains treatment of employee stock options in H.R. 8363. We are also sympathetic with the committee's objective of eliminating any abuses which may exist in connection with options. However, the proposal for serial option exercise is too broad in its application and the provisions for a maximum 5-year option term and a 3-year holding period for capital gains treatment are too restrictive.

H.R. 8363 would require that a qualified stock option, by its terms, not be exercisable while there is outstanding any qualified or restricted option granted at an earlier date. It is understood that the purpose of this provision—referred to herein as "serial exercise"— is to prevent the effective modification of the price of an outstanding option in the event of a decline in the market price of the stock by subsequent issuance of a lower priced option. There are many plans, however, which provide for the granting of stock options at regular intervals regardless of the market price action of the company's stock; the issuance of new options is not for the purpose of effectively modifying the price of an outstanding option. The proposal in H.R. 8363 would not distinguish such cases from those where additional option grants are merely to secure a price modification. We suggest that whenever an option plan approved by stockholders provides for annual—or periodic—grants of options on a consistent basis the serial exercise restriction should not apply.

As an example of such a case, under our plan "dividend units" are awarded annually to key employees, subject to prescribed limitations and depending upon

the employee's actual and prospective contribution to the company's success. Each dividend unit entitles the holder to receive for a certain period of years a payment equal to the dividends on a share of the company's common stock. Such participation in future earnings, although desirable, is not the equivalent of stock ownership, however, and most key employees are also granted stock options annually at the current market price. Upon exercise of a stock option a pro rata number of dividend units are terminated; thus, the optionee, through payment from his own funds, converts his right to participate in future earnings into full stock ownership. The relationship of current market price to outstanding option prices is not a factor in determining whether or not a new option is granted.

There are two objections to the application of the serial exercise restriction to options granted under such a plan. First, an optionee holding a "blocking" option (i.e., a higher-priced earlier option) should not be forced to wait until that option expires before being permitted to exercise an entirely unrelated option simply because it was granted in a later year. Second, an employee becoming an optionee for the first time could have an unfair advantage over another key employee who had received previous option grants, merely because the previously granted options represented "blocking" options.

The serial exercise restriction would seem to be particularly onerous when new options are granted for a term of 5 years (maximum permitted in the bill) while there are outstanding options expiring at a later date (granted under present law for terms up to 10 years). In such case, if the price of an outstanding option is higher than the new option price, the optionee must exercise the higher-priced option (which may not be economically attractive) in order to ever be in a position to exercise the new option, even though each option was granted independently under a plan providing for annual grants. While H.R. 8363 does provide that old options may be canceled prior to January 1, 1965, it seems manifestly unfair for an employee to have to cancel options granted in good faith under existing law, long before their expiration dates, in order to be in position to exercise options granted under the proposed law. Therefore, we suggest that the serial exercise restriction either be deleted from the bill or be modified to exempt those stockholder-approved plans which contemplate annual (or other periodic) option grants.

We recognize that the purposes of the 5-year maximum option term and the 3-year minimum holding period are to reduce the compensatory aspects of key employee options. However, these provisions are so restrictive that they would tend to defeat the stock ownership objectives of such options. In order to exercise options, employees must have sufficient time in which to accumulate the necessary funds. In many cases 5 years would be too short a time for the employee to reach a financial position where he is able to buy his option shares. Moreover, if he borrows funds for option exercise, a 3-year wait for favorable tax treatment seems unnecessarily long—particularly as compared with the 6-month wait that would apply if he invested in some company other than his own. Instead of correcting abuses and encouraging stock ownership, the proposed provisions would simply encourage option exercise and immediate sale merely for the small amount of profit that would be left after paying ordinary income tax. This, as we understand it, is the opposite of the intention of H.R. 8363. We suggest a 10-year term and a required holding period no longer than would apply to other securities.

Statement of General Motors Corp. With Respect to Group Term Insurance

The proposed Revenue Act of 1963 (H.R. 8363) as passed by the House of Representatives would impose, for the first time since adoption of the Federal income tax, a tax on the imputed current value to an employee of group term insurance paid for by his employer in excess of $30,000 face value, with such imputed value being subject to withholding tax. Group term insurance is currently made available to great numbers of employees by many employers as a means of providing protection to their families in the event of death. It has come to be an accepted feature of employment, is relied upon by employees for protection that would otherwise be beyond their means and, in some cases, be unavailable on any other basis. Its social value is generally uncontested.

The proposal to tax an employee on the imputed value of his group term insurance protection should be rejected on a number of grounds. The employee does not receive any cash value currently from an employer-paid premium nor is such value ever accumulated for his benefit, contrary to permanent life insurance. There would not appear to be any more reason to treat it as income than

the current value of workmen's compensation, unemployment insurance or the employer's contributions to social security benefits. Moroever, there would not seem to be any reason in sound tax policy for the particular limitation of $30,000, below which no tax will be imposed.

If abuses have developed in group term insurance as alleged, they should be remedied, without broad legislative action which would disrupt a method of insurance which has performed a worthwhile social and economic function for many years. Moreover, the undesirability of such action is underscored by the fact that only a small amount of revenue—$5 million—is estimated to be gained by reversal of the longstanding tax rules in this area and this result is obtained only at the cost of considerable complexity in compliance by taxpayers.

The proposal disregards the level employee contribution concept on which group term insurance is based. Instead, under the proposed bill, the amount to be included in each employee's income would be based on his attained age. Administratively, this would impose a burden on all employers providing employees with group insurance above the exempt level. A computation would be required for each employee of the amount of imputed income from the amount of insurance coverage during the period, the cost of such coverage based on the attained age of the employee and the employee's own contribution toward the insurance.

Moreover, the attained age concept does not recognize the "group" nature of the insurance involved. This results in inequities and discriminations. Older employees, subject to tax for the first time on such coverage, are discriminated against since a tax based on attained age overlooks the fact that in many cases the contributions made in earlier years may have exceeded the cost of the insurance at that time under the "attained age" concept. There would be a further discrimination in that two employees who have the same compensation and insurance (and who, in the case of a contributory plan, paid the same premium) would have a different tax burden simply because one is older. Furthermore, the older employee whose compensation and living standards have increased over the years and who has relied on increases in his group term insurance for estate planning, instead of purchasing additional life or term insurance at an earlier age and at lower cost, is penalized by action he could not reasonably anticipate because such legislation is unprecedented. Moreover, an employee whose services were terminated (other than by retirement) will have paid taxes during prior years as an employee but will have no insurance or accumulated value to evidence the "imputed value" on which he paid taxes.

In the event your committee should decide to accept taxation of the current value of group term insurance protection, in lieu of the attained-age method of computing premium costs provided in the House bill, an average premium cost to the employer should be used as a basis to measure employee benefits. Under the average cost approach, the tax would be based on the net average premium cost to the employer for each thousand dollars of coverage provided for all covered employees. This would enable employers to use a single rate for all employees in calculating the tax, instead of requiring a different rate for each age bracket. Administrative costs would thus be substantially reduced, and discrimination against older employees, many of whom have currently contributed for a long period of years, would be avoided. Its substitution for the House attained-age approach would aline the tax treatment with the generally accepted concept that group insurance provides blanket rather than individual coverage for a constantly changing group of employees.

However, modification of the proposed legislation to eliminate or minimize the inequities and burdens outlined above does not solve the problem. Your committee is urged to consider removing from the House bill a provision which will discriminate among employees, produce little revenue, burden employers with higher costs and subject employees to tax on unrealized income which must be met out of other income.

NEW YORK, N.Y., *November 29, 1963.*

Re H.R. 8363.

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

DEAR SIR: I hope you will oppose passage of the above bill providing for an income tax to the individual on premiums an employer pays for group life insurance in amounts exceeding $30,000, for the following reasons:

1. Passage would discourage adoption of plans providing adequate amounts of group life insurance for employees. Employers would think in terms of a $30,000 maximum in the future. This would mean that lower salaried employees and wage earners would be insured for probably $1,500, whereas the minimum now is usually $4,000 or $5,000 when key employees and officers are covered for amounts well above $30,000.

It seems to me it would be a mistake to discourage plans providing adequate amounts of life insurance for people at all levels of employment. The benefits paid through group life insurance are making a great contribution to the economy in providing funds for families in every walk of life, thus reducing the obligation of the Federal Government to care for families in serious need following the death of the breadwinner.

2. The anticipated tax revenue to be gained from this bill is estimated at only $5 million annually, possibly only enough to cover the cost of its administration. Beyond this, employers will be subjected to costly and very complicated recordkeeping to produce the relatively small amount of tax revenue anticipated.

3. Passage of this bill may very well be only the beginning of further efforts to tax employees in other areas, such as for hospital and surgical plans financed in whole or in part by employers. This would have a further limiting effect on the interest of employers in helping employees obtain protection for themselves and their families. Without adequate group health plans of this kind, the Federal Government would need to subsidize greatly increased costs of hospitalization and medical care for millions of citizens who would be unable to meet these ever increasing expenses without the help of their employers.

When I first entered the insurance business in 1926, the first $40,000 of an individual's life insurance was exempt from Federal estate tax, but this exemption was removed a number of years later. If H.R. 8363 should be passed, it would unquestionably have the effect of limiting many plans in the future to much smaller amounts of life insurance for key employees and officers. The result of this will be that what the Federal Government may gain from the income tax may well be more than offset by the loss it will sustain from smaller revenues from the Federal estate tax.

Sincerely yours,

PAUL DE F. HICKS,
Consultant, Employee Benefit Plans.

CONSOLIDATED EDISON CO. OF NEW YORK, INC.,
New York, N.Y., November 20, 1963.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

MY DEAR SENATOR BYRD: I would like to take this opportunity on behalf of our company, Consolidated Edison Co. of New York, Inc., to lodge a formal objection to those provisions of the proposed amendment to the 1954 Internal Revenue Code (H.R. 8363) dealing with group life insurance; more specifically, proposed section 79.

While the original administration proposal was intended to equate the amount of group life insurance coverage with the death benefit exclusion, presently in the law, the changes made by the Ways and Means Committee are apparently aimed at a procedure whereby a corporation can make it possible for their employees to avoid payment of taxes by purchasing unusually high life insurance policies in lieu of salary.

We recognize that this apparent purpose is consistent with current established tax policy; however, we take the position that the amendment is unsound as presently drafted.

In their efforts to prevent the aforesaid type of tax avoidance, the draftsmen have made the provisions of proposed section 79 so broad that, rather than correct existing abuses, they would impose unreasonable and harsh burdens upon employees and companies where no such design for tax avoidance exists.

Consolidated Edison Co. of New York, Inc., has a group life insurance plan which would fall within the provisions of section 79 of the proposed legislation. However, we feel that these provisions should be revised so as not to apply to plans such as we have.

Like innumerable other companies, Consolidated Edison's group life insurance plan is based upon a uniform formula whereby the amount of insurance coverage

provided is equal to a fixed multiple of annual salary; in our case one and one-third times an employee's salary. Our plan does not discriminate in favor of those employees who happen to be executives, by giving them an individual windfall tax advantage. Under the formula everyone is treated equally, from the janitor up to the president of the company and the chairman of the board.

Obviously, the amount of coverage provided for executives under plans such as ours exceeds that of newer and lower paid employees, but this is not a substitute for salary which otherwise should be received by executives and rightfully reported by them as ordinary income. Like the normal improvement in other fringe benefits, such as pensions, progressively increased insurance coverage represents reasonable recognition for many years of valuable service while ascending the ladder of increasing responsibility in the company.

The availability of such an insurance program has been a significant inducement to qualified people to accept employment with this company. The proposed legislation would not only adversely affect this condition of employment, but would also impinge upon our contractual undertakings with employees.

We, therefore, urge that an exception to the proposed provision be made applicable to companies which have plans such as ours, where the amount of coverage is determined uniformly for all employees in accordance with a fixed formula. Such an exception could be applicable to plans which are based upon uniform formulas expressed in multiples of annual salary, with a statutory limitation upon such multiple, such as "two times annual salary."

We also advance the following additional reasons why proposed section 79 should not be enacted in its present form. It would discriminate unfairly against those employees who receive more substantial salaries. It would have a serious disruptive effect upon many plans and would impair plans such as ours, which have been an important factor in the maintenance of sound employee benefit programs. Under our plan, the administration of the proposed inclusion as a part of ordinary income of so much of the premium paid by the employer on coverage in excess of $30,000 would be unreasonably onerous. Finally, we do not believe that the revenue advantages to be gained from the amendment justify the resulting disadvantages and hardships.

We respectfully urge you and your committee to thoughtfully consider these matters and propose amendments in accordance herewith.

Under separate cover we are sending you 25 copies of this letter for whatever convenience they may serve.

Very truly yours,

B. E. GALLAGHER, *Vice President.*

MILLER ELECTRIC MANUFACTURING CO.,
Appleton, Wis., November 19, 1963.

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

MY DEAR SENATOR BYRD: We understand that the Senate Finance Committee under your chairmanship is presently in the process of holding hearings on the new tax bill. One of the proposals seems to involve the taxation of employer-financed group term life insurance in excess of $30,000 (originally $5,000).

As a small manufacturer, we take a strong stand in opposition to this provision. Since none of the people here at Miller Electric come under this provision, we feel we can take this stand on moral and practical grounds without being accused of having a personal ax to grind.

We view this provision as simply another effort to stifle the basic private enterprise system. Quite obviously, no one can realistically believe, in view of the associated administrative cost, that any substantial amount of tax revenue would accrue. The proposal evidently is designed, as one of its aims, to seriously limit amounts of group life insurance that can be carried.

If the principle is once established, it can, like a cancer, grow to such proportions that it will encompass a tax levy on all fringe benefits. Then there may well be taxation on health insurance, workmen's compensation, etc. Setting the limit at $30,000 simply begs the issue of the fundamental principle involved. The limitation reiterates the principle that "the best tax is the one the other fellow has to pay." I'm sure that if the amount of the measure were clearly spelled out as a "tax on fringe benefits," the objections from the constituents would be very vocal to say the least.

I sincerely hope that you will exert all possible efforts to expose this portion of the bill in its true light and will see fit to oppose this phase of the bill.

Sincerely yours,

G. K. WILLECKE,
Director of Research, Member of Executive Committee.

P.S.—I am taking the liberty of mailing copies of this letter to all members of your committee and to the two Senators from Wisconsin so that our stand can be made well known.

DENVER, COLO.

SENATOR HARRY F. BYRD,
Chairman, Senator Finance Committee,
Washington, D.C.

MY DEAR SIR: I wish to testify upon that part of the Revenue Act of 1963 having to do with the inclusion in the gross income of an employee of an amount equal to the cost of group term life insurance on his life carried directly or indirectly by his employer.

Specifically, I urge the committee to make the following changes in the Revenue Act of 1963.

Page 39, lines 4 and 5 to be deleted.

Page 39, lines 10 through 17 to be deleted.

These deletions would mean that all premiums paid by an employer for group term life insurance on the life of an active or retired employee would be included in the employee's taxable gross income.

This inclusion in gross income is both necessary and just for the following reasons:

1. The additional revenue provided by this inclusion is desperately needed by the Government to reduce deficits in the Government's cash budget. Deficits can be financed only by borrowing at ever higher rates of interest from future generations (who surely will have financial problems enough of their own without having to pay for their forebear's errors), or by printing Federal Reserve bank notes without adequate amoutns of gold to back them.

An ever-increasing Federal debt with ever-increasing rates of interest can result in a time when the Government's revenues will not even be sufficient to pay the interest on that debt.

Printing Federal Reserve bank notes without adequate gold backing can lead at worst to "bank runs," even against a central bank as strong as the Federal Reserve System, and at best is a primary cause of price inflation and price inflation is the cruelest tax ever devised by man. Price inflation affects all men exactly alike and with no deductions and no exclusions and in addition prohibits countermeasures on the part of those people our society tries the most to protect—the aged and the infirm. The woman who cleans my apartment can no longer live on her savings and at the age of 73 must resort to working 4 or 5 days a week to support herself.

2. There are many millions of workers in the United States who are not and cannot be covered by employer financed (pretax) group-term life insurance.

Employer financed group term life insurance is yearly renewable term life insurance. This fact means that the rate charged by the underwriting life insurance company is adjusted annually upward or downward depending upon whether the mortality rate within the covered group is higher or lower than anticipated. Hence the larger the covered group, the more near normal is the mortality rate within the covered group. Thus, many life insurance companies will not insure smaller groups of workers and many States have legislation which restricts the minimum number of people in a group to be covered by group life insurance to 25. Many States do have special statutes which permit "baby groups" to have employer-financed group life insurance. ("Baby groups" are defined to be 10 to 24 persons.)

I know of no way to write employer-financed group term life insurance for groups of less than 10 employees.

However, generally speaking, the smaller the number of employees in the group, the more hesitant is the underwriting life insurance company to accept the risk and the higher the rates for the insurance (and hence the greater is the loss of revenue to the Government).

Many people are in vocations which permit them to work either for themselves, for a small company with few employees, or for a large company with many employees. Hence, chance and chance alone determines the availability of employer-financed group term life insurance with its attendant tax advantages.

Self-employed accountants as opposed to accountants working for a large employer.

Independent actuaries as opposed to actuaries working for large insurance companies.

Owner-operators of small advertising agencies as opposed to employees of large advertising agencies.

Secretaries working for a small company as opposed to secretaries working for a large company.

Independent consulting engineers as opposed to engineers working for a large company.

The list is endless.

Also to be considered is the fact that the size of a business may depend solely upon the size of the community in which it operates.

Hence, a large bank in Denver, Colo., may have employer-financed group life insurance but a small bank in Lamar, Colo. (the home of the Honorable Senator Gordon Allott), may have too few employees to get the tax advantage of employer-financed group term life insurance. This size difference in the area of operation applies equally to all types of businesses such as department stores, automobile sales companies, bakeries, and savings and loan associations—again the list of comparisons could be endless.

Finally, there are hundreds of thousands of businesses throughout the United States that simply never have more than nine employees regardless of location and even counting transient help which life insurance companies do not count in determining the size of a business.

Radio and television repair shops, restaurants, barber and beauty shops, small independent finance companies, automobile service stations, etc. Again the list could be endless.

3. Large quanties of employer-financed group term life insurance per person is offered by contractors to the Defense Department. This includes both prime contractors and subcontractors. Hence the cost of our defense program is increased as a result of employer-financed group term life insurance.

4. In my own case, I have employer-financed group term life insurance and would have to pay higher income taxes if my suggestions are adopted. However, many of my clients would increase their own personally owned life insurance programs if they lost their employer-financed group term life insurance and my income would increase. How much it would increase, I don't know. Many men will not buy life insurance on their own to replace life insurance they used to get free or partially free. They don't care for their wives and children enough.

5. Group term life insurance and all of its advantages except the income tax advantage would still be available to companies to their employees although I suspect the primary reason for its existence is the tax advantage.

6. It is likewise unfair that a retired employee who has worked by chance for a company that has employer-financed group term life insurance should have his life insurance financed by pretax dollars after he has retired while someone who has worked for himself or a company that for some reason did not have or could not have employer-financed group term life insurance must pay for this same protection out of after-tax dollars after he has retired.

Sincerely yours,

NORRIS E. CHAPMAN.

THE OHIO CRANKSHAFT CO.,
Cleveland, Ohio, November 20, 1963.

HON. FRANK J. LAUSCHE,
U.S. Senate, Washington, D.C.

DEAR SENATOR: In connection with the new proposed tax bill (H.R. 8363) pertaining to the provisions of the bill which would classify as income subject to tax and subject to withholding, any premiums paid by an employer on group term life insurance granted to employees in insurable amounts of over $30,000, we should like to make the following comments.

It is our opinion that the proposed House bill encroaches upon the area of insurance regulations which should remain the responsibilities of the individual States, and further that the tax revenue expected to be raised under this provision is so small that the paperwork involved and special handling of the few instances on individuals where taxable income arises by reason of premiums on group insurance in excess of $30,000 would require clerical effort far in excess of the benefit derived.

For example, in our company our employment approximates 950. The number of employees who carry in excess of $30,000 of group insurance is two; and the rate per $1,000 is 93 cents a month, of which 50 cents a month is paid for by the employee. The maximum insurance coverage limit by any employee of our company is $40,000. Therefore, $10,000 at 93 cents per $1,000 per month amounts to $9.30 per month, times two employees, or a total of $18.60 per month on which we would have to withhold taxes beside the withholding on our regular payrolls. In the reconcilement of withholding taxes paid, we would, therefore, entail clerical effort in not only reconciling payroll dollars but in a very few instances also insurance premiums which would complicate the reconcilement. The total premium involved for a year at the rate of 93 cents per $1,000 would amounts to $223.20 of taxable income for the entire year. In our opinion, this is certainly the tail wagging the dog.

On a broader concept, getting away from our own particular inconvenience, the income tax law and regulations with respect to compensation or remuneration states, in effect, that remuneration is an allowable tax deduction provided that it is reasonable and not excessive. Whether compensation is reasonable and not excessive depends upon the interpretation of all the facts and circumstances of the case. Now, Congress attempts to define a minor part of "compensation"; namely, group insurance premiums, and applies a specific formula, regardless of circumstances, for its includibility in income. Such action only complicates the already more than complex tax laws and regulations, and incites the attitude of the taxpayer to indifference to a law too voluminous and detailed to understand.

Wouldn't it be more acceptable to predicate the income includibility feature for group insurance premiums also on the basis of "reasonable and not excessive" in the light of all the facts and circumstances? Unreasonable premiums could then be disallowed as a deduction for the payer and includible in income for the insured.

Any efforts you can assert in defeating the new provision regarding group insurance premiums in the new tax law would be a service to employees, employers, and the country in general.

Very truly yours,

PAUL T. KOENIG, *Secretary and Treasurer.*

STATEMENT OF NORMAN F. DACEY, PRESIDENT, NORMAN F. DACEY & ASSOCIATES, INC.

My name is Norman F. Dacey, and I am the president of Norman F. Dacey & Associates, Inc., a firm of financial consultants and trustees with offices in Bridgeport, Conn. By way of stating my qualifications: For the past 34 years, I have been engaged in professional estate planning. I have lectured on the subject at public forums, at universities, national conferences, and on radio and television. I am the author of something over a hundred articles and books which have been used by more than 10,000 banks, insurance companies and investment firms in their estate planning work. I am the author of a book titled "What's Wrong With Your Life Insurance," which came out 5 months ago and which, happily, is in its third printing. When I was writing that book, I disclosed to the Senate Antitrust and Monopoly Subcommittee some of the information which I had uncovered. The committee was astonished at the facts and asked me to deliver a copy of the manuscript to it the same day I delivered it to the publisher—which I did.

Your committee is being asked to approve or disapprove a statutory change which will affect the tax deductibility of interest on loans made to finance the purchase of life insurance. If you are adequately to evaluate the propriety of such a statutory change, it is important that you know as much as possible of the background of circumstances which led to the suggestion that a change be made, and that you be aware of the motives which have inspired in some quarters vigorous opposition to the proposed change. To that end, I should like briefly to review a situation of which I suspect you may not be aware.

Life insurance is probably the most misused thing in our economic world. We all think of it as "protection," as a device for providing an estate for our heirs if we have not lived long enough to accumulate one ourselves. We are accustomed to seeking "protection" in other areas—we buy insurance on our automobiles, and fire insurance on our homes. In such instances, we pay the insuring company just the cost of providing the needed protection. We would not think

of sending the fire insurance company an extra $100 with a note asking that it be put aside in a savings account to be returned to us after 20 years, or at age 65 or age 100. No, if we wanted a savings account, we would open it with a savings bank, not with a fire insurance company. Consider, though, the phenomenon of life insurance—the vast majority of Americans have been educated— "brainwashed" might be a better word—not only to buy protection from life insurance companies but also to set up savings accounts with the companies.

Fire insurance companies do not sell savings accounts but let us assume for the moment that they do. Let us assume also that some time ago you purchased a fire insurance policy and you also opened a savings account with the fire insurance company. By last week, you had accumulated $3,000 in your savings account. You had a fire at your house which did $5,000 of damage and you promptly filed a claim for that amount. This morning's mail brought you a letter from the insurance company. Enclosed were two checks. One, for $3,000, had a note attached saying: "Here's your savings account." The other, for $2,000, had a note saying: "Here's the insurance money." You were perplexed, perhaps indignant, and you telephoned the company for an explanation. Where did they get off, you demanded to know, using your savings account to help pay the claim for the loss you suffered under your fire insurance policy? Patiently, the company explained that that's the way this insurance policy/savings account combination works—if you have a claim, they use your savings account to help pay it. Too late, you discovered that you were carrying 60 percent of the risk yourself, while the company carried only the remaining 40 percent. Too late, you realized that the insurance/savings "package" was simply a device for transferring the risk from the insurance company's shoulders to your shoulders.

In the field of fire insurance, there is no such package—for the simple reason that no one would buy it. In the field of life insurance, the combination does exist, however, and the vast majority of Americans have fallen victim to it. Life insurance companies go to great lengths to avoid seling "protection" alone, and all of their advertising and salesmanship is dedicated to selling the savings/insurance package which they call "cash value insurance" or "permanent insurance."

Pure life insurance protection is called term insurance and all policies issued are either term insurance by itself or term insurance in conjunction with a savings account. Whole life policies, 20-payment life policies and endowment policies are all varieties of the insurance/savings account package. Like the fire insurance "package" we just examined, they are al devices for gradually shifting the risk from the insurance company to the insured himself.

Insurance companies love to sell these package plans for obvious reasons. When you die, a substantial part of the death payment is your savings account coming back to you. Before you die, the insurance company has the use of your savings account for many years. It puts it to work and pays you only half of what it earns.

Conversely, insurance companies hate to sell term insurance. Every dollar that they pay to your beneficiary comes from their pockets, none of it from yours, and they don't have that savings account to help build profits for them. They discourage the sale of term insurance by paying their agents a reduced commission on such policies and by denying them volume credit toward company sales contests and membership in such sales achievement groups as the million dollar roundtable of big producers. For these reasons, most insurance men decry the purchase of term insurance and work ceaselessly to sell the idea of the insurance/savings "package." Only a small minority of laymen know about term insurance but education is progressing and more and more people have been demanding it. Bearing in mind the vastly reduced commissions to the agent who sells this form of policy, it is understandable that the life insurance fraternity cast about for a way to sell cash value insurance at term insurance rates. It came up with "bank loan" insurance, and the home offices cooperated by designing special policies with high first-year cash and loan values.

Approaching a prospect in a high tax bracket, the agents suggests that he purchase one of these special policies calling for a premium of, say, $1,000 per year. Pointing out that the policy will have a first-year cash and loan value of $700, the agents offers to negotiate a $700 loan with a bank using the insurance policy, when issued, as collateral. The first year's premium is thus paid by a net outlay of $300 on the part of the client plus a $700 loan from the bank. The agent represents to the client that this arrangement is cheaper than buying regular term insurance. At the end of the first year, the second year's premium

is paid by another $300 outlay by the policyholder, plus a new loan of an additional $700 from the bank. This latter is covered by the $700 increase in the loan value resulting from the payment of the second year's premium. In addition to the $300 net premium, the client pays the bank the interest on the $700 borrowed the first year. One of the claimed advantages of the plan is that the interest payable to the bank on the steadily increasing loan is tax deductible.

The agent has sold a policy with a premium of $1,000—and he is paid a commission of about 35 percent of that premium, or $350. But, you will recall, the purchaser paid a net premium of only $300. Who paid the difference? And what about the other expenses of putting the business on the books—underwriting, medical examination, agency expenses, advertising, setting up records, etc.? Who paid those?

The answer, members of the committee, is simple. You did.

The deficit was charged to "surplus." The "surplus" is your money, the undistributed profits from the operations of the life insurance company which were never distributed to the policyholders in the form of dividends but instead were sequestered in a fund ostensibly for the greater safety of your policy and its guarantees.

I ask you to observe what has happened: The agent has sold a policy which satisfied the buyer's demand for low-cost term insurance, but he has been paid a commission for selling the more expensive cash value insurance.

New York insurance laws include a very important section 213 which prohibits a company from paying first-year sales commissions exceeding 55 percent of the first-year premium. But bank loan insurance established a high premium for the record and permitted the company actually to pay out in commissions more than the new policyholder had paid in to it in premiums.

In the low-interest-rate period of the early 1950's, bank loans could be had at very low rates. The banks did not guarantee the rates, however, and as the rates rose by as much as 25 or 35 percent, purchasers of such plans found that the cost of carrying the policies was greater than they had been led to expect. Under the pressure from the field forces, many companies then brought out a "minimum deposit" policy, identical with the bank loan contract except that here the company itself agrees contractually to loan the money to the policyholder, making it unnecessary for the agent to negotiate a loan from a bank. The advantage of the minimum deposit policy is that the buyer is assured of his loan at an agreed date which is not subject to increase.

Agents have sold these policies with the claim that they are cheaper than pure term insurance. If it costs *a* dollars to insure a man of 40 for $1,000 for 1 year, how can the company sell him the same $1,000 worth of protection any cheaper than that simply by shuffling its own money around? The company cannot. The company can accomplish this only by taking the money from the surplus built up by its older policyholders to make up its loss—and that is what it does.

This year, approximately 18 million individual life insurance policies will be terminated in the United States. About 70 percent of these will be terminated with no benefit whatever to the policyholder. It is impossible to calculate the loss which this represents to those policyholders. The policyholders who terminate the remaining 30 percent of the policies will sustain an out-of-pocket loss which I estimate to be in excess of $1 billion.

A very large percentage of these terminations will have been instigated by agents incidental to the sale of bank loan or minimum deposit insurance. The life insurance fraternity is using its claim of a tax benefit as the basis for a massive campaign to churn the life insurance estates of Americans.

Some companies have refused to sell minimum deposit insurance despite pressure from the field force for a policy with which to compete with the agents of other companies. L. S. Norman, actuary of the American United Life, has pinpointed the objections of this group, saying:

"Minimum deposit insurance is hurting the good name of life insurance. How can there possibly be anything to borrow that has never been paid in or earned on the policy?"

Another company wrote to its agents:

"Your company has been increasingly concerned about the long-term social and economic aspects of minimum deposit insurance. We have withdrawn the policy because, in our opinion, it cannot be sold for the long term on an economically sound and socially proper basis."

Spencer L. Kimball and Bartlett A. Jackson, in their book "The Regulation of Insurance Marketing," state:

"The minimum deposit plan is very popular with many agents because it provides a relatively high commission * * * for a plan requiring only a small

cash outlay, and with policyholders because of its tax advantages. The plan has allegedly led to misrepresentation, incomplete comparison, misleading advertising, and replacement of existing coverage."

Robert W. Smith, general counsel of Union Mutual Life, in an authoritative paper on minimum deposit insurance, concluded:

"It is obvious that without the tax deduction, the policyholder would be better advised to purchase term insurance. Moreover, the tax deduction is a matter of legislative grace, and not every policyholder can be expected to maintain over a long period of years the same relatively high income tax bracket.

"Without the tax deduction, it seems unlikely that financed insurance plans would have any real purpose or attraction for anyone."

Carl H. Fischer, professor of insurance and actuarial mathematics at the University of Michigan, reported the findings of an actuarial study done on an IBM computer in this unequivocal statement:

"If there is no tax advantage, there is never a time when a loan plan is cheaper than term insurance."

The New York State Insurance Department looked at minimum deposit insurance and concluded:

"Much explanation for proper understanding is omitted from the illustrations and the result is that the prospect is not generally informed that the maintenance of the maximum loan will ultimately result in a decrease in the insurance coverage accompanied by an increase in cost. In connection with minimum deposit high cash value policies, the prospect may not be advised that his position would change if his income should decrease so as to put him in a lower tax bracket or if the income tax laws should change. Such policies have also been sold to people with only moderate or low incomes who would not enjoy the tax advantages mentioned in connection with the sale of such policies. Furthermore, from the nature of the high cash value minimum deposit plan, including the maximum policy loan feature, it is expected that the lapse rates will be high as the policies get older. It is common knowledge in the life insurance business that existing regular policies are being replaced by high cash value minimum deposit policies to the detriment of policyholders. The replacement has been effected in many instances by withholding information essential to the policy holder to arrive at a proper decision."

Representatives of two large national organizations of life insurance salesmen have appeared before your committee to plead for your disapproval of the proposal to restrict interest deductions in connection with their sales of minimum deposit insurance. I suggest that they did not come with clean hands. I suggest that they were here to do what they could to perpetuate an unwholesome situation which is costing the American people untold millions of dollars each year. I suggest that they see in the passage of the proposed new tax rule a serious blow to their continued enticement of great numbers of our people into unsuitable life insurance policies with the bait of a tax benefit.

One of the organizations which appeared before you was the National Association of Life Underwriters. This organization and its Washington representative, Carlyle Dunaway, are registered lobbyists. Last year, they conducted a massive lobbying effort in the Congress to defeat the proposed reopening of GI insurance. It was completely successful. Federal law requires such organizations to file quarterly reports of all such lobbying activities. The Clerk of the House of Representatives states that these people have filed no reports whatever since 1960. If left to their own devices, they will probably file no report of their lobbying efforts before your committee to defeat this tax proposal.

In 1961, the outgoing president of the same National Association of Life Underwriters said:

"Present practices represent a breakdown of the moral precepts and ethical standards, concepts which once played such an important role in building the life insurance business."

In his testimony before your committee, the representative of the National Association of Life Underwriters spoke feelingly of the need of young doctors to borrow premiums from insurance agents and from insurance companies "until they can earn enough to repay the loans." Clearly, he intended to leave you with the impression that the loans involved in these purchases of financed life insurance are in fact temporary loans to see the policyholder through a time when he cannot pay the premiums. Actually, the policyholder pays the premium for the protection—it is the premium for the savings account which is involved in the loan. That loan will never be paid off. To the best of my knowledge, there is no recorded instance of such a loan ever having been paid

off. It is purely and simply a gimmick to sell cash value insurance and thus collect the larger commission applicable to such policies rather than the smaller commission applicable to term insurance. It is a device for evading section 213 of the New York insurance laws limiting commissions to 55 percent of the premium.

To the extent that these minimum deposit insurance policies are represented as cheaper than regular term insurance, they are a fraud perpetrated upon the purchasers. To the extent that the excessive commissions paid on the policies are deduced from the surplus funds accumulated from the earnings on the contracts of older policyholders, they are a fraud perpetrated upon such older policyholders.

The other organization which appeared here to oppose the new restriction on deductions was the Association for Advanced Underwriting. It may be helpful to your committee if I quote here from a warning to the membership written by last year's president of the organization:

"In an almost complete disregard for commonsense, we permit practices and accept standards which are conceived out of avarice and greed, with little concern for the policyowner's long-term interest.

"I have cautioned against delusions that we are above reproach and called for a reawakening of the need to exercise our responsibilities. It may be too late for the answers if we wait until the public raises the questions. Certainly, it will be too late for answers if we find ourselves bogged down in a morass of bureaucracy resulting from a congressional investigation.

"It has become apparent that the speculative fever which has dominated our Nation's business for the past decade has crept into the life insurance business. Longstanding traditions have been swept aside by the siren promises of increased production. Carefully husbanded surplus reserves created by years of conservation are financing the free-swinging battle to acquire new policyholders."

(The above is a reference to the improper invasion of surplus which I have already described to you.) Let me continue with the quote:

"'How big' has replaced 'how sound.' New companies, many with little to contribute to society, are 'going public' because life insurance stocks are 'hot.' Looked after by State insurance departments, we remain the only financial institution not governed by Federal laws. * * *

"We have but little time to reverse trends which, unless reversed, will make us the target of a new investigation. For, as an industry, all are tarred with the same brush. Indictment of one will be an indictment of all. No one will escape the demands for greater public control and policing. Our history books are crammed with examples of bureaucracy moving in where self-policing failed. Our only alternative to Government action is self-respect, self-policing, and self-enforcement. If an important segment of our industry does not awaken to responsibilities owed the policyholders, we're going to deserve the restrictions which will be imposed by new Federal legislation. We won't like it; but once on the statute books, it will never be repealed.

"Recent articles dealing with replacement have ignored the policyholder's interest, to deal instead with the loss to the company due to the lapse. We have suggestions that if lapses and replacements continue to mount, dividend projections based upon previous experience, prior to the high lapse rate, will suffer. We have other suggestions that present commission schedules with high 'front money' will have to be adjusted, so that the agent bears his share of the policy's failure to stay on the books.

"An individual or an industry which considers itself above reproach and underestimates the force of public opinion is riding for a fall.

"We need no further headlines. We need no further legislation, but we do need some honest reevaluation and self-policing of the abuses against the policyholder."

Finally, let me present the testimony of Michael H. Levy, president of Standard Security Life Insurance Co.:

"Who is responsible for this unholy mess in which we now find ourselves? * * *

"A huge percentage of loan-financed insurance has been sold to people for whom it provided absolutely no tax benefit. It was easy to sell, people thought they were getting something for nothing. But the huge lapse rate of such policies is outstanding proof of bad service to the public.

"Every one of us must face up to our responsibility in this crime against those who have been trusting us."

From the facts which I have related here, your committee will, I hope, conclude that the whole system of borrowing against new life insurance policies to pay the premiums due on such policies is part and parcel of a life insurance industry sales effort which constitutes a financial rape of the American people. Implicit in that sales effort is the promise of a tax benefit from the borrowing, however nebulous that benefit may be. It is a principle of tax law that a tax advantage may not be achieved by a transaction having no purpose other than to create or obtain such advantage. The procedures involved in financed insurance have that purpose, aside from their primary purpose of enrichment of the insurance agent. Your committee can deal a blow to that scheme by making illegal the bait used to lure new policyholders into the trap. I quite realize that it is not your province to regulate the life insurance industry. But in the absence of any Federal regulation whatever and with State regulation a farce, it can be a source of gratification to you that your decision to support the proposed interest deductibility restriction will serve effectively to help end the exploitation of policyholders which I have here described to you.

People who have purchased cash value life insurance and who have accumulated savings accounts with the life insurance companies do have emergency needs, and the record shows that they do call upon the insurance companies for their money. I shall not dwell here upon the foolishness of lending money to an insurance company at 2½ percent interest and then borrowing it back at 5 percent interest. However unwise the person who enters into such an arrangement, he should still continue to be entitled to deduct the interest he pays to thus borrow back his own money to meet an emergency need. Such borrowing has not as its purpose the securing of a tax advantage. It is my opinion that the proposed restriction upon interest deductibility will adequately meet the legitimate needs of those who must borrow, while at the same time restricting the operations of unscrupulous persons who have used this tax loophole for personal gain.

HEALTH INSURANCE ASSOCIATION OF AMERICA,
Washington, D.C., December 4, 1963.

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

DEAR SENATOR BYRD: On behalf of the Health Insurance Association of America I submit the attached statement in opposition to section 204 of H.R. 8363 now pending before your committee. I respectfully request that this statement be made a part of the hearing record.

Very truly yours,

PAUL M. HAWKINS,
Washington Counsel.

STATEMENT OF THE HEALTH INSURANCE ASSOCIATION OF AMERICA IN OPPOSITION TO SECTION 204 OF H.R. 8363

On behalf of its 308 member insurance companies which write over 80 percent of the health insurance issued in this country by insurance companies, the Health Insurance Association of America respectfully requests that your committee reject section 204 of H.R. 8363 creating a new section 80 of the Internal Revenue Code. While the intended purpose of section 80 is to attempt to correct certain abuses in the field of health insurance, careful study leads to the conclusion that it would not accomplish its objective; indeed, it would create greater inequities than it would solve. The following points are submitted in support of this contention.

I

First, in recent years there has been a growing awareness of the serious nature of the overinsurance problem. For example, in November 1962 the New Jersey Hospital and Medical Legislative Study Commission found that overinsurance "furnishes the insured individual with a 'profit' incentive which is contrary to public interest," that it "encourages some patients' demands on the practicing physician for unnecessary hospital confinements and unjustified prolonged hospital stays," and that it is "a contributing factor to spiraling hospital costs * * *." Similarly, in May 1962 the Council on Employee Benefits submitted a resolution to the National Association of Insurance Commissioners reciting its findings that overinsurance "generally reduces an employee's incentive to control

costs, tends to increase usage, creates demands for unnecessary and deluxe services, delays recovery," and in other ways tends to "decrease the effectiveness of medical care coverage and to increase its costs * * *." Such factors, coupled with the inadequacy of the present overinsurance provisions of the uniform individual accident and sickness policy provisions law, led to the necessity for amendment of these provisions.

The National Association of Insurance Commissioners, consisting of the State insurance commissioners who are responsible for regulation of the insurance business, has been aware of the overinsurance problem and has been working toward an effective solution of this matter. Such efforts began in December 1959 when the NAIC asked the Health Insurance Association of America to review the adequacy of the overinsurance provisions of the uniform individual accident and sickness policy provisions law. Pursuant to such request, HIAA has repeatedly conferred with the NAIC Subcommittee on Overinsurance and has submitted six status reports on overinsurance to the NAIC. The first was submitted in May 1960,[1] the second in November 1960,[2] the third in November 1961,[3] and the fourth in June 1962,[4] the fifth in October 1962,[5] and the sixth in May 1963.[6] As a result of an October 16, 1963, conference between the HIAA staff and the NAIC Subcommittee on Overinsurance, a seventh and final status report on overinsurance will be submitted for consideration at the December 1963 meeting of the NAIC.

This final report will contain a revision of the overinsurance provisions of the uniform individual accident and sickness policy provisions law as agreed upon at the October 16 conference. There is every reason to believe that the report will be approved at the December 1963 meeting of the NAIC.

It should be emphasized that the policy provision approach attacks the overinsurance problem at its roots and accordingly should afford a complete and practical solution to the problem. At best, the tax approach, as embodied in section 80, would offer only a limited deterrent to the overinsurance problem by taxing a part of the so-called gain derived through overinsurance.

In the light of the foregoing, we are of the opinion that it would be unfortunate for the Congress to enact section 80 because we believe it would impede the efforts of the insurance commissioners and the health insurance business to provide an effective solution to the overinsurance abuse, through the means of direct regulation of insurance policy provisions. Moreover, the enactment of section 80 would create, as indicated below, additional burdens and inequities.

Second, the concept of the new section 80, irrespective of the language used, concerns the insurance business by reason of the possible analogy with the existing requirement that banks and insurance companies report to the Internal Revenue Service certain amounts paid as interest. It would be a physical impossibility, especially in the group insurance field, for insurance companies to report the names and addresses of all persons to whom health insurance benefits are paid. Under the prevailing group insurance practice, the insurer undertakes to indemnify the employees of a particular employer, or members of a particular union, without having any record of the identity of such employees or members. Indeed, the membership of a particular union and the employees of a particular employer are constantly changing, in varying degrees depending upon the type of industry, and the cost of group insurance would be increased significantly if the insurer were required to maintain a record of the names and addresses of all covered by a group contract. Inasmuch as dependents are often covered under group contracts, it would also be necessary for the insurer to maintain a record of all changes in dependency by reason of marriage, divorce, birth of children, etc. The cost of such a burden upon the insurer would virtually destroy modern group insurance practices as well as the economical coverage provided thereby.

II

While the two foregoing points constitute the major reasons why the new section 80 is inappropriate as a part of the tax law, we are also troubled by the manner in which this section purports to implement the policy.

First, the section embodies a per illness or per disability concept, as distinguished from a calendar year approach, for the determination of the taxable

[1] Proceedings of the NAIC, 1960, vol. II, pp. 549–564.
[2] Proceedings of the NAIC, 1961, vol. I, pp. 331–338.
[3] Proceedings of the NAIC, 1962, vol. I, pp. 90–96.
[4] Proceedings of the NAIC, 1962, vol. II, pp. 370–387.
[5] Proceedings of the NAIC, 1963, vol. I, pp. 85–94.
[6] Proceedings of the NAIC, 1963, vol. II (page citation not yet available).

profit from health insurance. Where a person has two separate and distinct injuries in 1 year he might have excess reimbursement as to the first disability and less than full reimbursement for the second. This could result in a person being taxed when, from an economic standpoint, he actually had a medical loss. For example, a person might be ill in February and incur $700 of medical expenses and receive only $400 of reimbursement. Then, he might have a second illness in November and incur $150 of medical expenses and receive $175 of reimbursement. Under the per illness approach contained in H.R. 8363, this person would have, with respect to the first illness, a medical deduction of $300 (subject, of course, to the 3 percent floor), and, with respect to the second illness, $25 of income under section 80. We submit, from an economic standpoint, that this person really had a net medical deduction of $275 ($300 less $25) and should not be subject to tax on the $25.

On the other hand, if the amendment required aggregation of expenses and reimbursements for each taxable year, this could easily lead to tax avoidance in various cases. For example, a person might be injured in the winter of 1 year, incur medical expenses and be reimbursed in the same year under one policy. Reimbursement under a separate policy might be delayed, however, until the following taxable year. A similar situation might be involved where an injury under one policy takes place in 1 year and the reimbursements do not take place until the next year. We can even envision, due to reasons such as required litigation, that reimbursement for medical expenses would not be paid until several years after a personal injury or sickness. Coupled with this same problem is the problem of the chronic illness. For those who are under treatment for such an illness over a period of years, or indefinitely, when does the taxpayer determine the impact of the section upon the benefits which he receives?

Both of these approaches, therefore, are inequitable. Nor do we know of an alternative means for implementing the policy embodied in section 80. This further substantiates our view that the control of overinsurance should occur through policy provisions rather than tax deterrents.

Second, there would be a distinct element of unfairness to the taxpayers under the proposed amendment by reason of the fact that overinsurance is a variable status. That is to say, an individual may go from a status of overinsurance to underinsurance and back again without any change in the number or content of health insurance policies applicable to him. This results partially from the wide differential in per diem hospital charges, according to the geographical accident of where the illness or disability begins, and partially from the composition of the claim itself. For example, a person covered by a policy providing $20 a day hospital benefits may become ill or be injured and placed in a hospital in one city with hospital charges of only $16 per day. Later the same year in another geographical area he may require hospitalization where the hospital rates are $30 per day. Under the policy provisions approach being considered by the NAIC, the insured may have his benefits prorated so that they cover but do not exceed his medical expenses; whereas under the section 80 approach, he might be misled by the tax consequences of one claim on which he was overinsured and reduce or drop some coverage which he would need for a subsequent claim.

Third, there is also the problem resulting from the limitation in proposed section 80 that the medical expenses must be "incurred by the taxpayer." If this phrase is construed strictly, absurd situations might arise in various family insurance programs. Suppose that the expense of A, the insured, are incurred or assumed by B (who may or may not be responsible for the support of A), and the insurance contract reimbursement may be paid to either A or B. Thus, we might have the absurd result in a family situation, that where the mother (the insured) is sick, and her medical expenses are paid by her son, if the medical expenses reimbursement is paid to the mother, the entire amount thereof may be taxable as income to her.

III

We, therefore, submit that through the overinsurance policy provisions, which are nearing approval by the NAIC, overinsurance in the health insurance field can be efficiently and specifically controlled. The tax approach as embodied in the proposed new section 80 is attempting to regulate through taxation and will create more problems than it will solve. The amendment should be eliminated from the proposed tax bill.

Attached is a letter from the American Life Convention and the Life Insurance Association of America supporting this position.

AMERICAN LIFE CONVENTION, CHICAGO, ILL.,
LIFE INSURANCE ASSOCIATION OF AMERICA, NEW YORK, N.Y.,
Washington, D.C., December 4, 1963.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
Washington, D.C.

DEAR MR. CHAIRMAN: The American Life Convention and the Life Insurance Association of America are 2 associations with an aggregate membership of 322 life insurance companies in the United States and Canada which have in force approximately 98 percent of the legal reserve life insurance written in the United States.

The Health Insurance Association of America is filing a statement with your committee recommending that section 204 of H.R. 8363 be deleted. We strongly endorse their recommendation and urge the deletion of this provision by the Finance Committee.

Yours very truly,

AMERICAN LIFE CONVENTION,
GLENDON E. JOHNSON,
General Counsel.
LIFE INSURANCE ASSOCIATION OF AMERICA,
EUGENE M. THORÉ,
Vice President and General Counsel.

(Whereupon, at 12:10 p.m., the committee adjourned, to reconvene tomorrow, Friday, November 22, 1963, at 10 a.m.)

REVENUE ACT OF 1963

FRIDAY, NOVEMBER 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, Gore, Talmadge, Hartke, Ribicoff, Williams, Carlson, and Dirksen.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

Mr. John F. Nagle of the National Federation of the Blind. Take a seat, sir, and proceed.

STATEMENT OF JOHN F. NAGLE, CHIEF, WASHINGTON OFFICE, NATIONAL FEDERATION OF THE BLIND

Mr. NAGLE. Mr. Chairman and members of the committee, my name is John F. Nagle. I am chief of the Washington office of the National Federation of the Blind. My address is 1908 Q Street N.W., Washington 9, D.C.

In his message to Congress on January 24, concerning tax matters, President Kennedy declared:

> The most urgent task facing our Nation at home today is to end the tragic waste of unemployment and unused resources, to step up the growth and vigor of our national economy, to increase job * * * opportunities * * *.

The House Committee on Ways and Means has developed a bill to give meaning to these fine objectives; the measure has passed the House of Representatives, and is now before you for consideration.

We of the National Federation of the Blind endorse the President's declaration; we approve H.R. 8363, which would translate high purposes into concrete gains in the lives and livelihoods of the Nation's citizens.

We, blind men and women, know from personal experience of—

> the tragic waste of unemployment and unused resources—

For many of us remain unemployed for all of our lives.

Possessing abilities and talents, many of us are denied the chance to use them for our profit and advantage.

Possessing developed skills and specialized education, many of us are denied the chance to work in the usual economic activities and endeavors of the community.

Possessing the desire and the ability to support ourselves and our families, many of us remain dependent upon others for all of our

24-532—63—pt. 4——27

lives—recipients of public relief, beneficiaries of our families' benevolence—a drain upon their limited resources.

Mr. Chairman, it is an economic fact of discouraging and disillusioning reality that when physically fit men and women seek jobs and do not find them, physically and mentally impaired men and women need not seek at all. When there is a labor surplus, physically and mentally disabled workers are not hired—and this is generally true, however well qualified they may be for particular jobs and positions that are to be filled.

It is generally true, even though these people may be better qualified than their physically fit competitors for such jobs and positions.

It is generally true, even though disabled applicants for work are in nowise limited or restricted in their ability to perform all of the functions and requirements of the work applied for.

During World War II, Mr. Chairman, thousands of men and women—elderly, blind, crippled, or otherwise disabled—were employed to perform a vast diversity of activities in our wartime economy—and they demonstrated beyond all possible doubt or question the capacity of such people to function productively and successfully in our normal economy.

But these workers were not hired as regular members of the Nation's labor force. Rather, they were military rejects, economic discards, and they were only hired when physically fit workers went to war—they were only hired when the numbers of jobs so increased that there were insufficient young and physically fit workers to fill them.

Then, Mr. Chairman, when the war was over, when the labor shortage was passed—in spite of the fine work record of these impaired men and women—in spite of their proven reliability and competence—in spite of the very low incidence of work accidents among them—in spite of all this, Mr. Chairman, when the war was over, the overwhelming majority of these people were discharged, for they were no longer needed or wanted—physically fit workers were again available to take back their jobs.

Perhaps, one day, Mr. Chairman, men who apply for work will be judged on their merits, on their ability to do the work applied for; perhaps, one day, Mr. Chairman, the best qualified applicant for a job will be hired, even though he is old or crippled or blind—but until that day comes, we who are impaired, we who are physically or mentally disabled, we must hope and plead for full productivity, for a labor shortage economy.

Therefore, Mr. Chairman, members of the committee, we urge you to adopt H.R. 8363, because we believe its enactment into Federal law will so stimulate and strengthen the Nation's economy that employment opportunities will be increased—opportunities for employment will be more readily available for all who wish to work—including trained and qualified men and women without sight or otherwise impaired by advancing years or physical or mental disability.

Mr. Chairman, now I would like to discuss briefly a proposal to amend the pending tax measure and to offer for this purpose S. 640, introduced by Senator McCarthy, of Minnesota, and S. 2227, introduced by Senator Hartke, of Indiana.

These two bills, similar in objective, and sponsored by two distinguished members of this committee, would allow an additional Federal income tax exemption to a taxpayer supporting a dependent who is blind.

Existing law now allows a taxpayer a deduction up to $600 for expenses incurred for the care of disabled dependents unable to care for themselves—and section 211 of H.R. 8363 provides for certain liberalizations in this provision of the tax law.

We believe that these proposed changes are totally inadequate to provide much needed tax relief for the taxpayer who supports a dependent disabled by loss of sight.

Not only must such taxpayer meet the usual costs of food, clothing, and shelter for the blind dependent—not only must he pay the cost of basic human needs—he must also pay the cost of special needs—needs which arise from the circumstances of blindness, needs which are incidental to blindness and result when a person without sight lives and would function with a measure of self-dependence in a world of sight.

If the dependent is a sightless child attending school, special tools, devices, and equipment must be purchased; sighted readers must be hired to supplement the efforts of family and friends.

If the child is unable to travel alone, a sighted guide must travel with him—at double expense—or special transportation arrangements must be made—and paid for.

If the blind dependent is an adult, he will probably be aged and unable to adjust to the changed conditions of living without sight, and he will need much help—he will need help in shopping, in keeping house—if he is fortunate enough to retain his separate and independent home—he will need a sighted companion to accompany him wherever he goes, he will have more frequent laundering and cleaning bills.

We urge, therefore, that the committee adopt the proposal contained in the bills S. 640 and S. 2227, which would grant an additional tax exemption to a taxpayer supporting a blind dependent.

This proposal is not new to the Federal tax law. It would serve only to extend an existing provision which allows a blind person himself an additional tax exemption because of blindness.

Since existing tax law recognizes that a person without sight might pay additional expenses—additional equalizing expenses—when he tries to live, work, and function without sight in a sighted environment, we ask that this recognition, that this principle and provision of existing law be extended to include taxpayers who provide for the needs—for the extra, the special needs, as well as the ordinary human needs—of their dependents who are blind.

We believe that, if the proposal contained in S. 640 and S. 2227 is adopted by this committee and the Congress, it will serve as an inducement to encourage and stimulate families to increase their assistance to their blind dependents, it will serve as a recognition and a reward for doing so.

I could not conclude my remarks here today, Mr. Chairman, without thanking Senator McCarthy and Senator Hartke for their sponsorship of the measures I have discussed.

We of the National Federation of the Blind are blind men and women, joined together and working together in common cause—and our cause is the improvement of opportunities and conditions for all who are without sight in America—for all who are without sight in the world.

But, though we strive mightily toward our goals, we would accomplish little without the always willing help and constant cooperation of such men as Senator McCarthy and Senator Hartke.

It is always reassuring for us, blind men and women, to know that we do not struggle alone.

I thank you, Mr. Chairman, for this opportunity to present these views to the committee.

The CHAIRMAN. Thank you, Mr. Nagle.

Any questions?

Senator HARTKE. Mr. Chairman, I would just like to compliment Mr. Nagle upon his fine statement, and thank him for his fine words.

I do think that with all the handicaps that these people have, some of the most severe, they are not entitled to sympathy but they are entitled to consideration for their efforts to try to better themselves and take themselves off the rolls of being public charges to the place where they want to go ahead and take care of themselves. Things of this sort could be very helpful in that effort.

Senator GORE. I would like to ask a question, Mr. Chairman.

The CHAIRMAN. Senator Gore.

Senator GORE. This is a very thoughtful statement which you have made, Mr. Nagle. Do you have any suggestions as to amendments to the pending bill or are you satisfied with its present content?

Mr. NAGLE. The only one I would suggest, Senator, would be the one that I have discussed. As I say, a blind person himself has a lot of additional tax exemption in the event that he is employed to offset the extra expenses that he incurs in trying to function. At the present time, although this——

Senator GORE. You are, as I understand it, asking the committee to give consideration to this as an amendment to the bill.

Mr. NAGLE. That is right; to extend this, and the bills that I cited are the means of doing so.

Senator GORE. Could you give us an estimate of what the size of the exemption would be, how much you think it should be?

Mr. NAGLE. I would say a similar or a straight $600 exemption, that is, the regular exemption which is now available to allow this additionally to the person supporting a dependent who is blind.

Senator GORE. You think the $600 would be sufficient?

Mr. NAGLE. I think so. As I say, it would be a matter of extending an existing provision. A blind person who is employed has this additional recognition of this problem of extra expenses. If a blind person is supported by parents or children support parents, this exemption is not available to the taxpayer, and we believe it would be beneficial.

We think, although certainly the additional tax saved to the taxpayer would not be anywhere near equal to the amount of costs for providing support to a blind dependent, we think that this money would help to persuade parents to expend additional expenses for their blind children, and we think it would be of help in persuading children to be more generous to their blind parents.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Any further questions? Thank you very much, Mr. Nagle.

Mr. NAGLE. Thank you.

The CHAIRMAN. The next witness is W. Evans Buchanan, National Association of Home Builders.

Take a seat, please.

STATEMENT OF W. EVANS BUCHANAN, PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS, AS PRESENTED BY LEONARD L. SILVERSTEIN, TAX COUNSEL; ACCOMPANIED BY HERBERT S. COLTON, GENERAL COUNSEL

Mr. SILVERSTEIN. Mr. Chairman and members of the committee, my name is Leonard L. Silverstein. I am an attorney in Washington, and I appear on behalf of the National Association of Home Builders, and for Mr. W. Evans Buchanan, president of NAHB who, unfortunately, is not able to be with you this morning.

I am accompanied by Herbert Colton, general counsel of the NAHB, who has been its general counsel since 1946.

NAHB serves its membership and public as the trade association of the homebuilding industry of America.

Its membership numbers in excess of 40,000 homebuilders in 378 affiliated local and State associations in all 50 States and in Puerto Rico. We are proud to state that our membership produces the bulk of this country's homes and apartment dwellings.

NAHB has given lengthy deliberation to the pros and cons of the tax reduction portions of H.R. 8363. Although we are keenly conscious of the necessity of moderation in Federal expenditures, our membership, day to day, faces a continuing demand from the home buying public for adequate housing.

Since we believe that satisfaction of this demand is so vital to our Nation's welfare, it is NAHB's position that no course of action should be taken which will in any way impair the ability of our citizens to be housed properly. According to Treasury estimates, full enactment of H.R. 8363 will make available an excess of $11 billion of expendable funds in the hands of the American public.

NAHB believes that this monetary pool will produce economic consequences which will operate in the best interest of the American economy. We believe that a prosperous American economy is best for the homebuilding industry. In the long term, lower taxes will produce a much needed change in the American economical environment, all of which will operate to the benefit of the public and their membership.

By the foregoing, we do not mean to advise this committee that our membership approves of each and every section of H.R. 8363. We are conscious that many aspects of the bill can add further complexities in the already complicated tax structure under which homebuilding operations must be conducted. Even here, however, NAHB believes that the corporate tax reduction features of the bill will go a long way toward alleviating the impact of its technical complexities.

We believe that a stimulus to the Nation's home buying economy will result from full enactment of this bill, and that as a result more people will be better housed in better homes.

We further agree with the recent statement of President Kennedy that "* * * we urgently need (a) tax cut as insurance against a recession next year." For these reasons, NAHB gives its full support to the passage of H.R. 8363.

We wish to advise the committee, however, that our membership has objection to certain technical features of the bill. We ask leave in a separate statement to submit to this committee the details of our

objections and our suggestions for alleviation of the problems. While we will not take the time of the committee to discuss these problems at length, we wish to note to the committee their general nature.

Section 223 of the bill provides a whole series of new rules respecting the operation of business through a series of controlled corporate entities. This provision introduces great complexities into the statute and, in fact, applies a penalty tax on the first $25,000 of income of each of the controlled corporations. Moreover, even the surtax exemption on the first $25,000 is not available unless the controlled group of corporations affirmatively elect pursuant to the terms of the statute.

We believe that the election requirement is unduly onerous. The surtax exemption should be available to controlled companies in the same manner that it is available to every other corporation, especially in light of the fact that the 6 percent penalty will automatically apply in any event to reduce the effect of this exemption.

For this reason, we suggest that the election provision of the bill be reversed so that a taxpayer elects to apportion a single surtax exemption or to file consolidated returns rather than the converse to elect to retain its right to an individual surtax exemption.

Another complicating aspect of the controlled corporations rules concerns attribution of ownership. Under the bill a wide sweep of persons is regarded as being related. Undoubtedly without further simplification and restriction of these provisions, certain corporations will unknowingly find themselves members of controlled groups within the meaning of the statute and entirely lose the surtax exemption. Accordingly, we believe these provisions should be considerably narrowed.

Under section 220 of the bill, gain from the sale of reality produces ordinary income on a sliding scale basis depending upon the holding period and depending upon the extent of previously allowed depreciation.

While NAHB appreciates the problems involved in this area and therefore does not quarrel with the general objectives of this section, we believe that the sliding scale should be changed so as to reduce the resulting lock-in of investment in depreciable realty.

We emphasize to this committee that unless the tax laws contain some stimulus for the investment in rental housing, capital presently being used for this purpose will be channeled elsewhere, thus leading to the reasonable conclusion that a major segment of the economy will be ultimately denied adequate dwelling accommodations.

We wish to caution the committee that NAHB in no way supports land speculators. Our interest in this proposal is in protecting the market mortgage for rental housing consonant with lowest cost to the rental public. We believe further that there are other technical means of achieving this insurance to the residential building field as well. While such means—in the nature of LIFO inventory treatment for land are outside the scope of H.R. 8363, we believe that the subject merits serious consideration at a later date.

Section 215 of the bill would impute interest on the sale of real estate or other property if the purchase price is deferred for more than 1 year and a determined rate of interest is not stated in the contract of sale. Aside from acting to rewrite an arms-length contract, the effect of this provision will undoubtedly be to increase the price of land to homebuilders and therefore increase the cost of homes to home buyers.

For these reasons we do not feel that this provision should remain in the bill.

We also note that under section 216 the personal holding company provisions of the law will be made more restrictive. Under these more narrow rules, amortization, interest, and taxes are subtracted from gross rentals in determining the proportion of rental income to total income. In addition, if passive income such as dividends and interest constitute more than 10 percent of gross income, the company is characterized as a personal holding company notwithstanding the amount of rental income.

NAHB appreciates that this area of the statute is presently regarded by the Treasury as a loophole. But, aside from other objections to this provision which we expand upon in our accompanying detailed analysis, we point out that the existence of this section has stimulated the purchase and erection of rental dwellings.

Any tightening such as that appearing in H.R. 8363 is bound to have a depressant effect.

Further, the proposal apparently is based on the wholly erroneous assumption that construction and operation of rental property is not a business but a passive investment. Nothing could be further from the truth. We object to this proposal.

In addition to the provisions now included in H.R. 8363, NAHB enthusiastically supports Senator Carlson's proposed amendment to the bill, which would permit a taxpayer to deduct the expenses of repair, maintenance, alterations, and additions to a residence. In our opinion, this measure is most beneficial for these reasons:

It will immediately operate in multiplier fashion to give jobs and produce income for the persons carrying on the repair work which would be deductible under the bill. By the same token, since home repair is a necessary adjunct of home ownership, this additional deduction will provide a direct stimulus to new home purchases and the better maintenance of homes now owned and occupied, thus helping to forestall the formation of slums.

We submit that all of this activity is so very much in the public interest as to need no further recitation of the reasons. NAHB and its technical staff stand ready to assist the committee in any way in which its efforts may be found useful in their deliberations on this bill.

We thank you for this opportunity to appear.

The CHAIRMAN. Thank you.

Any comments?

Senator CARLSON. Mr. Chairman, I wish to state to Mr. Silverstein and to the National Association of Home Builders that I appreciate their comments regarding my amendment, which I expect to bring up during the executive deliberations by the committee on this bill.

(The detailed statement of Mr. Buchanan follows:)

DETAILED STATEMENT IN SUPPORT OF THE TESTIMONY OF W. EVANS BUCHANAN, PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS

SECTION 223. REDUCTION OF SURTAX EXEMPTION IN CASE OF CERTAIN CONTROLLED CORPORATION

NAHB is in full agreement with the House Ways and Means Committee conclusion that, under proper circumstances, legitimate reasons exist for the use of separate corporations which are characterized by common ownership.[1] And,

[1] See H. Rept. 749, 88th Cong., 1st sess., p. 118.

correspondingly, we would conclude that in light of the validity of the use of such a corporate structure, no penalty should be merited.

Nevertheless, we do not now register objection to this section of H.R. 8363 which permits the use of multiple corporate entities subject to the incidence of a 6-percent penalty on the first $25,000 of income for each component corporation. We do, however, object to the approach taken in H.R. 8363 as to the determination of the availability of such individual surtax exemptions and upon certain of the ancillary rules set forth as to the application of these provisions.

Election requirement

Specifically, we object to the fact that corporations characterized in such a manner so as to constitute a controlled group of corporations must, under the proposed section 1562, affirmatively elect to avail themselves of the $25,000 surtax exemption, a right automatically available to other corporations. The making of such an election, through the filing of a written statement, is made a prerequisite to the retention by any component member of a controlled group of its right to an annual surtax exemption.

Thus, the distinct possibility exists that, due to the failure to include a corporation which was owned for only a short period of time, or perhaps even an inactive corporation owned by a component member of the group or by an individual stockholder, all component members of the group, including those not directly concerned, may be denied access to but a fragment of the statutory $25,000 surtax exemption.

It is our position that a controlled group of corporations should be entitled to individual surtax exemption, albeit subject to the 6-percent penalty, unless such group elects to apportion a single surtax exemption or to file consolidated returns. Such a procedure would retain the same penalty as is presently contained in H.R. 8363, but would not require the filing of additional costly and superfluous statements in order for a component member to maintain its existing right to a separate surtax exemption. The net result would be the same and taxpayers would be relieved of the additional expense and chance of disqualifying error involved in the filing of complicated written statements upon which the validity of an election would rely.

Attribution rules

In addition to the previous objection, we are also opposed to what we consider to be the overly stringent attribution rules which are set forth in the proposed section 1563(e). These rules would go so far as to attribute to an individual stock held by grandparents, and would also require an actuarial computation of a stockholder's interest in estates and trusts. We see no reason here to expand the normal attribution rules to include stock held by grandparents.[3] In such a situation it can hardly be said that a grandchild could control the actions of a grandparent.

The requirement of an actuarial computation for attribution from estates and trusts would be, in our opinion, completely unworkable. It would, in effect, require every stockholder who is also the beneficiary of an estate or trust to be an actuary in order to determine whether corporations in which he has an interest constitute a controlled group of corporations. This would be both inequitable and a source of extreme confusion.

A stockholder is also considered to constructively own any stock which can be acquired through the exercise of an option. While we specifically object to this provision, we take the further view that any such attribution based upon the existence of an option should clearly state that it pertains only to previously issued stock and does not extend to the right to acquire unissued stock subject to the payment of an appropriate purchase price.

Election after termination

Since access to individual surtax exemptions by members of a controlled group of corporations involves the imposition of a penalty on such component members which is not present in the normal corporate situation, we see no reason why a group of corporations that chooses to terminate such election as to any given taxable year should be precluded from again availing themselves of this corporate surtax exemption, with its allied 6-percent penalty, for the following 5 taxable years. Regardless of the alternative available to controlled groups of corporations which is chosen by any individual group, the component members

[3] Sec. 318 of the 1954 Internal Revenue Code does not apply the general stock attribution rules to grandparents.

will receive some form of detriminet, either in the form of a denial of the surtax exemption or the incurrence of a penalty, to which other corporations are not subject.

It is, therefore, our position that such a controlled group of corporations should be able to make an annual choice as to which of these alternatives would be the most desirable; or perhaps more properly, the least undesirable. While we recognize that a decision to file consolidated returns is binding upon subsequent years, except where permission is granted either individually or to corporations in general to rescind such an election, we see no reason to extend the binding nature of such a choice to the simple desire by component corporations to retain, subject to a penalty, that which they are otherwise entitled to. We thus urge that this 5-year limitation be deleted.

Stock exclusions for control test

The proposed section 1563(c) would exclude for purposes of applying the control test, stock of a subsidiary corporation held by an employee's deferred compensation trust. This appears to be unjustified. Stock held in an employees' trust is held subject to a fiduciary duty by whomever may be the trustee. To use this stock in a manner inconsistent with the employees' interest would be to commit an actionable breach of trust. Such breach of fiduciary duty should not be presumed; that is, however, what this stock exclusion appears to do. It is our position that such treatment is not in order and should be eliminated from this bill.

Also treated as excluded stock by proposed section 1563(c) is stock of a subsidiary owned by an individual who is considered to be a principal stockholder of the parent corporation. The determination as to who is a principal stockholder uses 5 percent as the line of delineation. It is our position that a 5-percent stockholder is not a principal stockholder and that this percentage should be substantially increased.

Two-percent tax on consolidated returns

As a corollary to the multiple corporation provisions, NAHB supports the repeal of the 2-percent additional tax for corporations filing consolidated returns. There appears to be no reason for continuing this tax obstruction to the filing by related corporations of a tax return aggregating the individual results of each member of the group.

SECTION 220. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY

It has been the consistent position of this association that the adverse results which can reasonably be expected to flow from a "lock in" of real estate investment through the imposition of ordinary income penalties upon its sale would outweigh any beneficial consequences which can be expected to result from legislation specifically designed to prohibit the purchase of depreciable realty so as to gain the benefit of depreciation followed by an early sale. While NAHB does not now, and has never sought to defend this so-called depreciation shelter type of corporation, we are of the opinion that the proposed new section 1250, due to its extensive "lock in" characteristics, would have a net adverse effect upon the economy and be thus undesirable at the present time.

As an alternative, however, we would see merit in this provision if the sliding scale reallocation from ordinary income to capital gain potential presently set at 1 percent per month after a holding period of 20 months was to be increased from 1 to 2 percent per month. The provision as so changed would strike a middle ground, effectively prohibiting an early tax-motivated turnover while not excessively locking in the owners of such realty.[3]

In line with the intent of this section, NAHB is also of the opinion that a proviso should be here inserted making clear that all depreciation, including depreciation taken in the year of sale,[4] be considered as a proper basis reduction under circumstances where original salvage estimates are reasonable.

SECTION 215. INTEREST ON CERTAIN DEFERRED PAYMENTS

NAHB objects to this provision which would, in effect, rewrite an existing contract by inserting an interest element wherein none was contemplated by the parties. In addition to impinging upon our traditional right to contract as we see fit within the confines of the law, such a provision will, by the insertion of

---

[3] The "lock in" period would thus be reduced from 10 years to approximately 6 years.

[4] This conflict is illustrated by comparing Rev. Rul. 62-92, 1962-1 C.B. 29, with the case of *Motorlease Corp.* v. *U.S.*, 215 F. Supp. 356 (D. Conn. 1963), on appeal 2d Cir.

ordinary income characteristics in an otherwise capital transaction, increase the price of land and, in turn, the price of homes to the ultimate consumer. For these reasons, NAHB urges that this provision be deleted from the bill.

SECTION 216. PERSONAL HOLDING COMPANIES

Under present law, a corporation can have the assurance that it will not be branded as a personal holding company if it derives 50 percent or more of its gross income from the receipt of rents. Thus, a corporation which actively engages in rental activities is now free to operate without being required to currently distribute, and thus inefficiently dissipate, resulting income that would otherwise be available for expanded rental activities and thus additional rental housing.

The personal holding company provisions of H.R. 8363 would end this. Not only does it make the rental income test largely a net rather than gross income test, it provides that for any year in which personal holding company income other than rents exceeds 10 percent, rental receipts, even should they constitute 89 percent of the corporation's income would not relieve it of the almost confiscatory personal holding company consequences. A relatively small drop in rental receipts in any year, coupled with the fixed expenses of depreciation, interest, and taxes would compel personal holding company treatment even to a corporation engaged almost entirely in rental activities. This is due to the fact that even incidental income from the use of funds set aside for expansion would equal more than 10 percent of the thus deflated rental income.

Businessmen cannot be expected to continue to invest money in an area so fraught with uncertainty. Thus, either of these proposed changes in the definition of a personal holding company as to rental receipts would keep money away from the rental field, and necessarily act to adversely affect this country's need for more and better rental housing.

In addition, we are of the opinion that the proposed elimination of capital gains as a nonpersonal holding company source of income further unwarrantedly hampers normal corporate business activity. We see no reason why a corporation in the fortunate position of having potential capital gains income should be prohibited from realizing this income in such a manner as to assure that it is not penalized by the imposition of a personal holding company tax.

In short, it is our position that existing law is sufficient to prevent any abuse in this area[6] and that enactment of this section would depress the rental housing situaion to the detriment of our economy.

ADDITIONAL PROVISIONS OF H.R. 8363

We desire to comment briefly upon the following additional sections presently contained in H.R. 8363.

SECTION 206. EXCLUSION FROM GROSS INCOME OF GAIN ON SALE OR EXCHANGE OF RESIDENCE OF INDIVIDUAL WHO HAS OBTAINED AGE 65

NAHB supported this provision due to its obvious benefit for our older citizens, and correspondingly, for our economy. This provision will allow an elderly person to maintain his estate, to the extent that it is represented by his principal residence, from depletion by the imposition of an income tax upon a sale needed to produce income for support in his later years. We feel that this provision is equitable and desirable and urge its passage as a part of H.R. 8363.

SECTION 202. REPEAL OF REQUIREMENT THAT BASIS OF SECTION 38 PROPERTY BE REDUCED BY 7 PERCENT; * * *

NAHB supports this provision as a deletion of what would amount to a required refund to the Government of a portion of the investment credit and a double increase in corporate earnings and profits due to the operation of the existing investment credit provisions.

PROPOSED AMENDMENTS TO H.R. 8363

NAHB also supports the enactment as a part of H.R. 8363 of the bills presently pending before the Senate as S. 110 (a bill, introduced by Senator Carl-

[6] In this respect, we point out that sec. 531, imposing the accumulated earnings tax, appears to us to place a sufficient control upon the accumulation dangers which are presently being advanced in support of these proposed crippling personal holding company changes.

son, to permit a taxpayer to deduce expenses paid for repair, maintenance, alterations, and additions to his residence) and S. 2068 (a bill, introduced by Senator Long to simplify the travel and entertainment provisions).

S. 110 would, in our opinion, be a well-merited spur to our economy. It would put the owner of a personal residence on a par with the owner of a rental dwelling. In addition, this provision would encourage the making of safety assuring and life prolonging repairs to our existing homes and be a deterrent to the formation of slums. NAHB urges the adoption of this bill as a part of H.R. 8363.

With respect to S. 2068, it is our firm belief that the existing travel and entertainment provisions are too complicated to be properly understood and complied with by the small businessman. Taxpayers with the time and facilities to study these provisions and to fully comprehend their ramifications can continue to deduct virtually all that could formerly be deducted. Only the small businessman without the time, technical understanding, or funds to finance such a legal analysis will lose legitimate travel and entertainment expense deductions from the operation of this recently enacted law.

We hope that the views herein contained will be of assistance to this committee in its deliberations on H.R. 8363. Our staff remains fully available to this committee should additional explanation of the material herein contained or any other assistance be desired.

The CHAIRMAN. The Chair recognizes the Senator from Tennessee.

Senator GORE. Mr. Chairman, it is a privilege and a pleasure to introduce the next witness before the committee. There is underway in Davidson County, Tenn., an experiment in consolidated government, Davidson County and the city of Nashville having merged into one governmental unit. Their experiment is being watched throughout the United States.

I think we are fortunate to have as major of this metropolitan area including, I believe, the entire county now, one who is experienced in government, whose integrity is clearly recognized, whose ability is great and well known. It is with great pleasure and, because of the experimental nature, thus far I think successful, of this undertaking of consolidation of county and municipal government, most appropriate for him to be here, that I introduce to the committee Mayor Beverly Briley of Nashville-Davidson County. Is that the correct title?

Mr. BRILEY. Nashville-Davidson County metropolitan government.

Senator GORE. It is both then; is it not?

Mr. BRILEY. Yes.

The CHAIRMAN. You may proceed, sir.

STATEMENT OF HON. C. BEVERLY BRILEY, COUNTY MAYOR, METROPOLITAN GOVERNMENT OF NASHVILLE-DAVIDSON COUNTY, TENN.; ACCOMPANIED BY C. D. WARD, GENERAL COUNSEL, NATIONAL ASSOCIATION OF COUNTIES

Mr. BRILEY. Chairman Byrd and members of the committee, I would like to file with you a printed statement; but, as an old advocate, I have found you can always say things a little bit better if you do not write it and let your staff write it and you file it, and you say what you think.

The CHAIRMAN. That is a very good suggestion.

Mr. BRILEY. I approach you on the basis, if you will permit me to file my statement——

The CHAIRMAN. The statement will be filed and printed in the record.

Mr. BRILEY. I say to you that as the county judge of Davidson County for some 14 years, and the present mayor of the Nashville-Davidson County consolidated government, the only real metropolitan government in America, and as past president of the National Association of Counties, and, I might say, a member of the U.S. Conference of Mayors, and of the American Municipal Association, the National Municipal League, that I have a very deep concern about the intergovernmental relationships that are involved in the matter of taxation.

We recognize that the Federal Government, along with the local governments, has a tremendous problem of financing their respective obligations, and that we cannot consider taxation at one level without considering taxation at all levels.

The real economic climate of each and every community of America is involved in local taxation primarily but, of course, it is involved in State and Federal taxation also.

Since 1861, when the first income tax was proposed, and this goes back when it was held unconstitutional, there was a recognition of the responsibilities of the various levels of government, and a tax forgiveness, a tax-exempt security in the municipal level, as being a part of the climate that we have built in this country, and I think it has been found, and very well found, that these have been done in this way because in terms of intergovernmental relationships it has given local and State governments the opportunity of financing in a capital way the projects that are necessary and essential for serving people in terms of schoolhouses and roads and bridges, and, at the same time, has always given us the opportunity to functionally operate budgetwise the responsibilities that we have in maintaining these matters of capital outlay that we use through tax exemption of our securities.

We testified before the House committee when this bill was up and, as a result of some of our testimony, we hope, they have reduced and relieved this bill of the State and local taxes on real estate and personal properties that are involved in manufacturing and so on.

But in the argument on page 48 of the Ways and Means Committee report accompanying H.R. 8363 reference is made to the fact that the Federal Government should not decide which taxes a State should levy from the point of view of furnishing localized services, and that it should not determine whether they should be sales taxes or income taxes or penalize one State or another because they do or do not levy such taxes. We feel the same thing is true in terms of the gasoline tax, tobacco tax, and the alcoholic beverage tax.

Again this is an area where the Federal and the State and the local governments are taxing the same operations, the same business, the same commerce. We feel that whenever the Federal Government invades the thing we have held rather sacred in intergovernmental relations since 1861—I am speaking of the original income tax laws of the country—we who are in local government have a real serious concern whenever the Federal Government changes something that is traditional in the history of this country and in intergovernmental relationships.

So I am here to take the view that while we may need tax reforms, the tax reforms should not invade the problems of this thing we have traditionally held sacred in this country. I am speaking of the deduction allowed and the exemption of interest from municipal securities.

We call attention to the fact that when Congress passed the life insurance income tax law of 1959 it clearly stated that there was not an attempt to tax the local securities. Yet today we are having to defend litigation under the Insurance Act across the country as amicus curiae in insurance cases in order to preserve the integrity of this principle that we think is primary in American government and in the system of taxation that we have established through the years.

We think the intention of Congress is very clear, and we have no hesitation to litigate with the administrative agencies of the Government to maintain this integrity that we think is a part of the tax system of this country.

As I say to you, I filed the full statement which gives categorically the sections that we are talking about and our views on it; and, at this time, I would submit myself to any questions that the committee would like to ask me.

(The prepared statement of Mr. Briley follows:)

STATEMENT FOR THE NATIONAL ASSOCIATION OF COUNTIES ON H.R. 8363, THE REVENUE ACT OF 1963, BY C. BEVERLY BRILEY, COUNTY MAYOR, METROPOLITAN GOVERNMENT OF NASHVILLE-DAVIDSON COUNTY, TENN.

Mr. Chairman and members of the committee, my name is C. Beverly Briley, and I am county mayor of the Metropolitan Government of Nashville-Davidson County, Tenn. In addition, I am the immediate past president of the National Association of Counties, an organization representing county government throughout the Nation. At the outset, let me state that the National Association of Counties supports a decrease in the Federal tax rates to stimulate our local and national economy. The following resolution was enacted at our annual conference in Denver, Colo., July 31, 1963:

"The National Association of Counties strongly opposes any effort to disallow for purposes of Federal income tax deduction, any State or local taxes, interest paid on mortgage debt, or charitable contributions. The National Association of Counties further endorses a decrease in the present Federal income tax rates to stimulate our local and national economy."

Our membership is uniquely sympathetic to the task with which you are presently laboring, as we too are faced with the problem of financing governmental units in as equitable and just a manner as possible. The intergovernmental complexities of our country naturally cause our respective governments to be extremely sensitive to one another's tax policies. This is especially true where we share the same tax source. The Federal Government has traditionally manifested a compensating attitude toward the other units of government in the field of taxation as originally demonstrated by the Income Tax Act of 1861. That act specifically provided for the deduction of State and local taxes and every income tax statute enacted since that date has continued their deductibility. We are convinced that this deductible feature has contributed significantly to local government's ability to increase its own taxes. This legislative forgiveness, combined with the constitutional exemption of interest on State and local securities, undoubtedly is our two greatest financial helpmates. Consequently, we view with considerable apprehension any efforts to delete or diminish them.

As you will recall, the original proposal for a tax bill this year was a sweeping limitation on the deductibility of all State and local taxes. This was cloaked in the provision commonly referred to as a 5 percent floor on itemized deductions. That proposal was rejected; however, the Revenue Act of 1963, as passed by the House, disallows all State and local taxes except real and personal property, income and sales taxes.

Virtually every person and organization connected with the Federal income tax laws are in agreement as to the need of tax reforms and reductions. We have, therefore, carefully examined the "reforms" dealing with State and local taxes to see if they would in effect improve intergovernmental fiscal relationships, an objective the original exemptions were designed to accomplish. We have concluded the arguments advanced for disallowing these taxes are not valid nor would the additional revenue gained by the Federal Government justify the adverse effects to the other levels of government.

TAPPING THE SAME SOURCE

The committee report of H.R. 8363—Revenue Act of 1963 states on page 48:

"In the case of State and local income taxes, continued deductibility represents an important means of accommodation where both the State and local governments on one hand and the Federal Government on the other tap this same revenue source, in some cases to an important degree. A failure to provide deductions in this case could mean that the combined burden of the State, local, and Federal income taxes might be extremely heavy."

Three of the major State and local taxes disallowed by H.R. 8363 are equally shared with the Federal Government and would certainly qualify for exemption under the above criteria:

[In billions of dollars]

	Federal	State and local
Gasoline	$2.4	$3.5
Alcoholic beverages	3.3	.7
Tobacco	2.0	1.1

We realize that much of these Federal taxes come back to State and local government in the form of grants; however, this only strengthens the argument that these tax sources might well be turned back completely to the State and local governments with the exception of a minimum Federal rate to substantiate regulatory powers.

FEDERAL PREFERENCE FOR CERTAIN STATE AND LOCAL TAXES

H.R. 8363 committee report further states, on pages 48 and 49:

"If property and income taxes are to be deductible in computing income subject to Federal income tax, it also becomes important to allow the deduction of general sales taxes as well. These are the three major sources of State and local government revenue, and were the Federal Government to allow the deduction of some but not all of these taxes, it would be encouraging State and local governments to use one or more of the other types of taxes. Since your committee believes that it is important for the Federal Government to remain neutral as to the relative use made of these three forms of State or local revenue sources, it in this bill has continued a deduction of these three types of taxes."

Why should the Federal Government remain neutral as to the relative use of certain State and local taxes and not others?

TROUBLESOME DEDUCTION?

Another reason given for disallowing the excluded taxes is that "they are troublesome to keep track of and are frequently unintentionally reported inaccurately. Secondly, since it is difficult to keep accurate records for gasoline, alcoholic beverages, tobacco taxes, etc., these deductions are often at best mere approximations. Furthermore, since many taxpayers are not satisfied with approximations, they forego the deduction of these taxes." (P. 49 of H.R. 8363 committee report.) We think you can appreciate our reluctance to see these taxes disallowed merely because some people find it too difficult to keep track of them or hesitate to approximate. Obviously there are many taxpayers who are willing to shoulder this burden in that the Federal Treasury estimates they will gain $520 million annually from this "reform" alone.

EXPANSION OF DEDUCTIONS FOR LOCAL IMPROVEMENT TAXES

Page 51 of the committee report points out that:

"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 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."

H.R. 8363 deletes this exemption.

We request that this provision be maintained and expanded to allow taxpayers to deduct for income tax purposes all charges levied by a municipality, county, or other local government. These charges include any tax, special assessment fee, or other service charges which are established and imposed by the local government for the performance of a service or to provide for local improvement, which the taxpayer has no option to reject. Such public services include sewage disposal, garbage-trash collection, water, recreation, utilities, roadbuilding, welfare, and other services deemed necessary or desirable.

Recent survey results indicate that some local governments finance public services through general revenue collections; others by imposition of service charges for the individual items, some by a combination of both methods. In all cases, the rate of taxation or assessment varies widely, and only one common factor is evident—the charge is imposed by the local government, the taxpayer having no option to reject it.

Under existing law, taxes paid which tend to increase the value of the property assessed are not deductible from income tax. On the other hand, taxes paid directly under the classification of "real property taxes"—which in some local governments support all or most of the public services—are tax deductible. Therefore, in those communities where the real property tax is substantial and there is little or no use made of the so-called service charge or assessment, the taxpayers residing therein enjoy a tax deduction for the payments.

In other local governments, where the tax rate on real property is low and the revenue to finance public services is collected through individual service charges or fees, the residents are not allowed such a tax advantage on the theory that such taxes tend to increase the value of the property assessed. This policy unduly penalizes the citizens of those communities where the local government is forced to levy these assessments in order to equitably distribute the cost of municipal services and public improvements.

We have witnessed in the last 20 years a tremendous growth in our communities with the resultant demand for more and better roads, hospitals, sewage systems, water supply facilities, and so forth. With the wide range of revenue sources already tapped by the Federal Government, local governments are solely in need of taxing sources in order to provide and support such services. Therefore, the service charge method has gained in popularity as a means to furnish these needed services.

It appears to us that it should make no difference to the Federal Government whether or not local services are financed under the general taxation method or the special taxation method. The primary consideration should be that all taxpayers are treated fairly and equitably.

With the wide variations in the rate of taxation or assessment and with the different methods of collection in common use, we believe Congress should seriously consider legislation making all charges imposed by municipalities tax deductible. Then the local governments could collect for these functions in the manner best suited to its own individual situation.

Congressman Fascell of Florida has introduced legislation (H.R. 8057) which accomplishes this objective. We commend this bill for your consideration.

INCOME FROM STATE AND LOCAL SECURITIES

Amendment 228 to H.R. 8363 provides alternative procedures for taxpayers in certain income brackets. One procedure would require the interest from State and local government securities to be included in taxable income. Notwithstanding the optional character of this procedure, we maintain it would be unconstitutional and would oppose the section dealing with interest from State and local securities (sec. 1393(b)(1)).

In view of the amendment 228, we feel it would be appropriate to bring to the attention of the committee a situation that has arisen. As recently as the Life Insurance Company Income Tax Act of 1959, Congress expressed its intent to maintain the constitutional tax exemption of interest from State and local securities. Notwithstanding the clear intent of Congress, the Treasury Department has interpreted the law in such a manner as to result in a tax on this interest. Our association has joined with a number of other associations representing State and local governments in legally contesting this decision. We are confident the outcome will substantiate our contention and will join the host of other judicial decisions upholding the constitutional exemption of these securities.

SUMMARY

We therefore oppose those sections of H.R. 8363 denying certain State and local taxes (sec. 207), and that section of amendment 228 (sec. 1393(b)(1)) disallowing the exemption of interest from State and local securities under certain circumstances. We would further urge the enactment of an amendment as outlined and embodied in H.R. 8067. We further endorse a decrease in the present Federal income tax rates to stimulate our local and national economy.

I appreciate the opportunity of appearing before you today to express our view of this important legislation.

The CHAIRMAN. Thank you very much indeed, sir.

Senator Gore?

Senator GORE. Mayor Briley, will you identify Mr. C. D. Ward?

Mr. BRILEY. He is the general counsel of the National Association of Counties, and sitting to my left here.

Senator GORE. The reason I ask you to identify him is that Mr. Ward addressed a letter to the chairman of this committee requesting an opportunity for the National Association of Counties to testify on this bill. I see from the file that the clerk of the committee, Mrs. Springer, notified Mr. Ward that a spokesman for this important association would be permitted to testify, at the direction of the chairman of the committee, and then I see that on November 7 Mr. Ward was notified as to the scheduling of your appearance. Mr. Ward had, prior to November 7, indicated that you would be the spokesman for the organization.

I bring that up because there seems to be a feeling on the part of some that this committee is guilty of obstructionism if it affords interested and concerned citizens an opportunity to testify.

Mr. BRILEY. I do not think so.

Senator GORE. Well, I think you have given important testimony, and I think it illustrates a point about this bill to which insufficient attention has been given.

Now, as you know, while you live in the great city of Nashville, and the big county of Davidson, I live 50 miles away in the small county of Smith.

Just outside my hometown of Carthage, where there is a broad place in the road, I see many people gathering early in the morning for the trip to Nashville to work each day. Now, this is a roundtrip of 104 miles. I know, I drove it at night for 3 years going to law school.

Mr. BRILEY. I remember very well, Senator.

Senator GORE. Let us take one of my neighbors who works at the Ford Glass Plant. I specify the plant because I have a neighbor who works at that plant, and it just comes to mind. It might be a neighbor who works at any other plant. This neighbor owns, I think a Chevrolet, although he works for Ford.

Whatever the make of the car, how much gasoline do you think one might burn in driving from Carthage to Nashville and return?

Mr. BRILEY. In the terms of taxation I would say probably in the 104 miles he will burn about 7 cents per gallon, at the rate of about 15 miles per gallon.

Senator GORE. Let us do a little calculation; I want to find out.

Mr. BRILEY. 28 cents in local taxes.

Senator GORE. 28?

Mr. BRILEY. 28 cents in local taxes.

Senator GORE. And this bill would deny him the privilege of deducting that from his——

Mr. BRILEY. Correct.

Senator GORE. If we extrapolate that it amounts to about $175 a year, does it not, in State taxes?

Mr. BRILEY. Yes.

Senator GORE. Now, this is something that is being taken away from this neighbor of mine by this tax bill, is it not?

Mr. BRILEY. That is correct, and it would put him in the same position of the fellow who does not even drive a car to go to his place of business, and takes a standard deduction. He would get as much tax exemption in his standard deduction as your neighbor who spends the 28 cents per day in State taxes.

Senator GORE. So you would think that this is a discrimination against——

Mr. BRILEY. I do.

Senator GORE (continuing). My neighbor who drives his automobile to work.

Mr. BRILEY. I do, very much so.

Senator GORE. And you are asking the committee to strike this from the bill?

Mr. BRILEY. Right; that is correct.

Senator GORE. And you have asked for the privilege of coming here to represent this National Association of Counties to ask the committee to do this?

Mr. BRILEY. That is right. We took the same view, Senator, on the basis that the homeowner and the taxpayer that you are describing are the best citizens in America. We do not believe that those people who do not subscribe to payment of these taxes and do not pay them should have the same tax exemption as the fellow who has that responsibility of paying these described taxes.

Senator GORE. Do you think that this neighbor of mine who is, by this bill, to be denied a deduction of $175 a year for his gasoline tax by this bill would think you are guilty of participating in any obstructionism on this tax bill?

Mr. BRILEY. I hope not.

Let me say this: My position is not just in this incident. My position is in the matter of intergovernmental relationships.

Senator GORE. I understand.

Mr. BRILEY. And I think that we who are in local government must take a position that sustains the traditional systems of government in this country, and the basic foundation of making the Federal Government sound is the base, grassroots function of America in local government.

Senator GORE. Mr. Mayor, you and I have been friends for a long, long while, and I appreciate this friendship, and I appreciate your testimony. I think your testimony is important. It brings to the attention of this committee one more part of this bill to which only minimal attention has heretofore been given; that is, the things that this bill would take away from the average citizen. I know that the Secretary of the Treasury likes to talk about the 15 cents a day tax reduction that this bill may give to a workingman, but while something is being given to him with one hand, more is being taken away with the other by this bill.

I am glad that you have come here to call this to the attention of the committee. I hope you do not mind if I ask you a few more questions to emphasize and illustrate this point.

Now, let us look at another thing. What would the State license tag for this workingman's automobile cost?

Mr. BRILEY. $10.50 to $13.50.

Senator GORE. Well, let us take the minimum, $10.50. That goes on top of the $175 gasoline tax, does it not?

Mr. BRILEY. That is right.

Senator GORE. We are up to $185.

Mr. BRILEY. We even might have a green sticker in Davidson, you know. [Laughter.]

Senator GORE. Do you either accept or claim responsibility for that?

Mr. BRILEY. I deny any credit for it. [Laughter.]

Senator GORE. How much would that cost?

Mr. BRILEY. It was $10, and we have removed it.

Senator GORE. You have removed it?

Mr. BRILEY. Yes.

Senator GORE. You claim credit for that, do you not?

Mr. BRILEY. I claim credit for removing it. You claim credit for everything that is good and disclaim credit for everything that is bad. [Laughter.]

Senator GORE. This bill would also deny the taxpayer a deduction for his tax on cigarettes and tobacco, would it not?

Mr. BRILEY. Yes.

Senator GORE. Now, being a nonsmoker——

Mr. BRILEY. I smoked three, I think, while I am sitting here. [Laughter.]

Senator GORE. Would you give us an estimate of what your taxes on cigarettes and tobacco would be in the course of a year?

Mr. BRILEY. From 7 to 14 cents a day.

Senator GORE. From 7 to 14 cents a day.

If it were 10 cents a day it would be about $36 a year.

Mr. BRILEY. For an average, yes.

Senator GORE. Well, let us lean over backward in this example, be conservative, and say $30 per year.

Now, we started with $175 on gasoline, and got up to $185 with the license fee. Adding the tobacco tax brings the deduction to which a citizen in Tennessee is entitled under present law, but to which he would not be entitled if this bill becomes law, up to $215.

Mr. BRILEY. Correct.

Senator GORE. By conservative estimates, wouldn't you say?

Mr. BRILEY. Very conservative.

Senator GORE. Would there be any way to estimate what the average citizen would pay each year in liquor taxes?

Mr. BRILEY. I think actually that in that particular area most taxpayers do not try to estimate it. The Treasury Department estimates it is $0.7 billion in State and local taxes involved there, whereas they collect $3.3 billion.

Senator GORE. If you divide that by the total number of men, women, and children, as an average it would be $3 to $4 per capita, but I do not believe we need to go that far in being conservative on the estimates. Suppose, just for the sake of this discussion, we say that

the average citizen, the average working man, in Smith and Davidson Counties would pay in the course of a year $5 in taxes on liquor.

Mr. BRILEY. Minimum.

Senator GORE. You think that would be small enough?

Mr. BRILEY. That would be a minimum.

Senator GORE. Mr. Chairman, would you think $10 would be a conservative estimate there, or do you want to get into this?

The CHAIRMAN. I do not want to get into this.

We would have to get into the question of a Virginia gentleman.

Senator GORE. Well, could we agree that $10 a year would be a conservative estimate, on the average?

Mr. BRILEY. Very conservative.

Senator GORE. Well, then, that brings us to $225. Then there are other local taxes for which deductibility is denied by this bill. Selective excises—I am not just sure just what taxes—I would like to ask the staff if this would include sewage, water, utility tax, and various——

Mr. BRILEY. It would include the improvement taxes that are abutting property taxes, an additional exemption that is involved in this bill.

Mr. WOODWORTH. You are speaking of the local improvement taxes, and these selective taxes are those, are selective sales taxes such as, well, the cigarette tax which, by itself, is a selective tax of this nature; a tax on movie admissions will be.

Mr. BRILEY. Gross receipt taxes on amusements.

Mr. WOODWORTH. That is correct, or a tax on jewelry or luggage.

Mr. BRILEY. Luxury taxes that we have——

Mr. WOODWORTH. Yes.

Mr. BRILEY. More primarily used in Tennessee as a matter of gross receipts.

Senator GORE. Have you made an estimate or would you be willing to suggest a rule of thumb estimate, again in the conservative spirit of our discussion, of what the average tax of an average citizen in Tennessee would be?

Mr. BRILEY. If we used the telephone and gas rate, the electrical taxes where they are assigned, they would run about 3 percent of those bills. I do not know what it would be per capita, but it would run about 3 percent.

Senator GORE. Three percent.

Mr. BRILEY. This would run about $3 billion, I would say about $3 billion a year—I mean $3 million a year.

Senator GORE. I am trying to get it down to my neighbor in Smith County, Tenn.

Mr. BRILEY. Well, he may not have gas. I think he has electricity on which he does not pay a tax. If he has private water subscription——

Senator GORE. Would you be willing to suggest an average figure, say, for Tennessee, for the average head of a family——

Mr. BRILEY. It would run between $10 and $20 per year.

Senator GORE. Let us say $15 then.

Mr. BRILEY. Yes.

Senator GORE. This brings us up to $240 per year to which this workingman would be entitled as a tax deduction under present law, and which this bill would deny him.

Mr. BRILEY. Right.

Senator GORE. For many people in Tennessee this would be more than the benefits they would receive from the bill.

Mr. BRILEY. We take the view that the people who are paying the taxes we are talking about are the same individuals who pay the property tax, and we do not think that they should suffer in favor of a standard deduction which would give a person who does not have the same taxes the same benefit.

Senator GORE. I see what you mean.

Then you think that it is fairer and more just for the taxpayer who incurs these expenses, or the payment of these local taxes, to be entitled to the deduction, rather than to give a standard deduction to him as well as to someone who does not incur these expenses?

Mr. BRILEY. That is correct. We take the view that the local government taxpayer does two things. In the first instance, he is a better citizen and, secondarily, he expresses himself with respect to appropriations made by local government, because he is a taxpayer.

Senator GORE. Well, Mr. Chairman, I think the mayor of Nashville-Davidson County has certainly justified his appearance before this committee. I think he has rendered a service by calling to the attention of this committee benefits which this bill would strip from many taxpayers, and I personally appreciate the opportunity of hearing the mayor of the capital city of my State testify on this portion of the bill.

Mr. BRILEY. Mr. Chairman, my prepared paper touches very lightly on another very important point. I recognize the efforts of the Treasury Department and the Members of the Senate and of the Congress to be concerned with the tax havens of municipal exemptions of tax securities.

I participated in 1962 in the Brookings Institution with many of the economists of the Treasury Department, wherein we discussed— two things involved in this tax bill. I think both subjects go back to the basic institutions of government:

No. 1 is the deduction we are talking about here. The second is the broad matter of tax exemption of municipal securities, which has been involved in the Insurance Act of 1959.

Every one of us agreed that there must be tax reforms. I certainly agree to this, and most of us in local government agree to this. But we want to make a warning that is very well expressed in the report of the Brookings Institution after this really comprehensive study. Economists who were in favor of removing the tax haven of certain citizens came to the unanimous conclusion that there must be Federal aid for schools and public improvements of local government unless we maintain the opportunity of marketing our bonds in the manner in which we market them today.

So I would like to add this comment, which is very briefly covered in my paper. We who are in local government are really concerned about any encroachment upon taxation that is going to affect local government.

The CHAIRMAN. You mean the report of the Brookings Institution?

Mr. BRILEY. Yes. This is "Federal Tax Treatment of State and Local Securities." All participants of the meeting are listed in this book.

The CHAIRMAN. Do you want to file that?

Mr. BRILEY. I will file this with the committee because this goes back to the basic philosophy of government.

The CHAIRMAN. Without objection that will be filed.

(The document referred to will be found in the files of the committee.)

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Mayor Briley, I just want to state this. As a member of this committee, I do appreciate your appearance here this morning. I think I should mention that there were at least four ex-Governors around this dais this morning, including our distinguished chairman, the Senator from Georgia, Mr. Talmadge; the Senator from Connecticut, Mr. Ribicoff, and myself.

This subject of intergovernmental affairs is one that has been close to all of us, and it needs more study, we need more discussion and more hearings on this phase of it, because the subject you brought up is really vital when it comes to an operation of the various governmental units in this Nation, together with the taxing of them, Federal, State, and local, and I appreciate very much your appearance.

Mr. BRILEY. Thank you very much, sir.

I will be at your disposal any time you want me. Thank you very much.

(The following article from the County Officer, official publication of the National Association of Counties, was subsequently submitted for the record:)

WILL THESE SNIFFLES DEVELOP INTO PNEUMONIA?

(By Bernard F. Hillenbrand, executive director)

Our National Association of Counties added a plank to the 1963 American county platform strongly endorsing a Federal tax cut. Chairman Wilbur Mills and the Ways and Means Committee should be praised for producing a generally excellent bill from the point of local government.

We do have one serious reservation, however, about the precedent the committee has established with respect to State and local government tax deductibility. Under the terms of the committee's bill, all State and local property, income and general sales taxes (some $27.3 billion) are deductible. However, no other State and local government taxes can any longer be deducted.

Specifically, Federal income taxpayers will not be able to deduct State and local gasoline taxes ($3.5 billion); alcoholic beverage taxes ($0.7 billion); tobacco taxes ($1.1 billion); and miscellaneous taxes ($1.8 billion).

The Treasury will pick up an estimated additional $520 million in new revenue.

THE INHERENT DANGER

The danger here is not the new burden this bill places upon State and local taxpayers (although $520 million of new taxes is not insignificant) but rather that you establish the precedent of shifting the burden of Federal taxes to State and local revenue sources.

You will recall that the original tax proposal of last January was to severely restrict deductibility of State and local property, income and sales taxes. In other words, the new bill establishes the undesirable principle of disallowing Federal deductions of some State and local taxes. We didn't get the pneumonia they originally recommended—we got instead a sniffling cold.

Viewed from another direction, the President wisely pointed out in a recent speech that the real burden of raising revenue is falling upon State and local government. From 1952 to 1962, for example, Federal tax receipts increased 38 percent. During the same 10-year period, State and local receipts increased 113 percent.

It is difficult to see where county government fits in the new national fiscal policies. As we understand these policies, taxes are reduced in order to stimulate spending. Spending stimulates employment. The increased revenues from corporate and personal income taxes increase greatly and make up the loss of the original Federal tax cut.

This makes good sense to us from a national point of view—but where do local governments fit into this picture? Some 87 percent of our county revenues come from property taxes. How then will a tax cut affect real estate revenues?

We can guess, for example, that the tax cut enables families to improve their housing standard. We doubt, however, if the small amounts of the tax cut will be sufficient to stimulate new house construction and it is only new realistic values that add to the property tax base.

Certainly local government will benefit from a tax cut by having reduced welfare loads and in many other direct and indirect ways. But local government still generally finds itself cut off from the main stream of taxable wealth—corporate and individual income taxes.

Perhaps it is time to give very deep consideration to getting local government into the Federal income tax picture. It might be possible, for example, to have a given percentage of the corporation or personal Federal income tax payment returned to the taxpayers' local and/or State government.

This is all the more urgent in the light of our very determined national efforts to use tax and spending policy to fight recession. We suddenly realize, for example, that a most welcome Federal matching grant-in-aid to accelerate local public works quite properly requires the local government to put up half the money. The problem is in getting our matching half.

Local government finances perhaps already have more than the sniffles—we need a fiscal checkup.

The CHAIRMAN. Thank you, Mr. Mayor.

I will associate myself with the distinguished Senator from Tennessee in what he said about your statement.

The next witness is Mr. Russell E. Singer, of the American Automobile Association.

Take a seat, Mr. Singer, and proceed.

Mr. SINGER. Thank you, Mr. Chairman.

STATEMENT OF RUSSELL E. SINGER, EXECUTIVE VICE PRESIDENT, AMERICAN AUTOMOBILE ASSOCIATION; ACCOMPANIED BY FLEMING BOMAR, TAX COUNSEL; AND KERMIT B. RYKKEN, DIRECTOR, HIGHWAY AND LEGAL DEPARTMENT

Mr. SINGER. Mr. Chairman and gentlemen, my name is Russell E. Singer. I am executive vice president of the American Automobile Association, and associated with me, this morning, are Mr. Fleming Bomar, our tax counsel, and Mr. Kermit Rykken, director of our highway and legal department.

The American Automobile Association appreciates the opportunity to submit its views on the Revenue Act of 1963 (H.R. 8363).

Our interest in this legislation is confined to section 207 of H.R. 8363, which revises section 164 of the Internal Revenue Code of 1954 so as to disallow State gasoline taxes, registration fees, and other State license fees as deductions in determining Federal personal income tax liability as applied to the personal use of automobiles.

The provision continues to allow the deduction of such State taxes in carrying on a trade or business. It is for this reason that we term it a "soak the motorist" provision. The annual cost to highway users is estimated to be some $300 million.

We object, strenuously, to having use of the automobile placed in the same category with the consumption of alcoholic beverages and the use of tobacco. We also object to legislation that would continue to allow deductions for State and municipal sales taxes on furs, jewelry, and other such luxury items, but takes away the right of deduction for State motorist taxes.

Study after study by the State highway departments in cooperation with the Bureau of Public Roads proves that 65 percent of all workers depend on automobiles to get to and from their jobs. In fact, a total of 80 percent of private automobile trips are for a necessary purpose. Therefore, the bill is a direct discrimination against millions of wage earners, housewives, and others engaged in meeting the necessities of life.

The Ways and Means Committee, in its report on this bill, sets forth some rather strange reasons for singling out the motorist as its prime targets for discrimination.

In the report issued by the Ways and Means Committee (House Report 749, 88th Congress, first session, pages 47–51) appears an expression of concern about disturbing the balance between homeowners' and non-homeowners' Federal tax liability by not allowing property tax deductions.

We believe this position was taken because of the storm of protest which arose from homeowners when this proposal was released as a trial balloon. The committee further states that general sales taxes would continue to be allowed as a deduction, but that remaining State taxes were to be disallowed because, of all things, they were difficult to substantiate.

We challenge this reasoning so far as motorist taxes are concerned. The 65 million automobile owners have no difficulty in computing the State tax on gasoline and the amount paid annually for the registration of motor vehicles and driver license fees. This is simple arithmetic compared to calculating general sales taxes.

As a matter of fact, the American Automobile Association annually produces one of its most popular publications for widespread distribution on this very subject. It is called Automobile Income Tax Deductions. I am filing a copy of this publication with the committee.

(The document referred to will be found in the files of the committee.)

Mr. SINGER. Furthermore, an increasing number of motorists are using credit cards which give an accurate monthly record of gasoline purchases.

The Ways and Means Committee notes, on page 48 of this same report, that motor fuel taxes accounted for State and local revenues of $3.5 billion in 1961, and that automobile registration fees and driver licenses brought in another $1.8 billion. This makes a total of $5.3 billion in State and local revenues derived primarily from the motorist. I might add, parenthetically, that a report just issued by the Bureau of Public Roads estimates that these taxes in calendar 1963 will yield about $6.1 billion. Thus the revenue in 1961 from State taxes on the automobile and its fuel are about the same as the receipts from general sales and gross receipts taxes which were $5.4 billion in that same year, and for which deduction continues to be permitted.

In comparison, the revenues derived by States from personal income taxes totaled $3.9 billion.

Thus, it can be seen that motorists' State taxes are as high as general sales taxes and higher than State personal income taxes. The Ways and Means Committee recognized the inequitable burden in the distribution of Federal income taxes between owners and nonowners of homes. But they refused to recognize the double taxes paid by the motorist in both Federal and State levies (in fiscal 1963, the Federal

Government collected, in special automative exicse taxes, $5,270,-240,000, of which a large proportion is paid by the motorist) by not allowing deductions for State and local taxes paid.

A further argument advanced by the Ways and Means Committee strikes us as the strangest of all. The committee takes the position that general sales taxes are easy to compute, but motorists' taxes are not. The reason given as to why general sales taxes are so easy to compute is worthy of quotation, and I quote the paragraph from the report:

> In the case of general sales taxes, the Internal Revenue Service has prepared tables which makes it possible for a taxpayer to pick from the table the deductions for general sales taxes which the Internal Revenue Service considers to be an appropriate estimate for an individual with a given income. As a result, this deduction also no longer represents a major problem of computation for taxpayers.

However, Internal Revenue Service warns that these tables cited in the paragraph quoted above are merely guidelines, and should not be considered as firm commitments for allowances since any deduction claimed on a taxpayer's return is subject to substantiation. In this case the language of the Ways and Means Committee is grossly misleading.

Finally, we point out that the dubious arguments and action by the Ways and Means Committee depart from the well-established principle that the Federal income tax be based on ability to pay. In general, the amount of motorist taxes is relatively the same for rich and poor alike, but if these deductions which we seek to protect are not continued, the burden will be felt much more by the lower and middle class income-tax payer. This is even more apparent when we remember that deductions for these State taxes are continued in the case of trades or business or for the production of income.

We respectfully urge the Senate Finance Committee to retain those provisions of existing law which give the motorist the right to deduct, for Federal income tax purposes, State and local taxes for gasoline, automobile registration, and driver license fees.

I should like to add, Mr. Chairman, that these provisions were deleted from the tax law by the Ways and Means Committee after public hearings and while in executive session, so that there was no opportunity for us to protest to the Ways and Means Committee on this particular issue.

Senator GORE. This is the first opportunity you have had to testify on this bill?

Mr. SINGER. Yes, sir.

The CHAIRMAN. You do not agree with Senator Clark then that the committee should be discharged, do you?

Mr. SINGER. No, I do not.

The CHAIRMAN. Senator Clark has offered a motion in the Senate that the committee be discharged and this bill be brought to the floor of the Senate without any further hearings.

Mr. Singer, I want to say this: You have appeared before our committee quite a number of times, and the Chair has refrained from expressing an opinion about the bill up to this date, but I want to say I am in hearty agreement with you on this question. It so happens that, as a member of the State senate and chairman of the roads committee in Virginia 40 years ago, I introduced, and Virginia passed a 3-cent gasoline tax. That was the highest of any State in the Union; very few States had a gasoline tax them, and I think the next one was Pennsylvania which had only a 1-cent tax.

So our people, the Virginia people, have cheerfully paid the gasoline taxes during all these years, and other taxes—it is now 7 cents—for the purpose of building our roads. Your first page states the matter very clearly, to take away the deduction of the gasoline tax, but allow it on furs and jewelry and a number of other things that the tax will be paid on, and so far as my vote is concerned I am going to vote to strike out of the bill this particular question of not deducting the gasoline taxes.

Mr. SINGER. That is very encouraging, Mr. Chairman.

The CHAIRMAN. And that applies to the license taxes as well, of course.

Senator GORE. I gather from your statement that, as between general sales tax payments, on the one hand, and a gasoline tax, on the other, you think the average taxpayer can more nearly and more accurately estimate his gasoline tax than he can his general sales tax?

Mr. SINGER. We do not think there is any question about that, Senator, as I have cited here.

Senator GORE. If one who uses tobacco, on the average, smokes a pack a day, do you think he would have any particular difficulty in estimating the amount of tax he pays in the course of a year on cigarettes?

Mr. SINGER. Well, Senator Gore, I would have to disqualify myself because I do not use tobacco, but my two associates do, and they might be willing to add to that.

Senator GORE. I do not use it either, but it seems to me that you and I could express some opinion that the pesron who bought, on an average, a pack of cigarettes a day could estimate at the end of the year, if he knew what the tax on a pack was, about what his annual tax on cigarettes would be.

Mr. SINGER. Well, of course, the tax on the cigarettes, as I understand it, is Federal as well as State tax, and I do not know the difference between the two rates. Do you know, Mr. Bomar?

Senator GORE. If you knew what the State tax was on a pack of cigarettes and you used a pack a day, you would not have difficulty estimating what you had paid in taxes.

Mr. SINGER. I should not think so.

Senator GORE. Thank you, Mr. Chairman.

Mr. SINGER. I could not qualify as an expert, Mr. Chairman.

Thank you very much.

Senator CARLSON. Mr. Singer, just this before you leave the witness stand. If the Internal Revenue Service is so capable of making tables for the deduction of sales taxes, why couldn't they make some tables for gasoline?

Mr. SINGER. I think that is a very pertinent observation, Senator.

Senator CARLSON. It just occurs to me it would not be very difficult. I agree with the chairman that as far as I am concerned this section is going out. But whether it goes out or not, I do not know. It just seems to me that I would say this for the State, too, having served as a Governor, that whenever we need new revenue we like to look to the automobile owner, and I think the Federal Government saw an opportunity here where they might like to pick up a few hundred million dollars, and that we just soak the automobile owner is the way it looks to me.

Mr. SINGER. That is the way it looks to me, too, Senator.

The CHAIRMAN. Thank you very much, Mr. Singer.

(The following was later received for the record:)

CINCINNATI AUTOMOBILE CLUB,
Cincinnati, Ohio., November 15, 1963.

Hon. HARRY F. BYRD,
U.S. Senate Building,
Washington, D.C.

DEAR SENATOR: On November 22, Russell E. Singer, executive vice president of the American Automobile Association, will appear before the Senate Finance Committee concerning the tax reduction bill. Mr. Singer will testify against section 207 of H.R. 8363 which specifically disallows the deduction of State gasoline taxes, registration fees, and driver license fees.

We offer this letter in support of Mr. Singer's stand. For many years Federal tax laws have permitted automobile owners to deduct, for Federal income tax purposes, taxes paid for the above-mentioned items. The House of Representatives Ways and Means Committee bill would not permit these deductions. In addition, the House passed bill disallowed the deduction of alcoholic beverages and cigarette taxes. We agree with this provision, however we do disagree that this should be lumped together with the disallowance of automotive taxes.

The bill you have before the Senate Finance Committee is supposed to be a tax reduction bill with certain so-called necessary reforms, but as far as the motorist is concerned it adds inequity to an already inequitable tax structure.

State gasoline taxes have no relation to the amount of income or ability to pay but rather depend on how many miles the motorist must drive. Sixty-four percent of all workers depend upon automobiles for the journey between work and home, and 80 percent of all automobile trips are for some necessary purpose.

The House of Representatives report claims that various State and local taxes for which deductions would be eliminated, are difficult to compute. This may be true for State taxes on alcoholic beverages and cigarettes, but it is definitely not true as to State taxes on the motorists. Car owners know to the penny how much they pay in driver licenses and registration fees. By determining a car's gasoline performance and checking the number of miles driven, the computation of State gasoline tax is simple arithmetic.

During the fiscal year 1963 the Federal Government collected in special automotive taxes $5,270,240,000, but only $3,278,698,000 of this went into the highway trust fund which supports the Federal road program. Thus, close to $2 billion paid by highway users was diverted to the support of general government. Basic highway legislation states unequivocally that "It is unfair and unjust to tax motor vehicle transportation unless the proceeds of such taxation are applied to the construction, improvement, or maintenance of highways."

We strongly urge that you give serious consideration to knocking out the "soak-the-motorists section" of the House passed tax bill (sec. 207 of H.R. 8363) which would disallow the deduction of State gasoline taxes, registration fees, and driver license fees for Federal income tax purposes.

Very truly yours,

OTIS R. HESS, *Vice President.*

The CHAIRMAN. The next witness is Mr. Richard Barker of Ivins, Phillips & Barker. Take a seat.

STATEMENT OF RICHARD B. BARKER, ATTORNEY AT LAW

Mr. BARKER. Mr. Chairman, my name is Richard B. Barker. I am a Washington attorney appearing before your committee in behalf of several companies who are interested in the recommendations of the administration with respect to the tax treatment of "employees' moving expenses."

Under the present case law, certain reimbursed moving expenses of persons who are not new employees may be excluded from gross income.[1]

---

[1] In Rev. Rul. 54-429, 1954-2 C.B. 53, the Commission held amount paid to or on behalf of an employee for the expense of moving the employee and his family and his personal and household effects were not compensatory in nature. In John E. Cavanagh, 36 T.C. 30 (1961), the Tax Court, in addition to excluding from income amounts representing reimbursement of the fare for petitioner's family and the freight cost of transporting his household goods, held reimbursement of "living costs incurred by him which were in excess of the ordinary living expenses of his family while his household effects were in transit" did not constitute income to petitioner.

These are primarily the moving expenses of the employee, his family and their personal effects, plus extraordinary living costs at his new situs while awaiting delivery of his household effects.

The House bill proposes to leave undisturbed the present-case law with respect to reimbursed moving expenses for such employees. Rather, the House bill proposes to change existing-case law with respect to two types of situations:

1. Where a person is a new employee it allows him to deduct the moving costs; and

2. Where a person is an old employee and is moved but not reimbursed by his employer, he may deduct the moving costs.

However, the House bill adopts a very restrictive definition of moving expenses and limits it to costs—

(*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 residence.

Due to our great increase in industrial capacity since the end of World War II, employers have found it essential to find new decentralized locations for such expansion and the mobility of our labor force has greatly increased.

By far the larger part of these moves has been for the convenience of the employer and he has found it essential for employee morale to minimize his employees' economic loss. While moving expenses; that is, moving vans and travel expenses are not cheap, they are nowhere near as important as the economic loss an employee may suffer on the forced sale of his old residence, including the legal costs and commissions incident to that sale.

These moves for the convenience of the employer generally come suddenly and often unexpectedly and the employee generally does not have time to wait until the right time of year to sell. Further, these moves often involve moving a whole section or division of a company at one time so that hundreds of houses may be dumped on the market at one time and no arm's-length fair market price is obtainable.

A house one day, before the announcement of a move, may be worth $20,000 and the very next day, after the announcement of the move, might be sold for only $15,000. Again, just as the employee must pay the moving van expenses and travel costs from the old location to the new location, so must he also pay a sales commission, usually 6 percent, in selling his old house.

It seems to us that these latter two items; that is, loss on sale of a house and sales commissions, are an integral part of moving expenses and employers have come to realize that where the employee is asked to move for the convenience of the employer, the employer should reimburse the employee for such economic loss.

In December 1962, the National Industrial Conference Board listed in its management record a survey made among its associates analyzing the practices of 46 companies in relation to help given their employees when they are relocated at the request of their employer. This survey was limited to the action taken by the employer when the employee had to sell his house at his old location.

Twenty-eight (61 percent) of the 46 companies offer to make good whatever loss a transferred employee may sustain in disposing of his old home.

Eleven (24 percent) of the 46 companies help the employees by paying certain of their selling expenses such as brokers' commissions, closing fees and expenses, appraisal fees, title guarantee expense, Federal transfer taxes, and mortgage prepayment penalties.

Seven (15 percent) of the 46 companies do not specifically help their employees with respect to the disposal of their old homes.

Another set of figures which I have recently received from four or five large corporations may help to bring this matter into better perspective. They are as follows:

	1961	1962
Number of employees owning homes and moved by company	2,187	2,534
Average selling price of homes	$18,348	$19,667
Average loss on sale of house reimbursed	$676.21	$919.21
Average selling costs reimbursed	$1,594.71	$1,763.19

I might add that the average loss on the sale of the house that was reimbursed was about 4 percent, whereas the average selling costs reimbursed were around 8 percent, almost double the average loss on the sale of the house. This tends to show the importance of the reimbursement of the selling costs, and it could be expected that they would be above 6 percent because you have a 6-percent selling commission, plus legal costs of closing.

I want to call your attention to a collateral aspect of this moving situation which virtually affects the U.S. Government. In March 1963, the Civil Service Commission published a report entitled "Moving Expenses of Federal Employees." In the introduction of the report the following statement is made:

> Effective use of the reservoir of competence represented by Federal employees requires career mobility; agencies must be free to move employees from job to job and place to place in accordance with the needs of the service. The development of the potential of the individual career employee demands this freedom for his own benefit as well as that of the Government . In recent years agency staffing programs have shown increased emphasis on such career mobility. Nationwide shortages of trained people for many types of jobs have added impetus and urgency to this development.
>
> The Government now pays some of the basic moving expenses of employees who relocate for its convenience. These payments are governed by legislation, but there is a serious question whether or not existing legislation is in step with today's needs. (For example, the actual travel of dependents is reimbursed but not their meals and lodging en route.) The Civil Service Commission understands from Federal agencies and from experiences with its own employees that there is an ever-increasing reluctance of employees to accept geographical transfers. The reason most often heard is that the burdens resulting from out-of-pocket losses are too great for the individual employee to assume and that even when an immediate promotion is offered, the employee has to consider the length of time that it will take him to recover financially from the "reward of excellence" offered him. Clearly, the Government should not expect its employees to subsidize the cost of staffing—beyond the inescapable hardship involved in any major household move.

The gist of this report by the Civil Service Commission is that the United States needs to revise its laws with respect to the moving of Federal employees; that they are antiquated; that they are finding it increasingly difficult to get employees to move, and the U.S. Government needs to have greater mobility of their governmental employees.

The report points out that the two major items of expense which

are causing concern to the Government in the moving of employees, and for which the employees, the Federal employees, are not reimbursed, are the loss on the sale of their homes and the costs of selling their homes.

With this background material before us, let us examine what has happened in the tax law with respect to the items of closing costs and economic loss on the sale of the employee's house in the past. As previously mentioned, many employers have felt morally, if not legally, obligated to reimburse their employees with respect to these two items of moving expense. In 1947, 16 years ago, in the case of *Otto Sorg Schairer*, the Tax Court (9 T.C. 549) said that the reimbursement of the loss by the employer on sale of an employee's house should be treated as part of the sale proceeds of the house and unless the total proceeds exceeded the basis, there was no income to the employee. Note that the *Schairer* case was decided in 1947 and the Commission of Internal Revenue allowed that decision to govern the situation for 15 years. Suddenly, in 1962, in the case of *Harris W. Bradley* (39 T.C. 652), on appeal to the Circuit Court of Appeals for the Fourth Circuit, the Tax Court reversed its prior position in the *Schairer* case and held that reimbursement for the loss on the sale of an employee's house was taxable income. It should be noted that the *Bradley* case was readily distinguishable from the *Schairer* case in that Bradley was a new employee. Five judges of the Tax Court either concurred on the ground that the cases were distinguishable or dissented from the majority opinion.

It is very disturbing to employer-employee relationships to have a practice built up over many years, have that practice sanctioned by the courts, and then have it suddenly reversed. These customs of employer-employee relationships, because of usage, become almost like contracts and it seems to me they should not be upset by changes in the tax laws unless there are compelling reasons to do so.

I can think of no such compelling reasons in this present situation. The administration admittedly is trying to alleviate the hardships of moving employees with respect to changes in location of work for the convenience of the employer. However, the administration, in opposing the relief we are seeking, advised the House Ways and Means Committee that the tax-free reimbursement of closing costs and economic loss on the sale of the employee's house would cost the Government $67 million annually in taxes. I cannot believe this is so for a number of reasons. First, for many years the Government has not been trying to collect taxes on such reimbursements so that their budget figures have not taken this item into account for income purposes. Second, the Government, even if it attempts to collect taxes on such reimbursements, is not likely to succeed. The corporations involved feel a strong moral, if not legal, obligation to protect their employees from economic loss when the employee is moved for the convenience of the employer. The whole problem might be solved, if necessary, by the purchase of the employee's house by the employer at its fair appraised value. This procedure accomplishes what happened in the *Schairer* case; i.e., the reimbursement of economic loss is treated as part of the sale proceeds of the house. Such procedure also eliminates the problem of selling commissions and closing costs. But my clients, and the corporations that have asked me to appear before you, do not want to get into the

real estate business. In short, we are asking you to continue the law that has been in existence for many years—at least up to the time of the unfortunate decision in the *Bradley* case in 1962.

We are asking you to make it possible to continue in existence fair and equitable employer-employee relationships. The effect on the revenue, in the light of what I have stated above, in our opinion, is nil.

Several minor items should be mentioned in closing. First, in the survey we conducted we found in the case of two large corporation that the reimbursement of economic loss almost entirely affects the ordinary employee and not the top executives. In corporation A we found that 85 percent of the reimbursements of economic loss related to employees earning less than $15,000 a year, and 100 percent were earning less than $25,000 a year. In corporation B the same percents were 91 and 99-plus.

These are the employees who cannot afford such economic loss and we insist that making them whole should not be treated as giving them income. You do not make income out of making good a loss. There is not, just is not, any logic to such a proposition of law.

Second, the House bill states that existing case law should control the taxing of reimbursed relocation expenses or losses. Certainly the *Bradley* case is not the final word on the subject. The case is on appeal to the Circuit Court of Appeals for the Fourth Circuit. It generally takes decisions from four or five circuit courts before case law becomes hardened. Thus, it is easy to see that, without legislation on the subject, thousands of taxpayers and the Government will be involved in multitudinous litigation. We think that this is the type of situation that should be solved promptly by legislation.

For example, when I gave the statistical figures of five corporations, those five corporations in and of themselves had over 2,000 employees moved each year, and all of them had this reimbursement policy in effect. That is a potential of over 2,000 tax cases a year. I suppose, as a tax lawyer, I should be delighted to have that many cases arise each year. But I do not think the multitudinous litigation involving all of these thousands of employees for the next 5 years is the way to solve this problem.

Attached to my written statement is a draft of legislation which would accomplish the results we are asking. I ask that it be inserted in the record of this hearing. In this legislation we do not propose that the reimbursement should be exempted from tax but rather that, as in the *Schairer* case, it be treated as part of the sale proceeds of the house and handled accordingly. It should be noted also that in order to prevent any abuses we propose that the amount of the reimbursement that can be treated as part of the sale proceeds of the house cannot exceed 15 percent of the sale price of the house.

Finally, we have added no provision as to effective date because we think the legislation should be deemed as a congressional declaration of existing law; that is, the *Schairer* case theory, which was the established cases law for 15 years. Thank you.

(The attachment referred to follows:)

AMOUNTS RECEIVED FROM EMPLOYER ON SALE OF RESIDENCE OF EMPLOYEE IN CONNECTION WITH TRANSFER TO NEW PLACE OF WORK

It is proposed that H.R. 8363 be amended by adding a new section 224 to the bill that passed the House reading as follows:

"SEC. 224. 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—

"(1) Part I of subchapter O of chapter 1 (relating to determination of amount of and recognition of gain or loss) is amended by adding at the end thereof the following new section:

"SEC. 1003. AMOUNTS RECEIVED FROM EMPLOYER ON SALE OF RESIDENCE OF EMPLOYEE IN CONNECTION WITH TRANSFER TO NEW PLACE OF WORK.

"(a) GENERAL RULE.— If —

"(1) property (in this section called 'old residence') 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 the old residence, and

"(2) the taxpayer's employer, not later than one year after the date such sales contract was entered into, pays part or all of the sale differential on the old residence,

then for purposes of this title the amount so paid shall be treated by the taxpayer or his spouse (as the case may be) 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.

"(b) LIMITATIONS.—

"(1) PERIOD OF EMPLOYMENT.—This section shall not apply unless, for the 6-month period ending on the day on which the taxpayer commences work at the new principal place of work, he was an employee of the employer.

"(2) LOCATION OF NEW PLACE OF WORK.—This section shall not apply unless the taxpayer's new principal place of work—

"(A) is at least 20 miles farther from the old 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 the old residence.

"(c) DEFINITIONS; SPECIAL RULES.—For purposes of this section—

"(1) FORCED SALE PERIOD.—The term 'forced sale period' means the period beginning 90 days before, and ending 180 days after, the date on which the taxpayer commences work as an employee at the new principal place of work.

"(2) SALE DIFFERENTIAL.—The term 'sale differential' means the sum of—

"(A) the amount by which the appraised value of the old residence exceeds the gross sales price of the old residence, plus

"(B) the selling commissions, legal fees and other expenses incident to the transfer of ownership of the individual's residence at the place from which he is moving.

"(3) APPRAISED VALUE.—The appraised value of the old residence is the average of 2 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, but shall not exceed the fair market value. Determination of appraised value shall be made as of the valuation date.

"(4) VALUATION DATE.—The term 'valuation date' means the date selected by the employer for purposes of determining the amount to be paid with respect to the sale differential. Such date shall be on or before the date the sales contract is entered into and within the forced sale period.

"(5) EMPLOYER.—The term 'employer' means the person who employs the taxpayer as an employee at the new principal place of work. Such term includes any predecessor or successor corporation and any parent corporation or subsidiary corporation. For purposes of the preceding sentence, 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 but by reference to the date on which the taxpayer commences work as an employee at the new principal place of work (in lieu of as of the time of the granting of the option).

"(6) EXCHANGES.—An exchange by the taxpayer or his spouse of an old residence for other property shall be treated as a sale.

"(7) TENANT-STOCKHOLDER IN A COOPERATIVE HOUSING CORPORATION.—References to property used by the taxpayer as his principal residence includes stock held by a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section) if the house or apartment which the taxpayer was entitled to occupy as such stockholder was used by him as his principal residence.

"(d) 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 I of subchapter O of chapter 1 is amended by adding at the end thereof the following:

"Sec. 1003. Amounts received from employer on sale of residence of employee in connection with transfer to new place of work."

The CHAIRMAN. Thank you very much, Mr. Barker.

Any questions?

The next witness is Mr. Hover T. Lentz, of Denver, Colo.

Would you take a seat, Mr. Lentz, and proceed.

STATEMENT OF HOVER T. LENTZ, ATTORNEY, DENVER, COLO.

Mr. LENTZ. Mr. Chairman and members of the committee, my name is Hover T. Lentz. I am a lawyer from Denver, Colo., appearing before you today on behalf of the Downtown Denver Improvement Association, an association of business and property owners in downtown Denver. My client is acting on behalf of its members and also the property owners at large of the Moffat Tunnel Improvement District of Colorado.

We are convinced that taxes levied by this district should continue to be fully deductible for income tax purposes by all real property taxpayers in the district. Subsection 164(5)(B) of the Internal Revenue Code of 1954 specifically permitted such full deduction. I appear before you because section 207 of H.R. 8363 as passed by the House of Representatives deleted this subsection because—to quote the Ways and Means Committee report—"This deduction is of quite limited application and your committee believes that provision for such deductions is no longer desirable."

We respectfully disagree with this conclusion. The deduction is of limited application but it is a proper one. The previous decision of your committee to permit the deduction was correct. We urge you to continue the deduction. The House proposal was not part of the Treasury Department's tax program. As our statement will demonstrate, in fairness and equity, taxes levied by the Moffat Tunnel District should be fully deductible as general ad valorem real property taxes by business, industrial, commercial and residential property owners, both large and small.

The Moffat Tunnel Improvement District is an old and unique district. It is a body corporate created by special act of the Colorado Legislature in 1922. It financed and constructed two tunnels approximately 6½ miles long under the Continental Divide west of Denver at an elevation of about 9,200 feet above sea level. The smaller or pioneer bore is used to divert much-needed water from the western slope of the Continental Divide to the Denver water system.

This tunnel currently supplies more than half of the water used by the Denver metropolitan area. A standard-gage, single-track railroad passes through the main tunnel which is part of the main line of the Denver & Rio Grande Western Railroad between Denver and Salt Lake City.

The district covers thousands of square miles and includes all of three Colorado counties and parts of six others. It encompasses most of the present city and county of Denver and extends northwestward from Denver to Colorado's borders with Utah and Wyoming. It has hundreds of thousands of residents and many thousands of property owners.

At its inception the district was legally conceived as a special benefit district, but by reason of a long and complex legal history, it evolved many years ago into a district which annually levies an ad valorem tax on all existing land and improvements in the district as their current values, precisely the same as does any other general taxing entity, such as a city, county, or school district. This history is detailed in our technical memorandum and attached exhibits which I would like to file for the record as a part of my statement.

The Federal income tax law since 1918 has allowed deduction of general property taxes but not taxes—

assessed against local benefits of a kind tending to increase the value of the property assessed.

This exception was intended to cover special improvement assessments (such as those for streets and sidewalks) which were in the nature of capital improvements. A 1928 amendment permitted deduction of such assessments to the extent allocable to maintenance or interest charges, since to that extent the assessments were akin to expenses rather than betterments.

In 1947 the Moffat Tunnel District commenced retirement of its bonded debt of about $15.5 million. The Internal Revenue Service, contending that its taxes were special improvement assessments, disallowed the portion thereof allocable to principal payments on the bonds. The nondeductible portion was all added to the cost of a taxpayer's land even though the tax was levied on the value of both land and improvements. Therefore, no tax benefit, through depreciation or otherwise, was realized unless and until the taxpayer sold his property. These disallowance rules applied both to business and residential properties.

District taxpayers vigorously but unsuccessfully contested this position with the Internal Revenue Service. Failing in this endeavor the matter was presented to your committee in 1954 by the then Senators from Colorado, Eugene D. Millikin, and Edwin C. Johnson, both members of this committee, when it was considering H.R. 8300 of the 83d Congress, which later became the Internal Revenue Code of 1954,

Your committee felt that Moffat Tunnel taxes should be fully deductible. Accordingly, it added subsection 164(b)(5)(B) to the 1954 code permitting full deduction of—

taxes levied by a special taxing district if—
(i) The district covers the whole of at least one county;
(ii) At least 1,000 persons are subject to the taxes levied by the district; and
(iii) 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.

It is this statutory language which the House bill, H.R. 8363 would delete.

This amendment was adopted by the Senate and became part of the 1954 code. Thereafter, the Internal Revenue Service ruled that the Moffat Tunnel District met these requirements and its taxes have been fully deductible since 1954. However, for prior years the Service continued to hold that Moffat Tunnel taxes were only deductible to the extent of interest and maintenance charges, and its position was ultimately sustained by certain court decisions.

The report of this committee on the 1954 amendment did not expand on its reasons for adopting this subsection. Presumably, however, it was convinced after careful study of the matter either (*a*) that taxes like Moffat Tunnel taxes were like general taxes and, therefore, should be treated as such, or (*b*) that they were not the type of local, special, direct benefit taxes which as a policy matter should be treated as nondeductible capital expenditures. Both reasons are sound and supportable as demonstrated in our technical memorandum.

Moffat Tunnel taxes possess the attributes of general property taxes. They are levied on an ad valorem basis for the general purposes of water, transportation, and communication. Each year the district determines the necessary mill levy which, when applied to the current assessed values determined by the various county treasurers for general property tax purposes, will produce enough funds to meet its budget. The tax applies to improvements existing each year, perhaps the majority of which have been constructed since the original formation of the district.

The two tunnels can hardly be said today to be of "local benefit" to the district. The railroad benefits a wide area far beyond the district boundaries. Through terminal connections at Denver and Salt Lake City it provides a direct rail route from Chicago to San Francisco. For many years the main line of the railroad has not run through Moffat and Routt counties in the northwesterly portion of the district as it did when the tunnel was first constructed. Only part of Denver is within the district, yet all of the large Denver metropolitan area is served by water passing through the tunnel.

For 1962 the district collected total taxes of $336,000 on a levy of 0.4 mill. Quite frankly, the House action will not adversely affect the average homeowner since his Moffat Tunnel tax is only a few dollars a year. As a practical matter most of them will continue to deduct the full tax since it is billed on the same tax statement as the general city, county, school district, and State taxes. However, the problem is financially important to my clients and to the many other substantial property owners who each pay several thousands of dollars of Moffat Tunnel taxes annually.

I have left with the committee clerk copies of letters and resolutions from other individuals and organizations supporting our position, including the mayor of the city and county of Denver, the Denver Chamber of Commerce, the Denver Building Owners & Managers Association, the Colorado Bar Association, and the Denver Retail Merchants Association. The Colorado State Chamber of Commerce acting through the Council of State Chambers of Commerce has also protested the House action.

We believe that this committee's decision in 1954, reached after full consideration of all the legal complexities and ramifications, was fair and equitable to district taxpayers and merely placed them on a parity with other real property taxpayers. The amendment did not confer, nor do we now seek, any special privilege or benefit.

The same considerations in favor of full deduction exist today as they did in 1954. We therefore urge you to reaffirm your prior action by amending H.R. 8363 to continue the application of section 164(b)(5)(B) to an existing district which meets its requirements. In our technical memorandum we have suggested an amendment to section 207 of H.R. 8363 which we believe appropriate to accomplish this purpose.

Thank you very much, Mr. Chairman.

(The memorandum previously referred to follows:)

TECHNICAL MEMORANDUM CONCERNING FEDERAL INCOME TAX TREATMENT OF MOFFAT TUNNEL IMPROVEMENT DISTRICT TAXES

The Moffat Tunnel Improvement District is a body corporate created under the statutes of Colorado comprising thousands of square miles. It includes most of the city and county of Denver and extends northwesterly to the borders of Utah and Wyoming.

GENERAL, FACTUAL, AND LEGAL BACKGROUND

The Moffat Tunnel plays an important and integral part in Western economy and life, and particularly in Colorado. From the days of the early settlers it was recognized that a direct, all-weather route across the Continental Divide, was an absolute necessity if Colorado, as the leading State in the Rocky Mountain area, was to grow and progress and reach its full potential. Prior to the construction of the Moffat Tunnel there was no direct transcontinental railroad or other adequate means of transportation east-west across the State. The Union Pacific Railroad bordered the State on the north through southern Wyoming, and the Santa Fe cut through its southeastern corner. The western portion of the State was served either by small branch lines or by no rail facilities whatsoever. The Moffat Road did transverse the Continental Divide but only by means of circuitous routes and ruinous grades. During the winter months it was often blocked for weeks and months at a time by heavy snowfall. A vast area of northwestern Colorado and eastern Utah with tremendous potential wealth in coal, oil, oil shale, and other minerals, as well as timber, ranching, grazing, and farming, was completely cut off from an adequate outlet for its products. A through, all-weather, transcontinental rail line was an absolute necessity to Denver, Colo., and the West.

An adjunct to the original plan for a railroad tunnel was the use of the pioneer tunnel bore for transmountain water diversion to the eastern slope of the Rockies. Hindsight now shows that this was at least equal to trade, transportation, and communication in importance to Denver and the eastern part of Colorado. Without the water that comes through this tunnel daily, Denver would have exhausted its water supply completely many years ago, and its growth would have been absolutely throttled. More than one-half of the municipal water supply of the city and county of Denver comes through this water tunnel.

In 1913, the city of Denver adopted plans to build a tunnel and lease it for railroad purposes, but this was held invalid by the Colorado Supreme Court as a lending of credit to private enterprise. *Lord* v. *Denver* (58 Colo. 1 (1914)).

Numerous other plans to construct such a tunnel by private financing had proved fruitless.

Finally in 1922, at a special session of the legislature, an enabling act was passed (ch. 2, session laws of 1922, extraordinary session; also cited as ch. 93, Colorado revised statutes, 1953).

At that state of legal development in this country, quasi-municipal corporations were an innovation, and as a result the act was originally based on the theory of benefit, that is, it was a special improvement district. Section 1 of the act (sec. 93-1-1, Colorado revised statutes, 1953—hereafter all references to the enabling legislation will be cited to ch. 93, Colorado revised statutes, 1953) sets forth the purpose of the legislation and of the tunnel in the following language.

"It is hereby declared that to provide for an avenue of communication by means of a transportation tunnel through the Continental Divide at or near James Peak will reduce the barrier which now separates the western portions of this State from commercial intercourse with the eastern portion thereof, will facilitate communication all seasons of the year, will promote the health, comfort, safety, convenience, and welfare of the people of the State of Colorado, and will be of especial benefit to the property within the boundaries of the improvement district hereinafter created."

If the draftsmen of this language could have had the benefit of experience now available to us, they could also have added that the Moffat Tunnel would inure to the benefit of not only the people and property within the boundaries of the district and the State of Colorado, but of the entire Western United States.

The Moffat Tunnel Improvement District was created a public body corporate by section 93-1-2. It encompassed all or parts of a number of counties in central and northwestern Colorado. Exhibit 1 shows a map of the district and the resources in the area opened to transportation by the tunnel. (This exhibit was made a part of the committee files.)

It was initially contemplated that the cost of the pioneer bore and the main tunnel would not exceed the sum of $6,720,000. Consequently, section 93-1-10 provided that:

"To pay for the construction of said tunnel, its approaches, equipment, and expenses preliminary and incidental thereto, and to pay interest on bonds issued as hereinafter provided for during the period of construction, the board is hereby authorized to issue the negotiable bonds of said district in an amount not exceeding ($6,720,000), to bear interest at a rate not exceeding 6 percent per annum, payable semiannually."

The act provided for management of the district by the Moffat Tunnel Commission consisting of five members (hereinafter referred to as the board) to be elected by qualified real estate taxpayers in the district (secs. 93-1-4 and 93-1-5).

Construction of the tunnel was directed along the route long considered the most feasible for such a project. The act stated that the tunnel and its approaches "shall be so constructed that the same may be used for standard gage railroads, for the transmission of power and for the use of telephone and telegraph lines, for the transportation of water and for the transportation of automobiles and other vehicles." (Sec. 93-1-6.) The board was given power of eminent domain and other broad powers to enable it to accomplish its assigned task (sec. 93-1-8); it was directed to build a tunnel, to issue bonds in payment therefor, and to contract for the use of the tunnel so as to obtain its maximum use for the aforementioned purposes (sec. 93-1-10).

Pursuant to the foregoing authority and powers, the district, shortly after its organization, issued its bonds in the amount of $6,720,000, bearing date of July 1, 1923 (hereinafter sometimes referred to as the original bond issue). It was anticipated that these bonds could be paid (without resorting to levy of assessments against the property in the district) from revenues to be derived as rentals for the use of the tunnel. However, it was provided (sec. 93-1-13) that if rental revenues should not be sufficient to discharge interest on and principal of the bonds and maintenance expenses of the district, then in order to prevent the occurrence of a deficit it would become the duty of the district to levy assessments annually, if necessary, and in a sufficient amount to pay the bonds, upon all real estate located in the district, except certain public lands which were exempted (secs. 93-1-11 and 93-1-12).

At the time the original bonds were issued, the contract for the building of the tunnel had not been let, nor had the district entered into a leasehold agreement with the Denver & Salt Lake Railway Co. Consequently, because the actual cost of the tunnel could not at that time be determined, no assessments as authorized were levied. Anticipating, however, that such a deficit might occur, counsel

for the purchasers of the original bond issue insisted that steps be taken to appraise the benefits to the several parcels of real estate within the district resulting from the organization of the district and the construction of the tunnel, in order that assessments might be levied against the appraised and equalized benefits in an amount sufficient to provide for any deficit should the revenues derived from the use of the tunnel prove insufficient to amortize the bonds. Accordingly, the board, by resolutions dated July 17, 1922, July 21, 1922, and July 27, 1922, determined that the aggregate full cash value of the real estate within the district for the year 1921, subject to assessment, was $288,443,661, and that said real estate was benefited to the extent of 15 percent of its then full cash value, to wit: $43,266,549.15. This determination was made at a hearing after notice to the owners of all real estate within the district that they might appear at the hearing and submit objections and exceptions to the appraisal of benefits. This procedure followed the district's statutory authority (secs. 93-1-11 through 93-1-18).

The validity of the organization of the district, the original bond issue, and the procedure adopted for the appraisal of benefits was approved by the Supreme Court of Colorado in *Milheim* v. *Moffat Tunnel Improvement District* (72 Colo. 268, 211 P. 649 (1922)) and by the Supreme Court of the United States (262 U.S. 710, 43 S. Ct. 694). No assessments were levied against the benefits so appraised for the purpose of providing funds to pay interest on the original bond issue until 1928. Accruing interest prior to that time was paid from the proceeds derived from the sale of the bonds or from the rentals received from the Denver & Salt Lake Railway Co. for the use of the tunnel. Consequently, initially the original issue of bonds was in the nature of a revenue bond issue supported, however, by the appraisal of the benefits against which assessments might be levied in the future, if necessary, to meet any deficit in the payment of the bonds. The justification for any such assessment, both under the statute and under the decisions upholding its validity, was that the real estate in the district was benefited in an amount at least equal to the benefits appraised.

Owing to the existence of unusual and unexpected physical conditions encountered in the construction of the tunnel, the proceeds of the original bond issue were exhausted long before the tunnel was completed, and it became necessary to raise additional funds. Section 93-1-11 had especially declared that the benefits accruing to the real estate in the district were in excess of the cost of the tunnel. It conferred power upon the board to appraise the benefits to the several parcels of real estate within the district and to levy special assessments upon all such real estate, such assessments to be made in proportion to the benefits to each piece of real estate accruing by reason of the tunnel. By three resolutions adopted March 16, 1925, April 22, 1926, and June 9, 1927, the board levied assessments against the appraised benefits in the amounts of $3 million, $4 million, and $3,250,000, respectively. Except as to amounts and dates, these three resolutions are in substantially the same form. They provided for giving notice to the landowners and fixed dates for hearings on objections to the assessments. No objections were filed. Landowners were notified that they would be permitted to pay their assessments in full within 30 days and that failure to pay within that time would constitute an election to pay in 10 equal annual installments. The district secretary was directed to prepare an assessment record which would include a schedule showing in properly ruled columns the following:

(1) The names of the owners of the property to which benefits are appraised;

(2) The description of the items of property appraised and assessed, arranged by counties;

(3) The total amount of benefits appraised against each item of property;

(4) The total assessment levied against each item of property to which benefits had been appraised, together with a provision for the entry of successive levies of assessment; and

(5) A blank column in which should be entered the assessments paid within the 30-day period.

The resolutions further provided (in accordance with sec. 93-1-18) that from the date of the filing of the assessment record with the treasurers of the various counties included within the district, the assessment should, until paid, constitute a perpetual lien on a parity with the lien for general State, county, city, town, or school taxes, and that no sale to enforce such taxes should extinguish the perpetual lien of the assessments.

It was not anticipated that any substantial number of property owners would pay their assessments in full within the 30-day period. The board recognized that the mere levy of the assessments would produce no immediate cash and would not aid in solving its critical financial problem. The tunnel was less than half completed and the district was in desperate need of cash. Consequently, these resolutions also authorized three bond issues (hereinafter sometimes referred to as the first, second, and third supplemental bond issues, or simply as the supplemental bonds) in the aggregate amount of $8,750,000, dated January 1 in the years 1925, 1926, and 1927, and collectively maturing serially in the years 1947 to 1983, inclusive. The time for the payment of the installments of the assessments was adjusted to anticipate by 1-year bond maturities. An appropriate amount was included in the assessment to pay the interest on the bonds as it accrued. The supplemental bonds were issued in anticipation of the collection of these assessments and were payable from the special fund resulting from their collection. They were not payable from the revenues to be derived from the use of the tunnel as were the original bonds. Interest on the supplemental bonds until 1929 was paid from the proceeds derived from their sale. The assessment record was never filed with the respective county treasurers and as a result the assessments never became a lien. The U.S. Court of Appeals for the 10th Circuit, in the case of *Boynton* v. *Moffat Tunnel Improvement District* (57 F. 2d 772 (1932), certiorari denied, 287 U.S. 620), ultimately held that the supplemental bonds were valid and were not subject to the limitation of $6,720,000 imposed by the original act.

The situation, therefore, until the adoption of the resolution in 1928, which we shall next consider, would seem to be somewhat as follows. The district had outstanding an original issue of bonds in the amount of $6,720,000 payable from the revenues to be derived from the use of the tunnel, but additionally supported, if necessary, to prevent a deficit, by assessments levied against benefits accruing to the real estate in the district, appraised to be $43,266,549.15. The district also had outstanding supplemental bonds totaling $8,750,000, issued in anticipation of the collection of assessments which had been levied in the total principal amount of $10,250,000 (the amount of the assessments exceeded the amount of the bonds, probably to take care of delinquencies, expenses, etc.), which, however, had not been certified to the county treasurers for collection. These assessments were based on a theory of special benefits. The procedure adopted conformed in substance to the usual procedure for defraying the cost of local improvements by the levy of special assessments against real property specially benefited by the improvements. By examining the assessment record prepared by the secretary, a landowner could ascertain the exact dollar amount of his assessment and the amount of his appraised benefits. He had been given the opportunity to pay in full the amount assessed against his land and thereby discharge the amount of the assessment. Up to this point the district had all the earmarks, so far as its legal status was concerned, of a typical improvement district. It is apparent, however, that it was of far wider scope and for an entirely different purpose than the normal special improvement district.

After the sale of the original and supplemental bonds, the board was faced with a very practical problem. To set up records in all counties included within the district for each of the four outstanding bond issues, as contemplated by the resolutions of 1925, 1926, and 1927, would have been extremely difficult and expensive. The cost would have amounted to something like $100,000. Since the adoption of the 1925 resolution, the district, by contract dated January 6, 1926, had leased the railway use of the tunnel to the Denver & Salt Lake Railway Co. for 50 years at a stipulated annual rental of two-thirds of the annual maturing principal and two-thirds of the annual accruing interest on the original issue of bonds and the first supplemental issue. Thus, the remaining one-third of principal of and interest on the original and first supplemental bond issues, together with all principal of and interest on the second and third supplemental issues was required to be financed by some other means.

1. In order to simplify procedure, to save bookkeeping costs and to assure the payment of interest on all outstanding bonds, the board adopted a very important resolution on May 8, 1928. This resolution recited that revenues received from the railroad lease were insufficient by $476,200, to pay interest accuring on the bonds of 1929 and estimated expenses of the district for that year in the amount of $40,000. It appraised the benefits accruing to the land in the district at 15 percent of the 1928 assessed valuation. This resulted in greatly increasing the benefit appraisal by reason of the increased assessed valuations since 1921 and the inclusion of improvements constructed thereafter. It

further provided that of the assessments previously levied under the resolutions of 1925, 1926, and 1927, $476,200 should be collected in order to pay interest on the supplemental bonds falling due during 1929 and in order to meet the deficit in the payment of the interest on the original issue, together with $40,000 to meet expenses. It assessed this amount against the lands in the district in the proportion that the total valuation of such lands bore to the valuation of each individual tract. No attempt whatsoever was made to fix the dollar amount of the assessment against any particular tract. The board determined the rate of the mill levy on the basis of assessed valuation on all lands in the district necessary to produce the needed amount and then certified the rate of mill levy to the county officials for collection. The county officials simply set up a separate column on their books representing the mill levy for the Moffat Tunnel Improvement District, applied that levy to the assessed valuation of the taxable real property in the district and included the result in the tax bill to the individual property owner. At this point we find a radical variation from the normal special improvement tax since this method was tantamount to a general mill levy for all purposes.

Prior to making this levy, the board had provided for a hearing on the amount to be assessed to meet the deficit on the original issue and on the appraisal of benefits. Presumably no hearing was held in relation to suplemental bonds since amounts in excess of the total of each issue had previously been assessed after hearings pursuant to the resolutions of 1925, 1926, and 1927. The 1928 resolution seems to proceed on the theory that it is simply directing a collection in part of assessments previously made for the payment of the supplemental bonds. Each year thereafter the Moffat Tunnel Commission has adopted similar resolutions and has simply made an ad valorem levy on all the taxable real property on a mill basis sufficient to produce moneys to meet interest and principal becoming due at the next ensuing year, plus the estimated expenses for that year. This is precisely the method of levying and assessing general taxes.

2. After the completion of the tunnel and the issuance of the bonds, the Denver Land Co., a property owner within the district, brought suit in 1928 in the Colorado district court in Denver, alleging, among other things, that the only valid bonds which the district was empowered to issue were the original issue of $6,720,000 authorized under provisions of section 209; that the supplemental bond issues were invalid: that by reason of the 1928 assessing resolution the district had abandoned all previous assessments; that the 1928 assessing resolution was unauthorized because of the invalidity of the supplemental bonds; and prayed for an injunction against the collection of any assessments to pay the supplemental bonds. The district answered asserting the validity of its proceedings.

In August 1930, during the pendency of the *Denver Land Co.* case, Boynton and others, suing on behalf of themselves and all other owners of the supplemental bonds, commenced an action in the U.S. District Court of the District of Colorado against the district and its officers alleging that the U.S. district court had exclusive jurisdiction of the subject matter of the suit, i.e., the validity of the supplemental bonds. This exclusive jurisdiction of the Federal court was ultimately determined and the validity of the supplemental bonds was established by the decision of the Court of Appeals for the 10th Circuit in *Boynton* v. *Moffat Tunnel Improvement District, supra*. This resulted in a final decree entered in the U.S. district court by Judge Symes on November 17, 1932. The Supreme Court of Colorado, at about the same time, held that the Federal court had jurisdiction and not the State court. *Denver Land Company* v. *Moffat Tunnel Improvement District* (92 Colo. 43, 18 P. 2d 455 (1932)). This decree of Judge Symes constituted the second step rendering the taxes assessed by the Moffat Tunnel Improvement District general taxes rather than special assessments, the first step being the resolution of 1928 assessing these taxes on a mill basis.

The decree confirmed the original 1922 appraisal of benefits based upon the assessed valuation of real estate in the district for the year 1921 and confirmed the assessments against benefits made in the years 1925, 1926, and 1927, and the issue of supplemental bonds in those years in anticipation of collection of the assessments. It particularly affirmed and ratified the resolution of May 8, 1928, redetermining benefits based upon the 1928 valuation, and making an assessment to be collected in the year 1929, sufficient in amount, exclusive of revenues from rentals, to provide for the deficit in the interest on the original issue and the interest on the supplemental bonds, together with the expenses

of the district. It also confirmed the similar resolutions of 1929, 1930, and 1931, and specifically approved the plan of appraisement and assessment set forth in the resolution of May 8, 1928, and directed and enjoined the board for each subsequent year to adopt and enforce a similar resolution until all of the bonded indebtedness should have been fully paid.

The decree emphasizes the following points:

(*a*) It validates all of the supplemental bonds and the assessments in anticipation of the collection of which the supplemental bonds were issued.

(*b*) It validates the plan set forth in the resolution of May 8, 1928, for an annual redetermination of benefits and an annual ad valorem mill levy based upon real estate valuations for each of the years in which such resolution and subsequent annual resolutions were adopted. This means that instead of using the real estate values upon which the original determniation of benefits was made, to wit: the year 1921, the board is authorized and directed to make annual appraisements of benefits based upon valuations for the year in which such appraisements are made. The effect of this is to subject to assessment all improvements to real estate which may come into existence from year to year and to take advantage of any increase in valuation of real estate.

(*c*) It enable the board to effect a large saving in the assessment and collection of taxes. Only a single mill levy is certified to the various county treasurers for collection. (This levy was 2 mills for some years prior to 1952 and was decreased to 1.5 mills in 1952 because of a tremendous increase in assessed valuation based upon a statewide propery reappraisal program. For several years now it has been 0.4 mill and will probably continue at that rate for at least several more years).

(*d*) Section 93–1–18 had provided that the assessments constituted a perpetual lien on a parity with the tax lien for general State, county, city, town, or school taxes. The *Boynton* decree affirms this principle.

3. Neither the original bond issue nor any of the supplemental issues was subject to prior redemption at the option of the district. In 1941, a plan was proposed for their voluntary refunding, which resulted in the adoption of a refunding statute (ch. 169, Sessions Laws of 1941). This plan was never consummated, but approximately $400,000 of bonds were actually refunded as the same became due under the authority conferred by this statute. This statute not only authorized the issuance of refunding bonds, but also attempted to clarify the powers of the district and to establish a procedure for the appraisal of benefits and the levy of assessments consistent with the actual practice of the board under the 1928 resolution and the *Boynton* decree.

This statute constitutes the third step in the transformation of Moffat Tunnel taxes into general taxes, and because of its importance we quote sections 3, 4, and 5, which are the only provisions pertinent to this inquiry.

"SEC. 3. PAYMENT OF BONDS.—The Board may, annually if necessary, appraise or reappraise the benefits to the several parcels of real estate within the District resulting from the organization of the District and the construction and operation of said tunnel, its approaches and equipment, and shall annually levy and collect a special assessment upon all assessable real estate, together with the improvements thereon, within the District, in an amount which, with the available revenues from the use of said tunnel, its approaches and equipment, will be sufficient to provide for the punctual payment, both principal and interest, of the bonds of the District, including bonds issued hereunder, such special assessment to be made in proportion to the benefits to each piece of real estate accruing by reason of said tunnel improvements and in accordance with the rules of apportionment adopted by the Board. In addition, the Board may, in its discretion, pledge as further security for the payment of bonds issued hereunder, both principal and interest, all or any part of the available resources and revenues of the District, in such form and upon such conditions as the Board may determine.

"All assessments provided for herein, together with all interest thereon and penalties for default in payment thereof, and all costs in collecting the same, from the date of the filing of the assessment lists in the office of the Treasurer for the county wherein the real estate is situated, until paid, shall constitute a perpetual lien on a parity with the tax lien for general state, county, city, town or school taxes, and no sale of such property to enforce any general state, county, city, town or school tax, or other lien, shall extinguish the perpetual lien of such assessments.

"SEC 4. DECLARATION OF BENEFITS.—It is hereby found and declared that the total benefits resulting from the organization of said District and the construction and maintenance of said tunnel, its approaches and equipment, accruing to the assessable real estate within the District, are continuing in character and are

not less than one and one-half times the aggregate amount of the bonds of the District hereinbefore in Section 1 described, together with the interest thereon therein described, from and after the respective dates of issue thereof to their respective maturity dates.

"SEC. 5. LIMIT TO THE COLLECTION OF ASSESSMENTS.—Anything herein to the contrary notwithstanding, the total amount of the assessments against the several parcels of assessable real estate within the District which may be collected hereunder shall not exceed the amount of the benefits appraised against such real estate, and in no event shall such collections exceed the total cost of said improvements, as evidenced by the outstanding bonds of the District, including the bonds issued hereunder, together with the interest thereon and such amount as will be sufficient to pay the expenses of the Moffat Tunnel Commission and the maintenance of the Moffat Tunnel Improvement District."

The Refunding Act thus provides for an annual appraisal of benefits. Section 93-1-11 of the original act is subject to construction that there should be only one appraisal of benefits. It had been contended in the *Bonyton* case that the only appraisal of benefits having legal sanction was that made in 1922 on the basis of the assessed valuations for the year 1921. The Refunding Act also declared that the benefits accruing to the real estate within the district "are continuing in character and are not less than one and one-half times the aggregate amount of the bonds of the district." Since the benefits have by legislative declaration been determined to be one and one-half times the principal and interest on the bonds, as a practical matter the bonds have been made general obligations of the district. It is manifest that assessments to pay the outstanding bonds can never exceed the determined benefits. The Refunding Act also seems to remove any doubt as to the power of the district to assess on the basis of valuations which include improvements made subsequent to the initial assessment of benefits and increases in value subsequent to that time. In essence, this legislation constitutes a legislative sanction of the method of assessment adopted by the 1928 resolution and judicially approved in the *Boynton* case, that is, assessment by an annual mill levy to meet the budgeted financial obligations of the district for the succeeding year. Precisely the same taxing procedure is followed in the normal general tax levies of any city, county, or other political subdivision.

4. The fourth and most important step in the legal transformation of the Moffat tunnel taxes into general taxes is the decision of the Colorado Supreme Court in the case of *Moffat Tunnel Improvement District* v. *Housing Authority of the City and County of Denver* (109 Colo. 357, 125 P. 2d 138 (1942)). In 1940, the housing authority, a public corporation, instituted proceedings to condemn certain land within the Moffat Tunnel Improvement District. The district was named one of the parties defendant and resisted the condemnation on two grounds: first, that the State court had no jurisdiction to adjudicate the question of whether the lien of the district assessments would or would not subsist after the condemnation award; and second, that the lien of these assessments was perpetual and that the court could not free the land therefrom. It appeared that all assessments levied against the property had been paid. The court, therefore, was concerned only with assessments to be levied in the future after the land passed into the hands of the housing authority. The Moffat Tunnel Act exempted property owned by the State, cities, towns, school districts, etc., and the Housing Authority Act provided that property owned by the housing authority should be exempt from general taxes and special assessments. The trial court held that the housing authority acquired title to the land and that the land would not be subject to future assessments by the Moffat Tunnel Improvement District. It also denied that the district had any lien or claim on the funds representing the amount of the award deposited with the court. The supreme court affirmed the trial court.

If taxes levied by the Moffat Tunnel Improvement District are special assessments based upon benefits, the lien thereof would attach at the time of the adoption of the assessing resolution and a transfer of real estate to tax exempt organizations thereafter would not free the land from the lien of the assessments. If, on the other hand, the taxes levied by the district are in the nature of general taxes, a transfer of the land to a tax exempt organization would exempt it from all future levies (McQuillin, Municipal Corporations, 3d ed., vol. 14, sec. 38.167, p. 386, and vol. 16, sec. 44.69, p. 184).

In order to clarify the supreme court's decision, we quote from page 12 of the brief filed on behalf of the Moffat Tunnel Improvement District:

"There are various statutes in Colorado which exempt publicly owned property from taxation. These refer to general taxes, in contradistinction to special

assessments based upon benefits. The assessments here are special assessments based upon benefits and are in no sense general taxes, although they are collected in the manner provided by law for the collection of general taxes. Therefore, any statute of the State in reference to general taxes, passed prior to the Moffat Tunnel Act, will not apply, and any general statute of the State, exempting property from special assessment, passed subsequent to the creation of the contractual obligation between the Moffat Tunnel District and the bondholders as set forth in the bonds and the resolutions, cannot apply."

The following is from the brief filed on behalf of the housing authority:

"It is stipulated (F. 120) that beginning in May 1928, and continuing down to the present time, the Moffat Tunnel Commission has levied annually upon all of the property in the district an amount sufficient to prevent a deficit.

"This levy is made not upon the basis of benefits to the property but is levied purely upon an ad valorem basis (F. 157)."

We now quote from the language of the supreme court, as follows (at p. 362):

"By statute all property of governmental agencies within the District is 'exempt from assessment and levy by the board.' '35 C.S.A., c. 138, § 211. By a like enactment all property of the Housing Authority is exempt 'from the payment of any taxes' and 'from all local and municipal taxes.' '35 C.S.A., c. 82, § 56; S.L. '37, c. 172, § 5. Nevertheless it is contended that title to property acquired by the Housing Authority since the Moffat Tunnel levies of 1925, 1926 and 1927, passed burdened with those and all future assessments. Under Denver charter provisions special improvement taxes become valid liens from the effective date of the pertinent ordinance. But as it appears from said stipulation, *the District collects its assessments annually under Section 212, Chapter 138, '35 C.S.A., and these are levied upon an ad valorem, not a benefit, basis.* It follows that property taken over by a tax exempt corporation, prior to such levy, ceases to be subject thereto. *Denver* v. *Tax Research Bureau* (101 Colo. 140, 71 P. 2d 809)." [Emphasis supplied.]

The case might have been decided in favor of the housing authority on the theory that the assessments of 1925, 1926, and 1927 were never certified for collection and, hence, never became liens. The court, however, flatly rests its decision on the character of the tax, i.e., that it is a general tax and not a special improvement tax, so that the lien ceases when the property passes into the hands of a tax-exempt corporation.

This lengthy review of the history and particularly the legal history of the Moffat Tunnel Improvement District clearly demonstrates that taxes levied by the district are in all material respects identical to general real property taxes and should be deductible, as such, for Federal income tax purposes. In summary, the facts show:

(*a*) That initially the district was established and operated on the theory of benefit to the property within the district, that is, it was in the nature of a special improvement district.

(*b*) That by reason of:

(1) The method of assessment adopted in the resolution of 1928;

(2) The approval of this method of the district court decree in the *Boynton* case;

(3) The legislative ratification of the action of the board and the courts by the 1941 Refunding Act; and

(4) The holding of the Colorado Supreme Court in the *Housing Authority* case that the tax was a general not a special improvement tax,

the nature of the taxes which the district levies have been transformed into general taxes as a matter of general law.

HISTORY AND SCOPE OF THE INCOME TAX CONTROVERSY

Section 23(c)(1)(E) of the Internal Revenue Code of 1939 provided as follows:

"In computing net income there shall be allowed as deductions: * * *

"(c) TAXES GENERALLY.—

"(1) ALLOWANCE IN GENERAL.—Taxes paid or accrued within the taxable year, except

"(E) * * * taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges, * * *."

Prior to 1947 there was no particular problem since all taxes levied and paid were used for maintenance of the district's property and to pay interest on its

outstanding bonds. Taxes were, therefore, fully deductible regardless of whether or not the taxes were within the contemplation of the above-quoted subsection.

On July 1, 1947, the first bonds commenced to mature and thereafter the Internal Revenue Service consistently disallowed the portion of the Moffat Tunnel tax which was allocable to payments of principal of the bonds. Prior to July 1, 1947, the district had purchased on the market and destroyed, from time to time, over a number of years, a few bonds, but the local office made no attempt to disallow any portion of the tax prior to 1947, apparently because these prior principal payments were so small as to render the problem de minimis.

Bonds of the district will mature periodically until 1983. As of July 1, 1947, the outstanding indebtedness was approximately $14 million. As of the present this has been reduced to $5,158,000.

The average taxpayer has uniformly deducted Moffat Tunnel taxes as taxes paid for county, city, town, and school district purposes. Prior to 1955 the local director's office raised the issue only where taxpayers owned real estate of substantial value. No attempt was made (except on sample statistical audits) to collect the tax from the average homeowner. Consequently, the action of the Internal Revenue Service fell entirely on large real estate owners, primarily utilities and owners of business real estate in Denver.

Failing to convince the Internal Revenue Service that its position was erroneous, district taxpayers sought legislative relief. Believing that the contention of such taxpayers was meritorious and that taxes levied by the district were like general real property taxes and should be deductible, the Senate Committee on Finance proposed an amendment to H.R. 8300, 83d Congress, 2d sess. (the Internal Revenue Code of 1954). The amendment added section 164(b)(5)(B) to the proposed code to permit the deduction of taxes assessed by special districts for debt retirement and capital purposes (S. Rept. 1622, 83d Cong., 2d sess., pp. 23, 196) and read as follows (added language italicized):

"(5) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not prevent—

"(A) the deduction of so much of such taxes as is properly allocable to maintenance or interest charges; or

"(*B*) *the deduction of taxes levied by a special taxing district if—*

"(*i*) *the district covers the whole of at least one county;*

"(*ii*) *at least 1,000 persons are subject to the taxes levied by the district; and*

"(*iii*) *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 amendment was adopted by the Senate, by the conference committee, and became a part of the Internal Revenue Code of 1954.

Shortly thereafter, the Internal Revenue Service ruled that for years under the 1954 code "annual taxes levied by the Moffat Tunnel Improvement District of Colorado * * * are levied within the requirements specified in section 164(b)(5)(B) * * * and are deductible by taxpayers" (Rev. Rul. 55-284, C.B. 1955-1, 25). The Service continued to disallow deduction for pre-1954 code years of that portion of such taxes which was allocable to debt retirement. In *Western Products Co.* (28 TC 1196, 1213 (1957)) as a minor issue in the case, the Tax Court held that section 164(b)(5)(B) was not intended to be retroactive and without discussion or reasoning merely affirmed Revenue Ruling 55-284, and held that Moffat Tunnel taxes were deductible in years prior to 1955 only to the extent allocable to interest and maintenance charges. This decision was followed in *The Denver & Rio Grande Western Railroad Company* (32 TC 43, aff'd. 279 F. 2d 368 (10th Cir. 1960)).

Therefore, for years prior to 1955 the Internal Revenue Service, and the courts which have considered the issue, denied full deduction of Moffat Tunnel taxes, but thereafter, such taxes have been fully deductible under section 164(b)(5)(B) of the 1954 code.

Section 207 of H.R. 8363 as drafted by the House Ways and Means Committee and passed by the House of Representatives would delete section 164(b)(5)(B) because: "This deduction is of quite limited application and your committee believed that provision for such deductions is no longer desirable" (H. Rept. 749, 88th Cong., 1st sess., p. 51). Unlike other proposed changes which it made, the Ways and Means Committee did not give any public notice whatsoever, prior to its introduction of the bill, that it was considering deletion of this section. As a practical matter it was then too late for taxpayers to protest before such committee or the full House.

Exhibit 2 shows the indebtedness of the district originally and presently outstanding. At issue in the House proposal are future deductions by district taxpayers from 1964 through 1983 of a substantial portion of the $5,158,000 of bonds still to be paid.

Exhibit 3 is a summary of receipts and disbursements of the district in 1962. As indicated more than half of the total district revenues come from rentals from the railroad tunnel, the water tunnel, and interest on U.S. securities owned by the district.

Approximately 86 percent of tax revenues come from that part of the city and county of Denver within the district. While figures are not available for the district as a whole, about 44 percent of total Denver assessed valuation is commercial and industrial property while 56 percent is individual residences, apartments, and multiple dwellings.

Homeowners will be affected by the House proposal only in rare cases because the amount of tax paid is very small. For example, a home worth $30,000 would be assessed in Denver at about $10,000 and the Moffat Tunnel tax at 0.4 mills would be $4 per year. They will undoubtedly continue to deduct the tax in full, since it is billed on the same tax bill as the general real property taxes. See examples in attached exhibit 4. (This exhibit was made a part of the committee files.) However, the issue is important to larger property owners such as the owners of downtown Denver buildings, manufacturing companies, and utilities. Moffat Tunnel taxes paid by some of the more substantial taxpayers in the district for 1962 are:

Denver & Rio Grande Western RR	$2,533.46
Mountain States Telephone & Telegraph Co	6,105.66
Gates Rubber Co	2,080.00
Public Service Co. (on assets other than office building)	4,315.15
Public Service Co. (office building)	1,462.46
First National Bank Bldg	2,016.32
Denver-United States National Center	2,262.52
Denver Club Bldg	968.00
Farmers Union Bldg	677.00
Hilton Hotel Complex	2,835.74
May-D & F Department Store	1,770.00

It is worthy of note that none of the above buildings were in existence when the district was formed and the original taxes were assessed. This serves to emphasize that in practice the district levies an annual ad valorem mill levy each year against each year's then existing land and improvements at then existing assessed values.

REASONS FOR RETAINING SECTION 164(b)(5)(B)

Taxes levised and assessed by the Moffat Tunnel improvement district are general taxes as opposed to special improvement or local benefit taxes under general law.

As indicated above, the district as originally formed had the typical legal structure and attributes of a special improvement district. This is shown by the form of the enabling legislation and by the court decisions in the *Milheim* case. Since its inception, however, it has been radically modified to the extent that it now has all the earmarks of a general taxing district and its taxes are indistinguishable from taxes levied for general purposes which are fully deductible.

Let us examine the attributes of general taxes as compared with special improvement taxes and see how they relate to Moffat Tunnel taxes. (See generally: Dillon, "Municipal Corporation," 5th ed., vol. IV, sec. 1430 et seq; McQuillin, "Municipal Corporation," 3d ed., vol. 14, sec. 38.01 et seq; Page and Jones, "Taxation by Assessment," vol. 1, ch. III.)

Attributes typical of general taxes include the following:

1. The purpose for which they are levied is for the general benefit of those within the boundaries of the authority levying the tax, although the absence of benefit to a particular individual is unimportant. General taxes, thus, are levied for the support of the Government, to provide fire and police protection, to provide for public buildings and public parks, to defray the cost of supplying water, sewer, and other utility services, in order to provide educational facilities and for many other purposes.

The principal benefits derived from the Moffat Tunnel are (*a*) the improvement in commerce, transportation, and communication of the area comprising

the district as well as the State of Colorado and the Western United States in general; and (*b*) the transmountain diversion of water for use by the people of the city and county of Denver and its metropolitan area. Improvement of commerce, transportation, and communication are broad general fields, generally fostered through general taxes. Highways, streets, airports, railroad stations, etc., are for general benefit of the public and are commonly financed from general tax revenues. A tunnel for railroad transportation is in a similar category. The supplying of water is a function of government generally supported by general taxes. As mentioned, the water which Denver now receives through the pioneer bore of the tunnel (more than half its current supply) has been absolutely vital to its people. Without it, Denver's growth and the health and welfare of its citizens would have long ago been drastically impaired.

2. General taxes are almost uniformly levied on an ad valorem basis: After the budget for the ensuing year has been determined, the tax authorities determine the applicable mill levy which, when applied to the then current assessed valuations, will produce sufficient funds to support all phases of government. This is precisely the method of levying and assessing the Moffat Tunnel tax. A glance at exhibit 4, which are sample real estate tax bills for the city and county of Denver, will show that the Hoffat Tunnel tax is billed and computed in the same manner as the general real estate tax levied for school, city, county, and State purposes. This attribute of general taxes was sanctioned judicially by the *Boynton* decree and legislatively by the 1941 Refunding Act. In our opinion it is a controlling factor in this case.

Page and Jones, "Taxation by Assessment" (vol. 1, sec. 36, p. 63), is in accord, stating:

"If the charge or exaction is levied upon all the property within the limits of some political unit, such as a city, county, and the like, and if the levy is made in proportion to the valuation of the property upon which it is levied, such a charge or exaction is held to be a tax, and not an assessment, even if it is levied for a purpose for which the local assessment might have been levied. If the charge or exaction is levied upon all of the property in some preexisting political subdivision of the given political unit, and is levied in proportion to the valuation of such property, such charge or exaction is ordinarily held to be a tax, and not a local assessment."

3. General taxes are annually assessed on the basis of the then existing assessed valuations: Consequently, the tax base is not fixed but changes from year to year as valuations fluctuate and new improvements are made. The Moffat Tunnel mill levy is assessed on each year's valuation.

4. The lien of general taxes attaches annually in the amount of taxes annually assessed: This was the point at issue in the *Housing Authority* case and the Colorado Supreme Court held that the Moffat Tunnel tax lien attached annually and was, therefore, not a continuing lien as to future assessments in the hands of a tax exempt corporation. This is another controlling characteristic of a general tax.

5. Public property and property devoted to charitable uses are generally exempt from general taxes (sec. 93-1-12 of the original act exempted):

"all property of whatever kind and nature owned by the State and by towns, cities, school districts, drainage districts, irrigation districts, park districts, water districts, or any other governmental agency or agencies within the said district."

6. Both the real and personal property within the jurisdiction of the tax authority are subject to general taxes: The Moffat Tunnel is levied only on real estate.

The Colorado decisions in this regard appear at first glance to be irreconcilable. In *Gordon* v. *Wheatridge Water District* (107 Colo. 128, 109 P. 2d 899 (1941)), the supreme court held that the attempt to levy a general tax by a water district only on real estate within the district, violated the uniformity and exemption provisions of the State constitution. However, the *Boynton* case upheld the validity of the Moffat Tunnel tax assessments against all contentions that were raised or could have been raised and is, therefore, res judicata on the question of whether or not the Moffat Tunnel tax is invalid because it is levied only on real estate. Furthermore, the *Housing Authority* decision was rendered subsequent to the *Wheatridge Water District* case and, as previously mentioned, held in effect that the Moffat Tunnel tax was a general tax. Therefore, either the *Boynton* decision was erroneous in holding that the tax was valid against all contentions of illegality and unconstitutionality, or the *Housing Authority* case, insofar as Moffat Tunnel taxes are concerned, in effect limits

the rule of the *Wheatridge* case. Whichever alternative is true, it would clearly appear that the Moffat Tunnel tax is a general tax and that no further constitutional questions can ever be raised against it on the ground that it is not levied against both real and personal property.

7. General taxes are superior to special assessments and a sale for general taxes destroys the liens of special assessments: This was the holding of the Colorado Supreme Court in *City Real Estate, Inc.* v. *Sullivan* (116 Colo. 169, 180 P. 2d 504 (1947)). The Pueblo Conservancy District, a public corporation, organized to construct dikes and other flood control measures on the Arkansas River at Pueblo, Colo., was authorized to levy two kinds of taxes; that is, ad valorem taxes on all property within the district and special assessments according to benefits against parcels of land within the district. In *Pueblo Conservancy District* v. *Moore*, (120 Colo. 287, 210 P. 2d 614 (1949)), the court held that a sale for general taxes extinguished the lien of special assessments which had been levied against the property. The court did not decide whether it extinguished the ad valorem taxes also assessed by the district on the same property. It would, therefore, appear that the question is open in Colorado as to whether a sale for Moffat Tunnel taxes would extinguish the lien of a special assessment tax on the property. This would appear to be the case, however, since the enabling legislation and the decree in the *Boynton* case provide that the taxes should be on a parity with general taxes for city, State, county, town, etc., purposes.

8. The property owner is not entitled to notice nor hearing on the amount of general taxes levied against his property. He cannot pay his general taxes in advance of the levy since the amount thereof is not known: Initially the property owners within the Moffat Tunnel District were given notice of this assessment and a hearing to protest the same. This is presently of no force and effect. The district, by its resolutions, which were confirmed by the *Boynton* decree and the 1941 legislation, declared that the benefits would always be in excess of the principal and interest on the bonds so that in effect the bonds became general obligations of the district and the property owner presently has no chance to protest the amount of his Moffat Tunnel taxes. The Moffat Tunnel taxpayer cannot pay his taxes in advance since the amount of levy is not known from year to year, nor is the assessed valuation of his property determined other than on an annual basis. He is, thus, in a radically different position from the taxpayer in a special improvement district.

9. With respect to general taxes, cumulative levies are permitted; i.e., a city, county, or other district having general taxing powers may levy sufficient amounts to pay its fiscal demands from only those property owners who pay their taxes regardless of how many others may default. Theoretically, one property owner could be required to bear the entire tax burden for the district. This is true as to the Moffat Tunnel Improvement District.

The contrary rule applies to special improvement districts. In the case of *Interstate Trust Company* v. *Montezuma Valley Irrigation District* (66 Colo. 219, 181 P. 123 (1919)), the Colorado Supreme Court held irrigation districts to be special improvement districts which levy assessments on a direct benefit theory only. It therefore held that cumulative levies were not permissible; that is, property owners who had paid their assessments could not be additionally assessed to make up for the delinquencies of nonpaying property owners. This decision has been followed by many subsequent decisions of the court as to other types of special improvement districts such as drainage (*Wilcox* v. *Riverview District* (93 Colo. 48, 25 P. 2d 172)) and water districts (*Gordon* v. *Wheatridge Water District, supra*). In the *Wheatridge* case the court stated (at p. 139):

"Further, insofar as an act attempts to provide for cumulative levies of special taxes to discharge delinquencies of local improvement districts, it is unenforcible under the doctrine announced in *Interstate Trust Co.* v. *Montezuma Valley District* * * *."

This is a very vital distinction between a special improvement tax and the Moffat tunnel tax.

In general, special assessments or taxes assessed against local benefits have attributes converse to those discussed above. However, a few comments should be made to supplement the foregoing discussion.

1. With special improvement taxes there is a localized benefit to the property assessed. Typically, special improvement districts are not separate public corporations, but merely geographic areas within a broader taxing district such as a city. Their chief feature, which is the legal basis for their validity,

is a direct localized benefit to the particular property. The property owner within the geographic area of the assessment district receives a greater, more direct benefit than those not within the district. It is highly doubtful whether a resident of the Moffat Tunnel District actually receives any greater benefits than those not within the district. Certainly as far as transportation, communication, and commerce are concerned, those without the borders of the district are greatly benefited. Property annexed to the city and county of Denver subsequent to the creation of the district receives all the benefits, including that derived from the use of the water tunnel, but is not subject to the Moffat tunnel tax.

To say that in all cases where the benefit to the property within the district is limited to or localized within that district that taxes assessed by such district are special taxes rather than general taxes proves too much. Carrying such a statement to its conclusion would result in the disallowance of all taxes on property for Federal income tax purposes, since no taxing authority or district, be it State, county, or city, can levy taxes on property outside of its jurisdiction, and the benefit derived from the moneys raised by such taxes will be received by the people and property within the district.

2. Special assessments are typically levied not on an ad valorem basis, but on a front foot or square foot basis regardless of the value of the real estate. In "Taxation by Assessment" (Page and Jones, sec. 697), the authors state:

"An assessment based upon valuation has been held in some jurisdictions not to be a true assessment, but rather to be a form of general taxation."

From the foregoing analysis it appears that Moffat tunnel taxes have all the earmarks of general taxes, both legally and practically speaking. If each county comprising the Moffat Tunnel District had joined in a plan to finance the tunnel by contributing their respective pro rata portions of the cost and had then raised their own portion by general ad valorem taxes, there would be no question as to deductibility of such taxes. The Moffat Tunnel District is precisely the same in effect, the chief difference being that the board determines the levy and then certifies it to the various county treasurers for collection from the property within their respective counties.

Even if the Moffat tunnel tax is a special improvement or local benefit tax under general law, nevertheless it is not the type of tax contemplated by Congress to be nondeductible under section 164(b)(5).

Section 164(b)(5) is based on the original Income Tax Act of 1913 which allowed a deduction for taxes "not including those assessed against local benefits." This phrase was expanded by the 1918 act by adding the italicized language: "not including those assessed against local benefits *of a kind tending to increase the value of the property assessed.*" The present statute is the same as the 1928 act which added the provision permitting the deduction for such portion of the taxes as is allocable to maintenance or interest charges.

The additional language added in the 1918 act has been stated to be merely explanatory and not amendatory. *Andrew Little* (21 BTA 911 (1930)). This holding would appear to be doubtful in view of the committee reports on the 1918 act. The report of the conference committee (1939 CB (pt. 2) 135) stated as follows:

"Amendment No. 62: This amendment authorizes a deduction in computing net income for taxes assessed against local benefits when such benefits are not 'of a kind tending to increase the value of the property assessed;' and the House recedes."

Seidman's "Legislative History of Federal Income Tax Laws," page 912, reports the following discussion on the floor of the House with reference to the 1918 act.

"Mr. SMITH of Michigan. Are taxes for local improvements deducted?

"Mr. KITCHIN (floor leader of the bill). No; you cannot deduct those if they are for local benefit.

"Mr. SMITH. The construction of a street in front of your residence or a sidewalk would be an example of a tax assessed against local benefits?

"Mr. KITCHIN. That is right."

It would thus appear that Congress did not intend to disallow deduction of all taxes assessed against local benefits, but only those tending to increase the value of the property assessed. It would further appear that Congress had in mind those districts where there is a direct, local, tangible benefit to the particular property. Witness the example of streets and sidewalks.

Manifestly, therefore, the Moffat Tunnel Improvement District could be a special improvement district under general law and, nevertheless, not come within the scope of section 164(b)(5).

The foregoing propositions are supported not only by the legislative history of the act, but by the regulations construing the act and by several leading court decisions.

The applicable regulation (Reg. § 1.164-4) provides in part as follows:

"So-called taxes, more properly assessments, paid for local benefits, *such as street, sidewalk, and other like improvements*, imposed because of and measured by some *benefit inuring directly to the property* against which the assessment is levied, do not constitute an allowable deduction for gross income. * * * [Emphasis supplied.]

The early and leading cast of *Caldwell Milling Company* (3 BTA 1232 (1926)) discusses the intention of Congress in the following language (at p. 1234):

"We think Congress used the word 'taxes' in this subdivision in a broad sense, and that when it qualified 'taxes' by the words 'those assessed against local benefits' it meant to specify that kind of tax commonly denominated special or local assessments, since the latter have their basis in compensating benefits.

"We are to presume that Congress in framing the Revenue Act of 1918 knew the law relative to special assessments and had regard to the principles underlying their imposition *Welch* v. *Cook* (97 U.S. 541, 543). We think the phrase in question was added in an attempt to clarify the clause and to *distinguish local public improvements*, the cost of which is assessed only against the property benefited, *from those indirect benefits* resulting from improvements such as schools, parks, *waterworks*, etc., which are usually paid for out of general taxes" (at p. 1236). [Emphasis added.]

Similar language is found in Mertens, Law of Federal Income Taxation (vol. 5, sec. 27.47, at p. 59):

"The general class of taxes to which the statute refers is that representing impositions upon property in the vicinity of a local public improvement in order to pay for such improvement, as distinguished from improvements which are citywide and which are usually paid for out of general taxes such as schools, parks, waterworks, etc."

It has been clearly demonstrated that nondeductible taxes or assessments are limited to those which benefit the property directly, such as assessments for street paving, curbing or sidewalks. Moffat Tunnel Improvement District taxes benefit property subject thereto only very indirectly, and the benefits are certainly not of the same nature as those resulting from streets or sidewalks.

One of the primary benefits from the Moffat Tunnel improvement tax is the receipt of water by the citizens of Denver and its surrounding area from the western slope of Colorado. Such benefit is denominated by the above authorities to be an "indirect benefit" which is "usually paid for out of general taxes."

Let us further analyze the applicable Treasury regulation. It states:

"A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited."

On its face this would deny deductibility of the Moffat Tunnel tax. However, it would also deny deductibility of all property taxes since a taxing authority can only tax property within its jurisdiction and can only expend the tax revenues for the benefit of the property or persons within its jurisdiction.

The regulation then goes on to say:

"The real property taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction."

This sentence applies to taxes levied by the Moffat Tunnel District which are levied for "the general public welfare," that is, for water and for improving transportation, communication, commerce and the economic welfare of the district. Moffat Tunnel taxes are levied by the "proper taxing authorities" and "at a like rate against all property in the territory over which" the district "has jurisdiction."

Today, there are a great multitude of special purpose taxing districts which levy general ad valorem taxes clearly deductible under the general rule. In Colorado, for example, there are fire protection districts, water and sanitation districts, water conservation districts, metropolitan water districts, metropolitan districts (providing water, sewer, fire protection, police protection, safety protection, mosquito control, and street improvement), metropolitan recreation districts and hospital districts. The Moffat Tunnel tax should be no different, and the Congress in 1954 agreed.

The same considerations which impelled this committee in 1954 to permit full deduction of Moffat Tunnel taxes still exist today. So far as we know only the Moffat Tunnel Improvement District met the strict qualifications of section

164(b)(5)(B) which this committee imposed. The Ways and Means Committee report reveals no policy or technical reasons for repeal. The 1954 act did not grant a special privilege to district taxpayers but merely recognized the true facts and equities and permitted deduction under the general rule of taxes which are in substance general ad valorem real property taxes annually levied by the district.

The district is unique.

Attached as exhibits are resolutions and letters of the following interested groups supporting the amendment of H.R. 8363 to permit continued full deduction of Moffat Tunnel taxes:

1. Letter from the mayor of the city and county of Denver.
2. Letter and resolution of Denver Chamber of Commerce dated November 18, 1963.
3. Resolution of Downtown Denver Improvement Association.
4. Resolution of Denver Association of Building Owners and Managers.
5. Resolution of Denver Retail Merchants Association.
6. Letter from Colorado Bar Association dated October 21, 1963, to Colorado Senators and Congressmen.

In summary, the taxpayers of the district believe that the action of the Congress in 1954 when it passed section 164(b)(5)(B) of the Internal Revenue Code of 1954 was fair and equitable. It accorded with the basic intent of the income tax law to permit deduction of general real property taxes but not that portion of taxes which are of special, local, and direct benefit to particular property which are really capital expenditures and should be so considered for tax purposes. Accordingly, we urge the Senate Committee on Finance and the Congress to reaffirm its 1954 decision by continuing the existing application of subsection 164(b)(5)(B) to a district which presently meets its requirements, such as the Moffat Tunnel Improvement District of Colorado.

SUGGESTED AMENDMENT TO H.R. 8363

We respectfully suggest that our purpose could be accomplished by amending section 207(c) of H.R. 8363, 88th Congress, 1st session, to read as follows (new language italicized):

"(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1963, *except that such amendments shall not apply to taxes levied by a district described in section 164(b)(5)(B) of the Internal Revenue Code of 1954, for the purpose of retiring indebtedness existing on the date of enactment hereof.*

Respectfully submitted.

DAWSON, NAGEL, SHERMAN & HOWARD, HOVER T. LENTZ,
As Attorneys for Downtown Denver Improvement Association.

DENVER, COLO.

EXHIBIT 2

Moffat Tunnel bonds retired up to and including Oct. 9, 1963

	Rate of interest (percent)	Total number issued	Total principal	Number retired	Balance outstanding	
					Number of bonds	Total principal
1st issue (1923 series)	5½	6,720	$6,720,000	6,720	0	0
2d issue (1925 series)	5¼	2,500	2,500,000	13	2,487	$2,487,000
3d issue (1926 series)	5¼	3,500	3,500,000	3,500	0	0
4th issue (1927 series)	5	2,750	2,750,000	79	2,671	2,671,000
Total		15,470	15,470,000	10,312	5,158	5,158,000
MT refunding bonds (1949)	1.69	200	200,000	200	0	0
MT refunding bonds (1950)	1.4	200	200,000	200	0	0
Total		15,870	15,870,000	10,712	5,158	5,158,000

NOTE.—Retirement dates:
1923 series July 1, 1944, to July 1, 1963, inclusive.
1925 supplementals Jan. 1, 1964, to Jan. 1, 1973, inclusive.
1926 supplementals July 1, 1947, to July 1, 1956, inclusive.
1927 supplementals Jan. 1, 1974, to Jan. 1, 1983, inclusive.
Refunding bonds (1949) July 1, 1957, redeemed Jan. 1, 1955.
Refunding bonds (1950) July 1, 1957 and July 1, 1958, redeemed Jan. 1, 1956.

EXHIBIT 3

Moffat Tunnel Improvement District: Receipts and disbursements, calendar year 1962

RECEIPTS

Tax collections:	
Adams County	$11,801.99
Boulder County	462.89
Denver County	287,765.66
Eagle County	199.12
Gilpin County	947.16
Grand County	3,940.73
Jefferson County	16,495.70
Moffat County	7,608.49
Routt County	6,440.38
Total	335,662.12
Other revenue:	
Railroad tunnel rental	341,980.00
Water tunnel rental	10,000.00
Miscellaneous (including interest on U.S. obligations)	36,806.57
Subtotal	388,786.57
Total	724,448.69

DISBURSEMENTS

Interest paid	293,400.00
Bonds retired	336,000.00
Expenses for collecting taxes, maintenance of tunnel, etc	100,705.46
Total	730,105.46
Excess of disbursements over receipts	5,656.77
Cash balance:	
December 31, 1961	60,308.24
December 31, 1962	54,651.47

The CHAIRMAN. Thank you very much.

Any questions?

(The following letter concurring in the testimony of Mr. Lentz was later received for the record:)

U.S. SENATE,
Washington D.C., November 27, 1963.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Committee on Finance,
Washington, D.C.

DEAR MR. CHAIRMAN: We would like for the record to add our voice to the testimony given by Mr. Hover Lentz of Denver, Colo., urging retention of section 164(b)(5)(B) of the Internal Revenue Code of 1954, relating to special taxing districts. Mr. Lentz is a practicing attorney, who has been known to both of us for many years, and whose practice includes a large amount of tax work. He was, until very recently, a member of the Tax Advisory Committee of the Commissioner of Internal Revenue.

We have examined Mr. Lentz's statement before your committee on November 22 and we are in complete accord with it. We join him in urging that the House bill be amended to continue the equity afforded special taxing districts by section 164(b)(5)(B) of the code.

Thank you for your cooperation and assistance.

Sincerely yours,

GORDON ALLOTT,
U.S. Senator.
PETER H. DOMINICK,
U.S. Senator.

The CHAIRMAN. The next witness is Mr. Otis Ellis of the National Oil Jobbers Council.

Mr. Ellis, take a seat, sir, and proceed.

STATEMENT OF OTIS H. ELLIS, GENERAL COUNSEL, NATIONAL OIL JOBBERS COUNCIL, INC.

Mr. ELLIS. Mr. Chairman, I would like to have my complete statement, if possible, included in the record, and I will use the time limitations here to do the best, in my long-winded way, to digest it.

The CHAIRMAN. Without objection.

Mr. ELLIS. I would like to state at this point I want to add my words and the feeling of the people I represent, that when it comes to criticism of this committee for being obstructionist and taking the time to look into this tax bill, my people like that kind of obstructionism.

We appeared before the House committee and, at that time, all we had were some nebulous recommendations submitted by the President through some of his stratospheric brained economists who were drafting up some of those things, and it was sort of like trying to put a necktie on a beer belch.

Now we have something concrete that we can make contact with, and we commend this committee for taking the time to listen to businessmen and the people in this country who would be affected.

I am appearing for the National Oil Jobbers Council. We represent 34 State and regional associations in the United States, and 12,000 jobbers in 41 States.

Now, to give you some background of these people so you can best appraise the reasons for their feeling about the bill, the most concise definition of an oil jobber is that he is a relatively small, independent businessman engaged primarily, but not exclusively, in the bulk distribution of petroleum products. These people sell approximately 85 percent of all the oil for home heating, over 50 percent of the petroleum products sold to farmers, approximately 30 percent of the gasoline sold to service stations, approximately 75 percent of the commercial heating oil, and a small portion of petroleum products sold to commercial consumers.

In addition, some jobbers sell tires, batteries, and accessories, and practically all jobbers own one or more service stations which they either lease to others or they operate for themselves with salaried personnel.

These businesses are scattered all over the United States. Approximately 40 percent of these people operate as sole proprietors or partners, and the remainder operate under a corporate structure.

Now, this latter group, the corporate structure group, may operate under more than one corporate structure, depending upon the nature, the type, and the business needs of each particular jobber. In practically every instance most of these corporations are of a closely held family-type corporation.

I would like to state that the jobber segment has found itself confused by the economic principles on which this bill is premised, and this is particularly so when viewed in the light of our national debt.

As small businessmen, jobbers, as a general rule, are not economists, and their knowledge of economics is limited to the elementary eco-

nomic maxim if you don't take in more than you pay out you aren't going to be in business very long.

Whether a jobber operates as a sole proprietor, a partnership, or under the corporate structure, he has long since been aware that his chances for business survival are decreasing each year due primarily to confiscatory taxation, harrassing and costly governmental regulations, and ever-increasing competition from large oil companies who have tax advantages that the jobber does not have. Certainly we need relief from them.

In my statement I point out that on the basis of a survey which we have made, the average jobber of the corporate type has a net return after taxes on sales of 1.56 percent. This contrasts to the 25 major oil companies whose returns for 1962 showed that they had a net return after taxes of 9.02 percent, a 600-percent differential between the jobber and the major oil company with whom he competes.

Since the jobber can market petroleum products as economically as any oil company, in fact more economically than any major oil company, it is obvious that the major companies' profit picture is primarily attributable to an artificially supported price before the crude oil produced; and, secondly, the special benefits available by virtue of allowances for depletion and intangible drilling costs.

When the Secretary of the Treasury appeared before the Ways and Means Committee he made the statement:

> Small business, their strength and vitality, are the keystone of our competitive economy and its potential for growth. This must be recognized in the implementation of tax reform.

Unfortunately, however, Mr. Dillon departed from this theme statement in the formulation of the President's proposed reforms, although some improvement has been made by the Ways and Means Committee.

I cannot discuss all of the items in here that affect us, such as some that have been discussed this morning, and I must limit it to the principal things.

First, let us look at the individual income tax structure. Forty percent of these jobbers operate as sole proprietors or partners which means they are going to be subject to the individual tax scale.

The average income for this category of jobber will range between $15,000 and $50,000 per year which, in reality, is a middle-income bracket. It is to be noted that the relief granted to the middle-income bracket is considerably less than that granted to other brackets.

Since this individual is deprived of several deductions heretofore available to him, it cannot be seen that the net effect of this new tax law will produce any tax benefits of consequence to him. In contrast, his rich competitors, the major oil companies, continue with their special tax privileges and, in addition, will obtain significant corporate reductions. Certainly the middle-income member of the small business family is, in reality, the backbone of the small business community, and unless he receives more aid than this bill gives he will continue his consistent voyage to extinction. We, therefore, recommend more equitable treatment be given to the middle-income bracket.

Now, as to the corporate structure in which about 60 percent of my people—under which about 60 percent of my people operate, under the provisions of this bill, the percentage of tax application to the taxable corporate income would be reversed but, unfortunately, this revision leaves the $25,000 dividing line as it is.

Now, many years ago $25,000 of corporate income might have represented the breaking point between small business and intermediate or large-size business. But this breakoff point is no longer realistic and should be nearer $75,000 or $100,000.

The incorporated oil jobber, with a taxable income of less than $25,000, would receive some relief on the basis of the tax rate change to 22 percent. However, when this jobber goes above $25,000, either in one or more corporations of the brother-sister variety, under common control, the situation changes considerably.

As will be noted from the example which I have attached to this statement, the jobber with a multiple corporate structure could, under the 6 percent additional tax alternative, effect some small savings in the corporate tax. This amount would be insignificant when related to the other deductions which would be disallowed, and also when related to the changes in the capital gains structure for the sale of depreciable real estate.

How this Congress can expect a small businessman to continue as a competitive factor in the marketing arena with negligible tax relief is beyond our comprehension.

Now, as to the capital gains from disposition of certain depreciable property, the average oil jobber considers himself fortunate if he is able to earn enough after taxes to maintain his family in a respectable manner, educate his children, and in all other respects to be able to currently meet his bills for living expenses. Unfortunately, many jobbers erroneously think they are making a profit when, as a matter of fact, they are living off their depreciation reserves. No single jobber of my acquaintanceship is the in-and-out type of promoter such as some who engage in building office buildings, apartment buildings, and other commercial properties, and after holding them for a relatively short time, sell these properties subject to the capital gains tax provision, after taking accelerated depreciation. In this way they make quick capital gains profits.

All jobbers go into the business with a view toward (*a*) either making the jobbing business a lifetime work or (*b*) making it a lifetime work until such time as he is forced by circumstances to get out and take a capital gain rather than continue in a losing business.

Jobbers who have expanded their operations during the last few years by the building of additional service stations and storage facilities have been compelled to use accelerated depreciation in order to obtain capital. The average small businessman in the petroleum industry cannot obtain long-term capital without selling his soul to his major company supplier.

Through the medium of accelerated depreciation, the jobber has been able to amortize some relatively short-term capital acquisitions. Due to Government pressures and the competition of big business, jobbers have been selling out for the past few years by the hundreds. Since a jobber, if he sold out after this bill passes, would be required to pay tax on a portion of capital gain on the basis of ordinary income, the one remaining inducement for trying to continue in business will be gone. The inducement I refer to is the jobber's ability to build up an equity in his business over a period of years which would inure to him if there are no sons to carry on the business for his family in the event of his death.

Under the new bill, he would have to hold every piece of realty for a period of 10 years before he could recover full capital gains treatment on resale. As stated, he must use accelerated depreciation in order to get capital for expansion and this creates a definite hardship which would be difficult for a jobber to overcome. This bill, if it is enacted, I am certain, in 1964 you are going to see hundreds of independent jobbers sell out, and when they sell out, the credit for the farmer, the credit for the homeowner, for his fuel oil supplies has gone down the drain, because the "Mr. Bigs" of this industry do not provide that credit.

Since a critic should have something better to offer, we would like to make these recommendations:

First, individual income tax rates in the $15,000 to $50,000 bracket should be reduced more than is reflected in the present bill. We feel that to do otherwise will seriously jeopardize that portion of the small business community who operate as sole proprietors or partners.

Second, we recommend that the taxation on corporate income be as follows: 22 percent on the first $25,000 of the taxable corporate income; 30 percent on the next $75,000 of income; and the normal tax of 22 percent plus the surtax of 30 percent, graduated downward as provided in this bill, be applied to corporate income in excess of $100,000.

If this is not done, then the provisions relating to the multiple corporations should be stricken from the bill, and the provisions under current law be continued where each corporation was entitled to the separate $25,000 breakoff point regardless of common ownership.

Third, it is recommended that the provisions relating to capital gains on certain depreciable real property be changed in such a manner as to deprive entrepreneurs of tax windfalls but, at the same time, give the full capital gains treatment to businesses and businessmen who have demonstrated by a historical basis of operation that they are not in-and-out business enterprises. For example, if an establishment has been engaged in a particular line of business for a period of 10 years, full capital gain would be given on a sale of all or part of its business assets after such assets had been held for a minimum period of 2 years. I thank you, Mr. Chairman.

(The prepared statement of Mr. Ellis follows:)

STATEMENT OF OTIS H. ELLIS, GENERAL COUNSEL, NATIONAL OIL JOBBERS COUNCIL, INC.

My name is Otis H. Ellis. I am engaged in the general practice of law in Washington, D.C., maintaining offices at 1001 Connecticut Avenue. I am appearing here today on behalf of the National Oil Jobbers Council, in my capacity as general counsel for that organization, for the purpose of presenting the council's views on H.R. 8363.

The National Oil Jobbers Council is a trade organization composed of 34 State and regional associations of independent oil jobbers engaged in the distribution of petroleum products. These State and regional associations represent approximately 12,000 jobbers in 41 States. The associations represented are as follows:

Alabama Petroleum Jobbers Association, Inc.
Arkansas Oil Marketers Association, Inc.
California Oil Jobbers Association.
Colorado Petroleum Association.
Connecticut Petroleum Association.
Empire State Petroleum & Fuel Merchants Association, Inc. (New York).

Florida Petroleum Marketers Association, Inc.
Georgia Oil Jobbers Association.
Illinois Petroleum Marketers Association.
Independent Oil Marketers Asociation of Indiana, Inc.
Intermountain Oil Marketers Association (Idaho, Nevada, and Utah).
Iowa Independent Oil Jobbers Association, Inc.
Kentucky Petroleum Marketers Association (jobber division).
Louisiana Oil Marketers Association (jobber division).
Michigan Petroleum Association.
Mississippi Oil Jobbers Association.
Missouri Oil Jobbers Association.
Nebraska Petroleum Marketers Association, Inc.
Independent Oil Men's Association of New England (Maine, Massachusetts, New Hampshire, Rhode Island and Vermont).
Fuel Merchants Association of New Jersey (jobber division).
New Mexico Petroleum Marketers Association (jobber division).
North Carolina Oil Jobbers Association.
Northwest Petroleum Association (Minnesota and North Dakota).
Oklahoma Oil Marketers Association.
Oregon Oil Jobbers Association.
Pennsylvania Petroleum Association, Inc.
South Carolina Oil Jobbers Association.
South Dakota Independent Oil Men's Association.
Tennessee Oil Men's Association.
Texas Oil Jobbers Association.
Virginia Petroleum Jobbers Association.
Washington Oil Marketers Association.
Wisconsin Petroleum Association.
Wyoming Oil Jobbers Association.

In order to properly appraise the jobber's viewpoints on this bill, it is deemed necessary to describe the jobber's functions and the role he plays in the distribution of petroleum products. The most concise definition of a jobber is that he is a relatively small, independent businessman engaged primarily, but not exclusively, in the bulk distribution of petroleum products. In the United States, independent jobbers sell approximately 85 percent of the oil for home heating, well over 50 percent of the petroleum products sold to farmers, approximately 30 percent of the gasoline sold to service stations, approximately 75 percent of the commercial heating oils and a small portion of petroleum products sold to commercial consumers. In addition, some jobbers sell tires, batteries and accessories and practically all jobbers own one or more service stations which they either lease to independent dealers for operation or operate themselves with salaried personnel. These businesses are scattered throughout every State in the Union and are in reality the smaller tributaries for bulk distribution of petroleum products. Approximately 40 percent of the jobbers operate as sole proprietors or partners and the remainder operate under the corporate structure. The latter group may operate under more than one corporate structure dependent upon the nature, type, and business needs of each particular jobber. Most of the corporations are close held family-type corporations.

The jobber segment has found itself confused by the economic principles on which the current tax bill is premised and this is particularly so when viewed in the light of our national debt. As small businessmen, jobbers, as a general rule, are not economists and their knowledge of economics is limited to the elementary economic maxim that "if you don't take in more than you pay out you aren't going to be in business very long." Whether a jobber operates as a sole proprietor, partnership, or under the corporate structure, he has long since been aware that his chances for business survival are decreasing each year due primarily to confiscatory taxation, harassing and costly governmental regulations and ever-increasing competition from large oil companies who have tax advantages that the jobber does not have. Certainly, the jobber needs relief from these pressures.

The council has compiled a consolidated report of 516 corporate jobber tax returns—such jobbers representing a true and representative cross section. This report reflects the average profit return of this type jobber, before Federal income tax, is 2.6 percent of sales for the year 1962, and after deducting 40 percent for Federal income tax (a weighted average), it was determined that

this jobber had a net return on sales of 1.56 percent. For comparison, a study was made of the 25 largest major oil companies with sales in excess of $100 million each in the year 1962. The combined sales revenue of these 25 companies in 1962 totaled $36,094,244,000. The net profit after taxes was $3,257,072,000 or a return on sales of 9.02 percent. The jobbers' net of 1.56 percent compared to 9.02 percent for the major companies is a difference of approximately 600 percent. Since the jobber can market petroleum products as economically as any major oil company, it is obvious that the major companies' profit picture is primarily attributable to—

(1) An artificially supported price for the crude oil produced and

(2) The special benefits available by virtue of allowances for depletion and intangible drilling costs.

In view of this difficult situation faced by independent petroleum distributors, the Secretary of the Treasury's statement to the Ways and Means Committee in regard to small business was indeed welcome. This statement was "Small business, their strength and vitality, are the keystone of our competitive economy and its potential for growth. This must be recognized in the implementation of tax reform." Unfortunately, however, Mr. Dillon departed from this theme statement in the formulation of the President's proposed reforms, although the bill produced by the Ways and Means Committee is some improvement but certainly not enough to be significantly helpful to the small business community, and particularly the independent petroleum distributor.

Time does not permit discussing in depth each feature of the bill before you as it might affect the oil jobber, and for that reason we will direct our remarks to those features of the bill which affect us the most.

THE INDIVIDUAL INCOME TAX STRUCTURE

Since approximately 40 percent of all jobbers operate as sole proprietors or partners, the income from their business will be subject to the proposed revised tax rates for individuals. The average income for this category of jobber will range between $15,000 and $50,000 per year, which in reality, is the middle income bracket. It is to be noted that the relief granted to the middle income bracket is considerably less than that granted to other brackets. Since this individual is deprived of several deductions heretofore available to him, it cannot be seen that the net effect of this new tax law will produce any tax benefits of consequence for him. In contrast, his rich competitors—the major oil companies—continue with their special tax privileges and in addition, will obtain significant corporate reductions. Certainly, the middle income member of the small business family is in reality the backbone of the small business community and unless he receives more aid then this bill gives he will continue his consistent voyage to extinction. It is, therefore, recommended that more equitable adjustment be made in the proposed schedule of rates for individuals in order that this middle income small businessman may have enough left over to modernize, expand, and in other respects, try to keep competitive with the large oil giants.

THE CORPORATE TAX STRUCTURE

Since 60 percent of the jobbers operate under the corporate structure, they are vitally concerned with the proposed revisions and particularly as to the multiple surtax exemption. Under the provisions of the bill, the percentage of tax application to the taxable corporate income would be reversed but unfortunately this revision leaves the $25,000 dividing line as it is. Many years ago, it was possible that a $25,000 corporate income would represent the breaking point between small business and the intermediate or large size business. With the advent of the 50-cent dollar, this breakoff point is no longer realistic and should be nearer $75,000 or $100,000. The incorporated oil jobber with a taxable income of less than $25,000 would receive some relief on the basis of the tax rate change to 22 percent; however, when this jobber goes above $25,000, either in one or more corporations of the brother-sister variety, under common control, the situation changes considerably. As will be noted from example No. 1 attached to this statement, a jobber with a multiple corporate structure could under the 6-percent additional tax alternative effect some small savings in the corporate tax. This amount would be insignificant when related to the other deductions which would be disallowed and also when related to the changes in the capital gains structure for the sale of depreciable real estate. In brief, unless the corporate jobber had a taxable income less than $25,000, the relief

granted is far overwheighed by other disadvantages in the bill. How this Congress can expect small businessmen to continue as a competitive factor in the marketing arena with negligible tax relief is beyond our comprehension.

CAPITAL GAINS FROM DISPOSITION OF CERTAIN DEPRECIABLE REALTY

The average oil jobber considers hmiself fortunate if he is able to earn enough, after taxes, to maintain his family in a respectable manner, educate his children, and in all other respects to be able to currently meet his bills for living expenses. Unfortunately, many jobbers erroneously think that they are making a profit when, as a matter of fact, they are living off their depreciation reserve. No single jobber of my acquaintanceship is the in-and-out type of promoter such as some who engage in building office buildings, apartment buildings, and other commercial properties, and after holding them for a relatively short time, sell these properties subject to the capital gains tax provision, after taking accelerated depreciation; thus, making quick capital gain profits. All jobbers go into the business with a view toward (*a*) either making the jobbing business a lifetime work, or (*b*) making it a lifetime work until such time as he is forced by circumstances to get out and take a capital gain rather than continue in a losing business. Jobbers who have expanded their operations during the past few years by the building of additional service stations and storage facilities have been compelled to use accelerated depreciation in order to obtain capital. The average small businessman in the petroleum industry cannot obtain long-term capital without selling his soul to his major company supplier. Through the medium of accelerated depreciation, the jobber has been able to amortize some relatively short-term capital acquisitions. Due to Government pressures and the competition of big business, jobbers have been selling out for the past few years by the hundreds. Since the jobber, if he sold out after this bill passes, would be required to pay tax on a portion of his capital gain on the basis of ordinary income, the one remaining inducement for trying to continue in business will be gone. The inducement I refer to is the jobber's ability to build up an equity in his business over a period of years which would inure to him if there are no sons to carry on the business for his family in the event of his death. Under the new bill, he would have to hold every piece of realty for a period of 10 years before he could recover full capital gains treatment on resale. Since, as stated, he must use accelerated depreciation in order to get capital for expansion, this creates a definite hardship which would be difficult for a jobber to overcome. It is our firm belief that this single feature of the new bill, if enacted, will cause several hundred jobbers to sell out in 1964.

While there are other features of the bill which are repugnant to the jobber, the foregoing are those of principal concern

CONCLUSION

In conclusion, the jobber recommends that the following changes be made in H.R. 8363.

First, the individual income tax rates in the $15,000 to $50,000 bracket should be reduced more than is reflected in the present bill. To do otherwise will seriously jeopardize that portion of the small business community who operate as sole proprietors or partners.

Second, we recommend that the taxation on corporate income be as follows: 22 percent on the first $25,000 of the taxable corporate income, 30 percent on the next $75,000 of income (up to $100,000), and the normal tax of 22 percent plus the surtax of 30 percent, graduated downward as provided in H.R. 8363, be applied to corporate income in excess of $100,000. If this is not done, then the provisions relating to multiple corporations should be stricken from the bill, and the provisions under current law be continued where each corporation was entitled to the separate $25,000 breakoff point regardless of common ownership.

Third, it is recommended that the provisions relating to capital gains on certain depreciable real property be changed in such a manner as to deprive entrepreneurs of tax windfalls, but at the same time, give the full capital gains treatment to businesses and businessmen who have demonstrated by a historical basis of operation that they are not in-and-out business enterprises. For example, if an establishment has been engaged in a particular line of business for a period of 10 years, full capital gain would be given on a sale of all or part of its business assets after such assets had been held for a minimum period of 2 years.

EXAMPLE 1—REDUCTION OF SURTAX EXEMPTION IN CASE OF CERTAIN CONTROLLED CORPORATIONS

A. Assume: Mr. Jones owns all the stock of four corporations, each of which has anual taxable income of $25,000.

Present tax ($25,000×30 percent×4)		$30,000
H.R. 8363:		
Choice 1 (allocate 1 surtax exemption among 4 corporations):		
$25,000×22 percent equals	$5,500	
$75,000×48 percent equals	36,000	
Total	41,500	
Choice 2 (pay 6 percent additional tax):		
$25,000×22 percent×4 equals	22,000	
$25,000×6 percent×4 equals	6,000	
Total		28,000
Tax reduction under H.R. 8363		2,000

B. Assume: Mr. Smith and his wife own all the stock of corporations X and Y; X has taxable income of $20,000 and Y has taxable income of $5,000.

Present tax ($20,000×30 percent equals $6,000; $5,000×30 percent equals $1,500)		$7,500
H.R. 8363:		
Choice 1 (allocate 1 surtax exemption):		
$20,000×22 percent equals	$4,400	
$5,000×22 percent equals	1,100	
Total		5,500
Choice 2 (pay 6 percent additional tax):		
$20,000×28 percent (22 percent+6 percent equals)	$5,600	
$5,000×28 percent equals	1,400	
Total	7,000	
Tax reduction under H.R. 8363		2,000

C. Assume: P. corporation has $50,000 taxable income and owns all the stock of corporations X, Y, and Z. X has $50,000 taxable income; Y and Z have $10,000 each.

Present tax ($70,000×30 percent equals $21,000; $50,000×52 percent equals $26,000)		$47,000
H.R. 8363:		
Choice 1 (allocate 1 surtax exemption):		
$25,000×22 percent equals	$5,500	
$95,000×48 percent equals	45,600	
Total	51,100	
Choice 2 (pay 6 percent additional tax):		
$70,000×28 percent equals	19,600	
$50,000×48 percent equals	24,000	
Total		43,600
Tax reduction under H.R. 8363		3,400

The CHAIRMAN. Thank you very much, Mr. Ellis.

The committee will recess until next Monday at 10 o'clock

(By direction of the chairman, the following is made a part of the record:)

ILLINOIS STATE CHAMBER OF COMMERCE,
Chicago, November 22, 1963.

Hon. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I am enclosing a copy of a supplemental statement by the Illinois State Chamber of Commerce in regard to acceleration of corporate taxpayments. At the time the chamber's testimony was presented on November 7, it was emphasized that under House bill 8363, as passed by the House, we feel that corporations could be subject to a penalty resulting from circumstances occurring after the filing of the estimated tax return.

Senator Dirksen asked us to provide some examples and to express our views on this section at greater length, which has prompted us to prepare the enclosed supplemental statement.[1]

Should you have any additional questions, please feel free to contact me.

Very truly yours,

RAYMOND A. HOFFMAN,
Chairman, Federal Taxation Committee.

SUPPLEMENTAL STATEMENT OF ILLINOIS STATE CHAMBER OF COMMERCE IN RESPECT TO THE REVENUE BILL OF 1963 (H.R. 8363)

Among the specific recommendations made to the Senate Finance Committee in respect to the revenue bill of 1963 (H.R. 8363) was the following relating to section 122:

"Provisions for current taxpayments by corporations should be eliminated or at the very least materially modified."

In connection with the public hearings of the Senate Finance Committee a request was made to have a supplemental statement submitted amplifying the position of the Illinois State Chamber of Commerce with respect to this matter.

The Illinois State Chamber of Commerce submits that the proposals for current taxpayments by corporations should not be enacted because—

1. The proposals apply to only the approximately 15,000 corporations whose annual Federal income tax liability exceeds $100,000.
2. The large corporations which would be affected are recognized in our business economy as having an indefinite, if not a permanent, existence; and the tax burden placed upon these corporations annually is the amount paid into the Treasury out of the corporate assets.
3. The proposal cannot be justified by reference to the tax withholding and other existing provisions of the Internal Revenue Code for current taxpayments.
4. A penalty can be imposed even where an underestimate results from the unavailability of information, errors in computation made in good faith, or from events which transpire after the date on which the estimate is made.

CONTRIBUTION TO GOVERNMENT REVENUES BY LARGE CORPORATIONS

The large corporations which would be affected by this proposal represent approximately 2½ percent of the total taxpaying corporations in the country. These corporations are recognized generally as having an indefinite, if not a permanent, existence. They must be thought of on a "going concern" basis. The tax burden placed upon these corporations annually is the amount paid into the Federal Treasury out of the corporate assets regardless of how the tax may be accrued for financial statement purposes. The proposal in section 122 is that over a 7-year period, 1964 through 1970, in the case of calendar year corporations with tax liabilities in excess of $100,000, 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. This is an advancement of 11 and 12 months, respectively. A comparable advancement is made for fiscal year corporations.

---

[1] Senator Dirksen's request appears on p. 1450 of pt. 3 of the printed hearings.

The report of the Ways and Means Committee to accompany H.R. 8363 states that the proposal of a 7-year transitional period was selected "so that the speedup in corporate payments would not exceed the reduction in tax liabilities provided by the bill." It is significant that in the table provided in the Ways and Means Committee Report (table 10, p. 31, H. Rept. No. 749) the assumption is made that the corporation has $10 million of taxable income, and has based its estimates on 75 percent of this income. Merely providing that there will be no penalty charge for underpayment if the amounts based upon declarations of estimated taxes meet certain requirements (one of which is that the payments equal 70 percent of the tax shown on the final return after subtracting $100,000 and allowing credits) is not a satisfactory answer to a conscientious corporate official. The requirement of section 6016 is for a "declaration of estimated tax," and Treasury Department form 1120-ES includes the following statement immediately above the signature of the corporate official, "I declare under the penalties of perjury that this declaration has been examined by me and to the best of my knowledge and belief is a true, correct, and complete declaration."

If it is assumed that a corporation consistently earns $10 million before providing for Federal income taxes, corporate officers should not be expected to disregard the wording of the Internal Revenue Code and the Treasury Department declaration form and file an estimate each year based upon the assumption that its income will be only $7,500,000. As a matter of interest the following tabulation has been prepared on the basis of the assumption that the declarations of estimated tax filed by corporations having a fixed level of annual income will reflect the actual estimated tax.

	Assuming the annual income subject to tax of a calendar year corporation is—		
	$500,000	$1,000,000	$5,000,000
Tax computed at—			
Current 1963 rates	$254,500	$514,500	$2,594,500
Proposed 1964 rates	243,000	493,000	2,493,000
Proposed rates for 1965 and subsequent years	233,500	473,500	2,393,500
Required taxpayments, under current proposal, during the calendar years—			
1963	254,500	514,500	2,594,500
1964	251,610	511,610	2,591,610
1965	246,070	505,270	2,578,870
1966	246,850	510,850	2,622,850
1967	246,850	510,850	2,622,850
1968	246,850	510,850	2,622,850
1969	244,180	503,380	2,576,980
1970	238,840	488,440	2,485,240
1971	233,500	473,500	2,393,500

Among the significant observations which might be made with respect to the foregoing tabulation are: (1) The annual tax reduction is very small between 1963 and 1971; (2) in the case of corporations with taxable income of $1 million per annum (and actually with respect to corporations whose income is less than that amount but more than $500,000), the tax payments in 1966, 1967, and 1968 are more than the payments required during the calendar year 1965; and (3) in the case of corporations with taxable income of $5 million per annum (and actually with respect to corporations whose income is less than that amount but more than $1 million), the tax payments in 1966, 1967, and 1968 are more than the payments required during the calendar year 1963 under the present law.

LACK OF JUSTIFICATION FOR CURRENT CORPORATE TAX PAYMENTS

The provisions of the Internal Revenue Code requiring tax withholding and declarations of estimated tax by individuals were introduced in the law as aids in collection rather than merely to provide funds for our Government in an earlier fiscal year, and with respect to individuals there was a gesture of tax "forgiveness." There is no intimation—and there should be none—that the proposal is needed to collect the proper amount of Federal income tax from the 15,000 corporations to which it would apply.

In considering the proposals for current corporate tax payments, several factors must be kept in mind concerning the 15,000 corporations which would

be subject to these provisions and distinguish them in large measure from the individual taxpayer.

First, these corporations have very substantial fluctuations in their income which, to a large extent, are unpredictable. The Department of Commerce estimates of net income of corporations by calendar quarters demonstrate the extent of the variations. Something as extraneous as inclement weather in the Christmas season may substantially reduce a department store's entire annual net income. This is not quite so true of individuals who generally realize their income from rather fixed periodic payments such as salary, wages, interest, and dividends.

Secondly, in general, individuals have a fairly current knowledge of their income. On the other hand, these 15,000 corporations obviously conduct large scale operations. Most of them have operations scattered over large parts of the United States, and in many instances all over the world. Their size and geographic scale means a much greater delay in determining income. It is unreasonable to require a corporate officer to sign an estimate of Federal income tax (under penalties of perjury) until he has had an adequate opportunity to gather his financial information. This takes at least 45 days.

The third difference is that individuals generally are on a cash basis and so, when they realize taxable income, they have the cash to pay their tax. Substantially all of these 15,000 corporations are on the accural basis, and the generation of cash lags after the realization of taxable income due in large measure to the collection of accounts receivable. These corporations should not be required to pay tax on income until they have had a reasonable opportunity to realize cash out of this income, and this requires, at the least, a 45-day collection period.

The fourth difference is that an individual on a cash basis of accounting can compute his income from his cash books. A corporation on an accural basis of accounting will have many yearend accruals and adjustments which can not be prorated under the tax law. For instance, a corporation may receive a deduction for pension contribution if made by March 15 of the following year. In many cases the corporate controller will budget this pension contribution throughout the year, and charge a pro rata share of it against income monthly. Pertinent to this point is the following sentence in regulations 1.6655-2(d): "In determining the applicability of the exception described in paragraph (a)(3) of this section, there must be an accurate determination of the amount of income and deductions for the appropriate period, that is, for the 6, 8, 9, or 11 months of the taxable year." The exception is based upon a recognition of technically determined taxable income rather than the income reflected by the corporate accounting statements.

EXPOSURE TO PENALTIES

Specific examples of situations in which a penalty might be unreasonably imposed upon a corporation are described below:

(*a*) Raw material dealers and processors, typically in the food industry, carry large inventories valued on the closing price of a commodity market such as the Chicago Board of Trade. Fluctuations in the commodity market between December 15 and December 31 may eliminate the corporate annual income or may more than double it. The recent headlines concerning Allied Crude Vegetable Oil & Refining Co., which filed in bankruptcy on November 19, 1963, show what can happen when the market drops. Apparently in a space of less than 3 weeks, this corporation lost $19 million. If the commodity market had risen by a comparable amount instead of falling, presumably Allied would have made $19 million. Any estimate of its current annual income made before the market change would, of course, be hopelessly inadequate.

(*b*) Where a corporation conducts substantial operations outside of the United States, it values its net current assets which are in foreign countries at the rates of exchange on the last day of the taxable year. An upward adjustment in these conversion rates could very easily produce large amounts of taxable income in the last 15 days of the corporate year. Two recent examples of sudden changes of currency rates upward were the revaluation of the West German mark and the Dutch guilder up 5 percent in 1961.

(*c*) Corporations doing a substantial defense business may also have large amounts of income generated by a stroke of the pen.

(i) A defense contractor may have large overruns in excess of funds appropriated for his contract and may create the overrun on the informal assurance that the contract will be subsequently amended and the overrun authorized. However, until the overrun is authorized, the Government has no obligation to pay and the contractor has no income to match the expense of the overrun. At the instant the Government issues its contract supplement authorizing the overrun, the contractor suddenly realizes a large amount of income. This income legally accrues in one instant which could occur in the last 15 days of a year.

(ii) Similarly, where a defense contractor has been operating under change orders, the extra compensation to the contractor for the change orders often is in dispute. When these are settled and the contract price adjusted, the contractor may realize a large amount of income or a large loss. Numerous examples of these are found in the decisions issued by the Board of Contract Appeals and a Federal tax case illustrates the point to the extent of $1,143,000 (*Marquardt* 39 TC No. 42).

(*d*) Yearend adjustments in corporate accounting can very substantially affect a corporation's income and is often affected by substantially more than 5 percent, yet the report of the Ways and Means Committee includes an illustration where a corporation files its estimates based on 75 percent of its income (table 10, p. 31, H. Rept. No. 749). Yearend accruals which affect the corporate income by more than 5 percent could result in a penalty. Examples of such estimates include: pension and profit-sharing plan accruals, inventory variations, accruals for vacation pay, adjustments of standard costs to actual costs, etc.

SPECIFIC RECOMMENDATIONS FOR MODIFYING PROPOSAL

As possible modifications of the provisions for current tax payments by corporations, consideration should be given to—

1. Stimulating acceleration of corporate tax receipts by the granting of a discount for voluntary prepayments; or
2. Having the first payment of estimated tax by corporations be required during the 6th month of the taxable year (such payment would combine the presently proposed first two payments) and eliminating the payment required during the 12th month of the taxable year, with a provision that one-half of the remaining tax would be payable at the time the return is due and the other half of such balance payable 3 months thereafter; or
3. Provide for payments on declarations of estimated tax on June 15, October 15, and February 15 for the periods ended April 30, August, 31, and December 31, respectively, with the required percentage of estimated tax to be paid by the respective dates being 33⅓, 66⅔, and 100 percent, and any balance of the computed tax for the year payable 50 percent at the time the return is due and 50 percent 3 months thereafter.

Consideration might also be given to reducing the rate of penalty below 6 percent or converting the penalty amount into interest so as to be allowable as a deduction in computing taxable income. Further, there would be merit in providing for the allowance of a credit where the payment made on account of the estimated tax exceeds the minimum amount required by the statute.

In evaluating proposals for accelerating corporate tax payments several basic factors need to be considered. First, the primary purpose of corporate acceleration appears to be to lessen the impact of tax rate reductions upon the budgeted Government deficit by advancing collections of corporate taxes from one Federal fiscal year into the preceding year. Secondly, in fairness to the 15,000 corporations which would be affected by the proposal, it is important that a minimum of administrative burden be placed upon the corporate officers.

Under the proposals, a corporation is subject ot a penalty if payments based upon its declaration of estimated tax do not aggregate at least 70 percent (less $100,000) of the actual tax computed on its return for the year, unless it meets one of three exceptions. The first exception is that it has paid tax on the basis of its previous year's tax return. This does not apply in cases in which there was no tax liability in the previous year, and can only be met by material overpayments of tax if corporate officers have a sound reason to believe that there will be a decrease in corporate tax liability for the current year. The second exception is merely a modification of the first, taking into account any differential in tax rates applicable in the current year. The third exception allows annualization of taxable income of various expired portions of the year. As pointed out hereinbefore, it would be impossible for a corporate official to deter-

mine taxable income for the applicable expired portion of the year by the times suggested for filing an estimated return and making payment.

Applying these considerations specifically to the recommended alternative modifications, the granting of a discount for voluntary prepayment could be of sufficient magnitude to insure the advance of the receipt of tax by the Federal Government and could eliminate all problems and penalties involved in the proposed system of accelerated payments.

The second proposal, by eliminating on April 15 payment and combining it with the June 15 payment, would allow the collection of the same amount of additional revenue in an earlied governmental fiscal year while, at the same time, allowing a sufficient period for most corporations to make a reasonable calculation of income which could be annualized. Other scheduled payments would similarly allow an opportunity for reasonable calculation, and would minimize the discrimination in time of payment of tax between corporations with an annual liability of $100,000 or more and other coporations subject to tax.

The third proposal would also reduce the number and frequency of required calculations of estimated tax while allowing the Federal Government to materially increase its revenues during the acceleration period by the advancement of collections from one fiscal year to the next earlier year. Similarly, this suggestion would allow a more reasonable period for calculation of income, and would make it somewhat more feasible for corporate officers to schedule tax payment with reasonable relationship to corporate net income and with a materially decreased possibility of accidentally incurring the imposition of a penalty.

It is recommended, as a minimum, that the language of section 6655 be changed to substiute for the annualization of "taxable inome" the annualization of the amount of income for the elapsed months as reflected by the accounting records of the corporation. Further, in the event it is expected that corporate taxpayers should rely upon the percentage leeways in section 6655(d), this should be written into the Internal Revenue Code so that a corporate official signing a declaration of estimated tax will not be subject to the provisions of section 7207 relating to fraudulent returns, statements, or other documents.

AMERICAN GAS ASSOCIATION, INC.,
New York, N.Y., November 12, 1963.

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I am writing as chairman of the American Gas Association Committee of Executives on Taxation, which has followed with interest and studied in detail H.R. 8363, a bill to amend the Internal Revenue Code of 1954.

While the attached review traces the point we are attempting to make, in detail, we feel it useful to summarize briefly our thoughts herein.

Essentially, it seems to us that during the course of drafting H.R. 8363 and the consequent revisions of the Internal Revenue Code, an unintentional oversight may have occurred. Specifically, we find failure to include a specific provision in the Revenue Act of 1963, for the deductibility of Federal excise and stamp taxes, when paid or accrued in carrying on a trade or business, or related to the production of income. We feel somewhat clearer legislation draftsmanship would be desirable, so that there would be no doubt as to legislative intent.

Accordingly, we respectfully suggest the addition of the following paragraph (6) under section 275(a) of the Internal Revenue Code:

"(6) Federal import duties and Federal excise and stamp taxes (not described in pars. 1, 2, 3, and sec. 164(c)); but this paragraph shall not prevent such duties and taxes from being deducted under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income)."

Please let us know if you desire any further explanation regarding our statement of position.

Cordially yours,

R. P. BRIGGS,
Chairman, Committee of Executives on Taxation.

AMERICAN GAS ASSOCIATION

RE REVENUE ACT OF 1963 (H.R. 8363) BY COMMITTEE OF EXECUTIVES ON TAXATION, R. P. BRIGGS, CHAIRMAN

Section 164(a) of the 1954 Internal Revenue Code allows as a deduction, taxes paid or accrued within the taxable year, with the exception of taxes specifically listed in section 164(b) 1 through 7. As an exception to the exception, section 164(b)3 reads:

"(3) Federal import duties, and Federal excise and stamp taxes (not described in pars. (1), (2), (4), or (5)); *but this paragraph shall not prevent such duties and taxes from being deducted under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income)*."

In rewriting section 164 for the revenue bill of 1963, the drafters have changed their approach from that of "allowing all taxes except" to a positive approach of "allowing the following."

Present section 164:

"(a) GENERAL RULE.—Except as otherwise provided in this section, there shall be allowed as a deduction *taxes paid or accrued within the taxable year.*

"(b) DEDUCTION DENIED IN CASE OF CERTAIN TAXES.—No deduction shall be allowed for the following taxes: (7 categories of taxes are then listed)."

Proposed bill section 207(a) code section 164:

(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.

"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 or an activity described in section 212 (relating to expenses for production of income)."

You will note that Federal import duties and Federal excise and stamp taxes are not included in the last sentence above.

In addition, present section 164(b) has been transferred in large part to a new section—section 275——which lists taxes for which no deduction is allowed. However, present section 164(b)3 (see above) is omitted from new section 275.

As a result of this omission from new section 275, and the failure to mention Federal import duties and Federal excise and stamp taxes in the last paragraph of proposed bill section 207(a) code section 164(a) (see quote above), nowhere in the revenue bill of 1963 is the deduction of these taxes specifically permitted, even though paid or accrued in carrying on a trade or business.

The report of the Committee on Ways and Means, House of Representatives, to accompany (H. Rept. 749), refers to the deductibility of Federal import duties, Federal excise taxes and stamp taxes under the present law on page 48 (paragraph starting on line 14), but does not refer to any change in their treatment under H.R. 8363.

The same report, page A41 (last paragraph), entitled "Taxes paid or accrued in carrying on a trade or business or for the production of income" states:

"Such taxes which are now deductible under section 164 remain so; those taxes which are not presently deductible under section 164 are not made deductible by the amendment."

Also, on page A44 (last paragraph), the statement is made:

"The rules presently contained in the other paragraphs of section 164(b), with the exception of paragraph (3), are retained in the new section 275 (described below). The existing paragraph (3) (relating to denial of deduction under sec. 164 for Federal import duties and Federal excise and stamp taxes) is eliminated as unnecessary in view of the revision of the language of section 164 by this section of the bill."

However, the failure to include a specific provision in the Revenue Act of 1963 for the deductibility of Federal excise and stamp taxes, when paid or accrued in carrying on a trade or business or related to the production of income, is not as clear legislative draftsmanship as would seem desirable where, as here, there is no doubt as to the legislative intent.

Accordingly, we suggest the addition of the following paragraph (6) under section 275(a):

"(6) Federal import duties and Federal excise and stamp taxes (not described in par. 1, 2, 3, and sec. 164(c)); but this paragraph shall not prevent such duties and taxes from being deducted under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income)."

GREATER HARTFORD CHAMBER OF COMMERCE,
Hartford, Conn., November 8, 1963.

Hon. ABRAHAM A. RIBICOFF,
Senate Office Building,
Washington, D.C.

DEAR SENATOR RIBICOFF: The board of directors and the Congressional Action Committee of the Greater Hartford Chamber of Commerce want to be helpful with respect to the impact on Connecticut of H.R. 8363, which passed the House on September 25 and is now being heard by the Senate Finance Committee. We trust that our views will supplement your many other sources of information.

Last April the chamber recommended that individual tax rates be reduced to a range of 15 to 65 percent; that corporate tax rates be reduced to 47 percent from the present 52 percent level; and that Federal expenditures be reduced by at least $4.5 billion.

We still favor these goals and hope that you can direct your energies toward the balancing of rate reduction and structural changes with continued efforts to reduce the imbalance of the Federal budget.

In its present form, H.R. 8363 decreases calendar 1964 tax liabilities by $7.075 billion, of which $5.640 billion goes to individuals and $1.435 billion to corporations.

Calendar 1965 liabilities decrease nationally by $11.090 billion, with $8.755 billion going to individuals and $2.335 to corporations.

HOUSE REPORT 749, 88TH CONGRESS, TABLE 1, PAGE 13

You are interested in the impact of the tax reduction on Connecticut. Our research indicates that Connecticut contributes 1½ percent of total corporate tax revenue and 2.11 percent of individual tax revenues.

Thus, for calendar 1964 the tax reduction for Connecticut corporations will be approximately $21.5 million and for Connecticut individuals approximately $119 million.

For calendar 1965 the reduction for Connecticut corporations will be approximately $35 million and for individuals, approximately $185 million.

We have not used U.S. fiscal year figures which produce a very different, and lesser tax reduction. However, the size of Connecticut's Federal income tax contribution should be noted. For the fiscal year ending June 30, 1962, according to the Hartford office, Internal Revenue Service, $7,714,444,000 came from Connecticut, $325,943,000 from corporations and $1,171,788,000 from individuals.

Individual tax rate reduction.—Table 8, page 23 of the House committee report indicates that the rate reduction for those with adjusted gross incomes of zero to $3,000 is 38.3 percent, $10,000 to $20,000 is 16.4 percent, and $50,000 and over is 12.6 percent. We submit that the effect of this distribution is to place a disproportionate burden of taxation on those most likely to take advantage of incentives and to provide jobmaking investment that the Nation and Connecticut so badly need.

Group term life insurance.—An arbitrary ceiling (pp. 3, 39) is placed on group term insurance for the purpose of imputing income to the employee. The U.S. Chamber of Commerce opposed this provision before the Senate Finance Committee on October 21. We agree with their comment that—

"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."

Connecticut's insurance business has a very large stake in group term life insurance as a benefit program of great social and economic significance. Not only would the proposal as drafted add substantial administrative burdens on these companies and all employers, but it would also discourage a socially desirable method of providing security for vast numbers of wage earners.

Elimination of 4 percent dividend received credit.—This action (pp. 3, 32) will still further discourage investment. A sound principle of tax economics and fairness, the amelioration of double taxation of income, is dealt a severe setback.

The proposed increase of the dividend exclusion from $50 to $100 cannot be viewed as softening this blow.

Interest on loans on certain insurance and annuity contracts.—This proposal (pp. 4, 61) will disallow interest on policy or other loans "to purchase or carry" life insurance policies which are purchased pursuant to a plan which contemplates systematic borrowing of a part, or all, of increases in cash value. To single out certain taxpayers for unfavorable tax treatment because they may contemplate the use of policy values to keep their insurance in force is, we believe, not only an unwarranted discrimination against a particular class of taxpayers, but also against a particular class of property. We believe that no such deterrent to the purchse of cash value life insurance should be imposed.

We are quite aware from statements of both political parties, that if H.R. 8363 is lost, tax rate reduction conceivably may not come again for years. Therefore, we endorse the bill with the reservations noted above.

If there are other phases of the bill on which you feel that our assistance would be helpful with respect to the impact on Connecticut and the Greater Hartford area, we urge you to call upon us.

In order that future increased imbalance of the national budget will not occur, we earnestly urge that you devote your energies and efforts to continue the salutary efforts started in this session of Congress to control increased Federal spending. We suggest that one path to controlled increased Federal spending. We suggest that one path to controlled spending is reduced taxation, and we reiterate our view that tax reduction, effective January 1, 1964, is imperative to the continued health of the economy of Connecticut.

We are taking the liberty of sending a copy of this letter to the other members of the Connecticut congressional delegation and ask that you make it a part of the record of the hearings before the Senate Finance Committee.

Respectfully yours,

JAMES E. BENT, *President*.

CANTERBURY, N.H., *November 5, 1963*.

Senator NORRIS COTTON,
Senate Office Building,
Washington, D.C.

DEAR SENATOR COTTON: Your thoughtful letter of November 1 in reply to mine relative to the elimination of the dividend credit leads me to write again on the subject with some facts that are only dimly recognized by the financial community and not at all by the general public.

The present law permitting deductions for interest paid without granting similar treatment to dividends paid is leading to a dangerous situation. The most obvious effect is the huge expansion in corporate debt—much greater than the figures indicate due to the widespread practice of leasing which is really debt in a hidden form—and the very small offerings of new stock issues. We surely will regret this buildup of corporate debt if and when we have a real depression.

An even more disturbing situation is revealed by the SEC figures on the volume of new stock issues and the net purchases of stocks by (*a*) institutions and foreigners and (*b*) individuals and investment companies. As indicated in the table below, in 6 years the value of net stock purchases exceeded the value of new stock issues by $11.2 billion. Supply and demand still operates and here is the explanation of the dizzy and dangerous level of stock prices.

[In billions of dollars]

	Institutions and foreigners	Individuals and investment companies	Total	New stock issues
1957	1.6	2.2	3.8	2.5
1958	1.6	2.3	3.9	1.3
1959	2.6	1.9	4.5	2.0
1960	2.7	.7	3.4	1.7
1961	3.3	1.9	[1] 5.2	[1] 3.3
1962	3.1	(−.6)	2.5	1.3
Total	14.9	8.4	23.3	12.1

[1] Includes a single A.T. & T. issue of over $1.

The effects of the tax law are clearly evident in these figures. First, the steadily increasing purchases by institutions who largely avoid the double taxation penalty as most of them are either or partially (as is the case with insurance companies) tax exempt, and, second, the clear downward trend in purchases by individuals. As prices are driven up and yields down, the individual investor is being forced away from stock investment. This is the explanation of the dramatic growth in savings bank, saving and loan and time deposits but these funds are then loaned, increasing the overall debt structure, rather than providing equity capital for industry.

The ultimate effects of drying up the supply of equity capital from the great middle income groups and the transfer of ownership of our great corporations to a comparatively limited number of institutions are hard to visualize but surely a basic change in our economy is underway. It is not one that promotes initiative and growth.

It seems to me—and I earned my living for many years as an investment adviser to large and small investors, institutions as well as individuals—that we are setting the stage for a great stock market crash and a real depression which will affect everyone in the country even though they may have never directly owned a share of stock. The man who sold apples on the street in 1932 probably did not think in 1929 that the collapse in stock prices would put him there.

The proposals to increase the dividend income inclusion from $50 to $100 will benefit a large number of people with very small investment incomes but this is not the group that supplies the bulk of the equity capital needed for the growth of American industry. Investment incomes at this level are more likely to be derived from savings bank and similar deposits which (although our savings institutions call their distributions "dividends") are not eligible for the exclusion.

I feel sure that the economic historians in future years will look back and conclude that the double taxation of dividends was one of the greatest deterring factors in our economic growth. As I am sure you know, it is a mistake that is not being made to the extent that we are making it by any foreign countries that are enjoying growth rates better than ours.

Sincerely,

ALEXANDER STANDISH.

WAYNE HUMMER & CO.,
Chicago, Ill., November 14, 1963.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR CHAIRMAN BYRD: I am writing in respect to the tax reduction and reform proposals now before you. You will recall I took an active part last year in opposing tax legislation to effect withholding on interest and dividends. We can all be thankful that your committee vetoed the House measure and that a similar one is not before the Congress in 1963.

While the legislation now before you is intended to restore incentives and initiate creative spirit by stimulating investments and creating a more healthy position and employment environment, the reforms fall far short in two areas to do the job and should be revised by your committee.

AREA I

The House bill continues to tolerate what amounts to a war or excess profits tax on individual incomes. This must end in order to free our economy and provide for full employment. (Excess profits taxes were repealed promptly after World War II on corporations only, while the top individual rate has remained at 91 percent.) Tax rates which progress on individual incomes to 70 percent under the House bill are still self-defeating and should be further reduced as follows:

A. Stop the progression of rates on individual incomes beginning January 1, 1966, at 60 percent. (House bill reduces rate to 70 percent after January 1, 1965.)

B. Stop the progression of rates on individual incomes beginning January 1, 1967, at 50 percent.

A high degree of progression in our individual income tax laws creates serious economic as well as many administrative tax problems. Here are a few outstanding examples:

1. Forces taxpayers to make decisions based upon tax considerations rather than on sound reasoning.

2. Forces the Congress to enact tax relief measures such as investment credits and depreciation gimmicks, permitting partnerships to be taxed as corporations, allowing doctors to escape high brackets by incorporating, income averaging, etc.

3. Forces smaller business firms to resort to mergers or public sale which are unable to retain adequate capital to meet normal debts and capital expenditures.

4. Forces even the large public corporations to raise to abnormal heights salary, bonus, and retirement payments to executives to the detriment of all shareholders and the public interest. This is, of course, highly inflationary, and discourages thrift and encourages extravagances with the Government assuming most of the cost.

5. Discourages dividend outlays to stockholders and thereby reduces incentives for investment.

6. Forces billions of dollars into unproductiveness or to seek investment in tax-free holdings and other special tax havens.

7. Stimulates the establishment of nontaxable business organizations in many fields of private endeavor to compete unfairly with taxable enterprises.

With tax rate progression limited to 50 percent, many business firms will be allowed to live. Only by giving high bracket individual taxpayers a 50-50 chance, can incentives be maintained and the trend toward business monopolies reversed.

Moreover, a lower degree of progression would result in no permanent loss of revenues to the Treasury. On the contrary, business and employment would be stimulated to the point that higher revenues would be available for budget balancing purposes.

AREA II

You are, of course, familiar with the inflationary condition and wide fluctuations in the stock market in recent years. There are at present virtually billions of dollars in stock values locked up because of heavy capital gains penalties in the case of sale or conversion. Continuance of such unrealistic capital gains taxes proposed in the House bill rising to 21 percent, will not free capital, nor will it place this country in a position to meet competition of other leading nations which impose no tax on capital transactions to speak of. In order to free capital and remove these inflationary and abnormal conditions, it is recommended that two capital gains brackets be added to the House proposal as follows:

A. Provide for a third bracket to include 30 percent of capital gains or losses on property held from 2 to 5 years.

B. Provide for a fourth bracket to include 20 percent of capital gains or losses on property held 5 years or longer.

The adoption of this recommendation would greatly simplify the reporting of capital transactions through the elimination of alternative rates which are little understood by the average taxpayer. Capital would be made free by ultimately reducing the maximum effective rate on gains to 10 percent, and a tax of more than this will simply not do the job. Abnormal stock market relationships would disappear and prices would be stabilized realistically for all types of property. There would result from this recommendation a dynamic increase in the flow of funds to stimulate our economy, as well as provide a substantial increase in Government revenues.

It is my hope the Senate Finance Committee will initiate a crusade to reverse the thinking that profits are inherently wrong and should be penalized, to the fact that profits produce increased job opportunities and provide the basis for the growth of our economy. It is only through this economic growth that we will be able to successfully meet the challenge of an increasingly competitive world market.

I respectfully request that the committee give these recommendations its earnest consideration, and this letter be made a part of the current tax hearing record.

Sincerely yours,

GEORGE E. BARNES,
Partner, Wayne Hummer & Co.

STATEMENT ON BEHALF OF INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA WITH REFERENCE TO SECTIONS 201 AND 207 OF H.R. 8363

The Independent Natural Gas Association of America (INGAA) submits the following statement and requests that it be made a part of the printed record in connection with current hearings on H.R. 8363, the proposed Revenue Act of 1963.

This Association is a nonprofit corporation organized and existing under the laws of the State of Delaware. Its members include individuals and companies engaged in all phases of the natural gas industry and related businesses.

Our statement is limited to a discussion of two topics:

I. Elimination of the 4-percent dividend credit and doubling of the dividend exclusion of individuals (sec. 201 of the bill).

II. Deduction of certain excise taxes (sec. 207 of the bill).

I. ELIMINATION OF THE 4-PERCENT DIVIDEND CREDIT AND INCREASE IN THE EXCLUSION OF DIVIDENDS RECEIVED BY INDIVIDUALS FROM $50 TO $100

The bill proposes to eliminate the present 4 percent credit on dividends (reduce to 2 percent in 1964 and eliminate entirely thereafter) and to increase the present $50 exclusion for dividends received by individuals to $100 (sec. 201 of the bill and secs. 34 and 116 of the code).

The earnings of a corporation are taxed twice, once as corporate income and again as individual income when paid out as dividends to shareholders. This fact was recognized by the Congress and a dividend credit and exclusion to partially offset this duplicate taxation was inserted in the Internal Revenue Code of 1954.

It was apparent at that time the Congress was in sympathy with the proposition that the double taxation of corporate income should eventually be eliminated entirely and that the credit allowed in the 1954 act was the first step in that direction.

The proposed changes in treatment of the dividend credit would eliminate one portion of the credit and broaden another portion. The net effect would be to lessen the coverage of the credit. Any change in the law relating to the dividend credit should broaden rather than lessen its coverage.

Present provisions for relief of double taxation of dividends at the stockholder level make equity investments more attractive and are a step in the right direction. It is our view that they should be retained and expanded. The proposed changes might handicap our industry in financing further expansions.

The inequity of double taxation of corporate earnings should be eliminated entirely in any true reform of the income tax laws.

II. DEDUCTION OF CERTAIN EXCISE TAXES (SEC. 207 OF THE BILL, SEC. 164(a) OF THE CODE)

Your attention is directed to an apparent oversight relating to the allowance for certain tax expenses. Particular reference is to "Federal import duties and Federal excise and stamp taxes," which are not allowable as a deduction as taxes even under section 164 as presently drawn, but which are allowed as an expense when such taxes relate to a trade or business or to the production of income.

Section 164 presently contains this clause:

"No deductions shall be allowed for the following taxes:

"(3) Federal import duties, and federal excise and stamp taxes (not described in paragraph (1), (2), (4), or (5); but this paragraph shall not prevent such duties and taxes from being deducted under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income))."

The above-stated provision in the present law provides that taxes as enumerated are allowable as a deduction when related to a trade or business or to expenses for the production of income.

There is no comparable provision in the revenue bill of 1963 in section 164 as proposed and it is believed that such a provision should be placed in the law in order to prevent controversies between the Internal Revenue Service and the taxpayer.

THE AKRON AUTOMOBILE CLUB,
Akron, Ohio, November 14, 1963.

Hon. FRANK J. LAUSCHE,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LAUSCHE: With regard to the public hearings currently being held by the Senate Finance Committee with respect to the new tax bill (H.R. 8363).

This bill, as you know, recently passed the House and contains a provision which would disallow the deduction of State gasoline taxes, registration fees, and driver license fees for Federal income tax purposes.

However, this bill was sent to the House floor under a closed rule and therefore no amendments could be offered.

Our only hope now, and the hope of all motorists, to have this "soak-the-motorist section" deleted from the House-passed bill is in the Senate.

A representative of our national organization, the American Automobile Association, will soon testify during the current hearings and voice opposition to the items mentioned above and request their deletion from the bill, this deletion felt to be in the best interest of the American motorists.

The House report concerning these items bases its case on the contention that the various State and local taxes for which deductions would be eliminated are difficult to compute.

This argument may be true as to the disallowance of deductions for State taxes on alcoholic beverages and cigarettes, but it is definitely not true as to State taxes on the motorist. The car owner knows to the penny how much he pays in driver license and registration fees. By determining his car's gasoline performance and checking the number of miles driven, the computation of State gasoline tax is simple arithmetic.

What with the diversion during the fiscal year 1963 of almost $2 billion of moneys collected by the Federal Government from special automotive taxes, from the highway trust fund to general government use, the taking away now of the exemptions in question would only add insult to injury where the motorist's rights and interests are concerned.

Your interest and favorable consideration of our position in this matter is solicited and will be greatly appreciated by motor vehicle owners everywhere.

Cordially,

ROGER T. MCCLOSKEY, *Secretary-Manager.*

AUTOMOBILE CLUB OF NEW YORK, INC.,
New York, N.Y., November 18, 1963.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: This is to inform you that the Automobile Club of New York, representing a membership of 395,000, is opposed to the provisions of H.R. 8363, now before your committee, which disallows deduction of State gasoline taxes, registration fees, and driver license fees in computing individual income taxes.

This proposal amounts to an unfair and inequitable additional tax assessment on automobile owners who are already paying more than their fair share of the cost of the Federal highway program and of the general cost of government on both Federal and State levels.

In addition, motorists have seen their special highway user tax revenue paid to the Federal Government being spent for other than highway purposes despite the fact that highway legislation states: "It is unfair and unjust to tax motor vehicle transportation unless the proceeds of such taxation are applied to the construction, improvement, or maintenance of highways." The motorists of New York State have seen over $1 billion of their special highway users taxes paid to the State diverted to nonhighway purposes since 1932.

The bill before your committee is supposed to be a tax reduction bill with certain so-called necessary reforms. But, so far as the motorist is concerned, it adds inequity to an already inequitable tax structure.

The fact that the disallowance of State gasoline taxes, registration fees, and license fees were lumped together with disallowance of alcoholic beverages and cigarette taxes is indicative of the fact that there is still misapprehension that the automobile is a luxury. Nothing could be further from the truth. Indeed, to the vast majority of households it has become an absolute necessity. It should be noted that 64 percent of all workers depend on automobiles for the journey between work and home and 80 percent of all automobile trips are for some necessary purpose.

We submit that to deny automobile owners the present allowable reductions will amount to a tax increase they can ill afford to pay.

We therefore strongly urge your committee to take whatever action is necessary to defeat this proposal.

Sincerely yours,

WM. J. GOTTLIEB, *President.*

DYNALECTRON CORP.,
Washington, D.C., November 16, 1963.

Senator HARRY F. BYRD,
Chairman, Finance Committee of the U.S. Senate,
U.S. Capitol, Washington, D.C.

DEAR SENATOR BYRD: As a policyholder of group life insurance I take strong objection to the new tax bill H.R. 8363 passed by the House of Representatives on September 25, 1963, taxing employees on the current value of amounts of employer-financed group term life insurance in excess of $30,000.

It is my opinion that such a bill is not in the best interests of group policyholders and I would like to reiterate here the principal objections to the proposal as made by the life insurance industry which I firmly believe are in the best interests of those employees holding membership in group plans:

1. The tax revenue expected to be raised is so small that the proposal now appears to be an indirect attempt to limit amounts of group life insurance without regard to underwriting considerations. As such it encroaches upon the area of insurance regulation, which is and should remain the responsibility of the States.

2. The additional income to the employee would be treated as regular income and be subject to withholding tax. The calculations and recordkeeping entailed will result in increased administrative burdens for group policyholders, which will in aggregate be substantial and completely out of keeping relative to the extent of the tax revenue anticipated.

3. The concept of imputed income might be extended to other areas of employer financed benefits such as health insurance and workmen's compensation with far-reaching and serious complications. Furthermore, the adoption of this measure may just become the ground work for the reduction of the tolerance in some future year from $30,000 to a lower amount, even to the $5,000 originally proposed.

I would appreciate your efforts as a member of the Finance Committee of the U.S. Senate to take a firm stand against this tax measure during the forthcoming hearings on the House version of the bill.

Sincerely yours,

CHARLES G. GULLEDGE, *President.*

NEW YORK STATE AUTOMOBILE ASSOCIATION,
Albany, N.Y., November 18, 1963.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: This is to inform you of the opposition of this association to the provisions of H.R. 8363, now before your committee, which disallows deduction of State gasoline taxes, registration fees, and driver license fees in computing individual Federal income taxes.

This provision would result in great hardship to the over 600,000 motorists who are members of the 21 AAA Clubs throughout New York State that comprise this association.

It amounts to an unfair and inequitable additional tax assessment on automobile owners who are already paying more than their fair share of the cost of the Federal highway program and of the general costs of government on both the Federal and State levels.

We would like to point out that half of the more than $1,837,217,000 New York motorists have paid in Federal highway user taxes since the start of the Interstate Highway program 7 years ago was not spent on highways. Recently released U.S. Bureau of Public Roads figures that show between July 1, 1956, and December 31, 1962, the Federal Government placed only $986,019,000—53.7 percent—of the highway user taxes paid by New York motorists into the highway trust fund. The remaining 46.3 percent, $851,198,000, was spent on projects having no connection with roads.

This has occurred despite the fact that the intent of Congress is clearly spelled out in Federal highway legislation as follows: "It is unfair and unjust to tax motor vehicle transportation unless the proceeds of such taxation are applied to the construction, improvement, or maintenance of highways."

In addition to this, the motorists of New York State have seen over $1 billion of their special highway user taxes paid to the State diverted to nonhighway purposes since 1932.

The automobile is no longer a luxury but to the vast majority of American households it has become an absolute necessity. It should be noted that 64 percent of all workers depend on automobiles for the journey between work and home and 80 percent of all automobile trips are for some necessary purpose.

We submit that to deny automobile owners the present allowable deductions will not only amount to a tax increase but may well add that one additional burden which will seriously affect the entire economy.

We therefore strongly urge your committee to take appropriate action to defeat this proposal.

Sincerely yours,

GEORGE M. FRAUENHEIM, *President.*

RESOLUTION ADOPTED

At the regular stated meeting of the board of directors of the Blair County Motor Club (AAA) Monday, November 18, 1963, the following resolution was submitted by Milton E. Emeigh, chairman of highways, and was unanimously adopted.

RESOLUTION

"*Be it, and it is hereby resolved*, That the board of directors of the Blair County Motor Club (AAA), Altoona, Pa., representing approximately 12,000 members, make a special appeal to the members of the U.S. Senate Finance Committee to file, or permanently retain in their committee, tax reduction bill (sec. 207 of H.R. 8363) recently passed by the U.S. Congress; be it further

"*Resolved*, That the Blair County Motor Club board wish to publicly express their opposition to the manner in which this bill (H.R. 8363) was handled by the Ways and Means Committee while in this year of 1963's executive session of the House of Representatives, as, after the President's tax proposals, they wrote into the tax bill a provision disallowing the deduction of State gasoline taxes, registration fees, and driver license fees. The bill was then sent to the House floor under a closed rule, which meant no amendments could be offered. As a result, no American citizen was afforded an opportunity to voice opposition to the 'soak-the-motorist' section of this bill, either before the Ways and Means Committee or on the floor of the U.S. Congress; and be it further

"*Resolved*, That the Blair County Motor Club takes this action to disseminate this information, not only to our members but the public as well. For many years, the Federal Government tax laws have permitted automobile owners to deduct for Federal income tax purposes taxes paid to States for gasolines, automobile registration, and driver license fees. The Blair County Motor Club board wishes to express our sincere thanks and deep appreciation to Russell E. Singer, executive vice president of the American Automobile Association for bringing this vital information to our attention. Mr. Singer is on the job in Washington, D.C., and is ever working, tirelessly, for the best interests of the motorists of our Nation; and be it further

"*Resolved*, That a copy of this resolution be spread upon the minutes of the meeting, and copies mailed to the press; Russell E. Singer, executive vice president, American Automobile Association, Washington, D.C.; Charles E. Pugh, general manager, Pennsylvania Motor Federation, Harrisburg, Pa.; Hon. Joseph S. Clark and Hon. Hugh Scott, Members of the U.S. Senate; Hon. J. Irving Whalley, U.S. Representative; and members of the U.S. Senate Finance Committee."

HON. HARRY F. BYRD, CHAIRMAN

DEMOCRATS

Hon. Russell B. Long
Hon. George A. Smathers
Hon. Clinton P. Anderson
Hon. Paul H. Douglas
Hon. Albert Gore
Hon. Herman E. Talmadge
Hon. Eugene J. McCarthy
Hon. Vance Hartke
Hon. J. W. Fulbright
Hon. Abraham A. Ribicoff

REPUBLICANS

Hon. John W. Williams
Hon. Frank Carlson
Hon. Wallace F. Bennett
Hon. Carl T. Curtis
Hon. Thruston B. Morton
Hon. Everett M. Dirksen

We certify this to be a true and exact copy of the resolution adopted by the above-named body on November 18, 1963.

GUSTAVE ETIENNE, *President*,

Attest:

PATRICIA L. BEYER, *Secretary*.

PATTERSON, BELKNAP & FARMER,
Washington, D.C., November 22, 1963.

Re H.R. 8363.

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

DEAR SENATOR BYRD: As general counsel of the National Metal Trades Association, a nonprofit management trade association composed of more than 1,400 companies (including manufacturing, service organizations, banks, and insurance companies), I wish to endorse, on behalf of the association, the position taken on the proposed Revenue Act of 1963, H.R. 8363, by Mr. Charles W. Stewart, president of the Machinery & Allied Products Institute in his testimony before your committee on October 28, 1963.

I am attaching a copy of a bulletin dated November 1, 1963, of the Machinery & Allied Products Institute stating the substance of Mr. Stewart's testimony on this matter before your committee. We desire to place our association on record with your committee as supporting and endorsing these views on the pending legislation.

Sincerely,

GUY FARMER,
General Counsel, NMTA.

ALLEGHENY POWER SYSTEM, INC.,
New York, N.Y., November 20, 1963.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Committee on Finance,
New Senate Office Building, Washington, D.C.

MY DEAR SENATOR BYRD: I urge you to oppose, at least in its present form, the proposed amendment to the Internal Revenue Code on moving expenses (section 212 of the revenue bill of 1963 as passed by the House and now before the Senate Finance Committee). The concepts on which it is based are unrealistic, it would give taxpayers very little which they do not already have and would freeze into the statutes the worst doctrines that have yet been suggested in court decisions.

The House Ways and Means Committee report says section 212 is intended to increase the mobility of labor and to remove discrimination (1) against employees who are not reimbursed for their moving expenses and (2) against new employees who are reimbursed for moving expenses. The report also says that it leaves for judicial interpretation whether an employee should be taxed on reimbursement of moving expenses not allowed by the new provisions; but the same report says later on that the new provision (1) would not permit deduction of costs incurred in the acquisition of property, costs incurred, and losses sustained in the disposition of property, penalties for breaking leases, mortgage penalties, expenses of refitting rugs or draperies, tuition fees, expenses of house or apartment hunting, expenses of trips to sell property, or living expenses preceding the date of departure for the new place of residence or following the date of arrival there; and (2) would require that any reimbursement of these items to be treated as wages subject to income tax withholding. That doesn't seem to leave much to judicial interpretation. The excluded items are just as much moving expenses as the purely transportation expenses which the new provision would allow, and should be reimbursed by an employer who moves an employee whether or not the Government insists on taxing them.

American business generally and my company in particular find it increasingly desirable to move employees from place to place. It is in the companies' interest to move them. A move may or may not involve a promotion to the employee: Since it is for company purposes and uproots the employee and his family from home and neighbors, the company reimburses him for those costs that can be measured in money—otherwise he has had his pay cut. The reimbursement is a company expense, not income to him. If the statutes should

tax it as income, the company would feel obligated to reimburse the income tax too.

Congress should leave the determination of business expenses to the marketplace. Its attempts to substitute artificial concepts for the judgment of the marketplace removes "taxable income" further and further from real income and increases the weight of the burden of so-called income tax. If it is doubted that the courts can reach a reasonable result under the present law, any new provision should avoid unrealistic limitations.

Very truly yours,

J. LEE RICE, JR., *President.*

ARIZONA AUTOMOBILE ASSOCIATION,
Phoenix, Ariz., November 19, 1963.

Hon. HARRY BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Recently the House of Representatives passed what is commonly referred to as the tax reduction bill (H.R. 8363).

For many years the Federal tax laws have permitted automobile owners to deduct for Federal income tax purposes taxes paid to States for gasoline, automobile registration, and driver license fees.

This year the Ways and Means Committee of the House of Representatives, after public hearings on the President's tax proposals and while in executive session, wrote into the tax bill a provision disallowing the deduction of State gasoline taxes, registration fees, and driver license fees. The bill was then sent to the House floor under a closed rule, which meant no amendments could be offered.

As a result, the American Automobile Association and its member clubs with more than 8 million motorist members have had no opportunity to voice opposition to what we term the "soak-the-motorist section" either before the Ways and Means Committee or by having friends in the House of Representatives propose amendments from the floor. Our only hope to have this "soak-the-motorist section" deleted from the House-passed bill is in the Senate.

During the fiscal year 1963, the Federal Government collected in special automotive taxes $5,270,240,000, but only $3,278,698,000 of this went into the Highway Trust Fund which supports the Federal road program. Thus, close to $2 billion paid by highway users was diverted to the support of general Government, despite the fact that basic highway legislation states unequivocally that, "It is unfair and unjust to tax motor vehicle transportation unless the proceeds of such taxation are applied to the construction, improvement, or maintenance of highways."

This bill is supposed to be a tax reduction bill with certain so-called necessary reforms. But, as far as the motorist is concerned, it adds inequity to an already inequitable tax structure. The disallowance of State gasoline taxes, registration fees, and license fees will make the Federal tax program for motorists more regressive, rather than less so because of the fact that State gasoline taxes have no relation to the amount of income or ability to pay, but rather depend upon how many miles the motorist must drive.

To the vast majority of American households, the automobile is an absolute necessity—64 percent of all workers depend upon automobiles for the journey between work and home, and 80 percent of all automobile trips are for some necessary purpose. This is especially true here in Arizona and other Western States where distances are great.

We strongly urge that this unfair section of H.R. 8363 be deleted in the Senate.

Sincerely,

FRED O. ADAMS, *President.*

THE CLEVELAND AUTOMOBILE CLUB,
Cleveland, Ohio, November 19, 1963.

Senator FRANK J. LAUSCHE,
Senate Office Building,
Washington, D.C.

MY DEAR SENATOR LAUSCHE: We understand that public hearings are presently being held by the Senate Finance Committee on H.R. 8363 commonly

known as the tax reduction bill which among other items contains a provision disallowing deductions for Federal income tax purposes of any gasoline taxes or registration or driver license fees paid to States by motorists.

We further understand that this provision was inserted in the legislation by the Ways and Means Committee of the House while in executive session after public hearings had been held on the President's tax proposals, and further, no opportunity was subsequently afforded to amend the legislation since it was presented for vote in the House under closed rule.

Historically, Federal law has permitted motorists to deduct State gasoline taxes and registration and driver license fees in computing income tax due the Federal Government. To now include such automotive taxes in the contemplated disallowance provision covering taxes paid on such luxury items as alcoholic beverages and cigarettes would seem to indicate that the House Ways and Means Committee considers the automobile as a luxury. Obviously, no one can subscribe to such thinking today, with the automobile being an absolute necessity to every household in our country.

For many years, a substantial portion of automotive taxes collected by the Federal Government has been allocated to the support of general government. In fiscal 1963, approximately $2 of the $5 billion plus collected in special automotive taxes were used for governmental purposes other than the construction, improvement or maintenance of our highways. Certainly, with this record of the use of tax dollars generated from the motorist, the further imposition of an additional tax burden as would result from the disallowance provision on automotive taxes as contained in H.R. 8363 appears most inequitable and without basis for justification.

While we are aware that you are not a member of the Senate Finance Committee, we respectfully urge your encouragement and support of any proposal to delete from H.R. 8363 the disallowance provision relating to automotive taxes. Your cooperation in this matter will be most appreciated.

Cordially,

FREDERICK T. MCGUIRE, Jr., *President.*

THE TOLEDO AUTOMOBILE CLUB,
Toledo, Ohio, November 11, 1963.

Senator FRANK J. LAUSCHE,
Senate Office Building,
Washington, D.C.

DEAR SENATOR LAUSCHE: Recently the House of Representatives passed what is commonly referred to as the tax reduction bill (H.R. 8363).

For many years the Federal tax laws have permitted automobile owners to deduct for Federal income tax purposes taxes paid to States for gasoline, automobile registration and driver license fees.

This year the Ways and Means Committee of the House of Representatives, after public hearings on the President's tax proposals and while in executive session, wrote into the tax bill a provision disallowing the deduction of State gasoline taxes, registration fees, and driver license fees.

We strongly bring to your attention the tax bill which has been referred to with certain so-called necessary reforms. As far as the motorist is concerned it adds inequity to an already inequitable tax structure.

The disallowance of State gasoline taxes, registration fees, and license fees make the Federal tax program for the motorist more regressive in that State gasoline taxes have no relation to the amount of income or ability to pay, but rather will depend on how many miles motorists must drive.

The automobile is no longer a luxury. Approximately 64 percent of all workers depend on the use of automobiles between home and work, and 80 percent of all automobile trips are for some necessary purpose.

Permit me to urge that you use every effort to have deleted from the House-passed tax bill section 207 of H.R. 8363. Whatever you can do to that end will be greatly appreciated by some 80 to 90 million motorists in this country as a whole, as well as many motorists from the State of Ohio.

Cordially yours,

E. L. BOWSHER, *Secretary-Manager.*

ALABAMA PETROLEUM JOBBERS ASSOCIATION, INC.,
Montgomery, Ala., November 25, 1963.

Re H.R. 8363.

Senator LISTER HILL,
Senate Office Building,
Washington, D.C.

DEAR SENATOR HILL: The Alabama Petroleum Jobbers Association would like to bring to your attention the fact that they are in accord with the following recommendations of the National Oil Jobbers Council and would appreciate any help you could give us on the Senate Finance Committee:

First, the individual income tax rates in the $15,000-to-$50,000 bracket should be reduced more than is reflected in the present bill. To do otherwise will seriously jeopardize that portion of the small business community who operate as sole proprietors or partners.

Second, we recommend that the taxation on corporate income be as follows: 22 percent on the first $25,000 of the taxable corporate income, 30 percent on the next $75,000 of income (up to $100,000), and the normal tax of 22 percent plus the surtax of 30 percent graduated downward as provided in H.R. 8363, be applied to corporate income in excess of $100,000. If this is not done, then the provisions relating to multiple corporations should be stricken from the bill, and the provisions under current law be continued where each corporation was entitled to the separate $25,000 "breakoff" point regardles of common ownership.

Third, it is recommended that the provisions relating to capital gains on certain depreciable real property be changed in such a manner as to deprive businessmen of tax windfalls, but at the same time, give the full capital gains treatment to businesses and businessmen who have demonstrated by a historical basis of operation that they are not in-and-out business enterprises.

With kindest personal regards, I am,

Sincerely yours,

RICHARD C. BELSER.

SALT LAKE CITY, UTAH, *November 27, 1963.*

Senator FRANK E. MOSS,
Senate Office Building, Washington, D.C.

DEAR SENATOR MOSS: In view of the present considerations being given to change some of the laws and rules pertaining to the Federal income tax, I wish to call to your attention what I consider an inequity and hope that you might pursue this matter.

I feel that the definition of "gross income" should precisely and specifically exclude moving expenses which an employer would underwrite for a new employee. (Obviously, it would follow that an employee who has to pay his own moving expenses should be allowed to deduct those similar expenses from gross income.) With the following reasons to support my contention of this inequity, I feel that you would agree with me that there is not only one reason to support this contention, but also a number of reasons, any of which give credence sufficient to support this claim. Therefore, I ask that serious consideration be given to change the definition of gross income so as not to include moving expenses. I further request and give you permission to transmit all of this letter to appropriate persons and committees for their consideration. My bases for changing the definition of gross income to exclude moving expenses are:

1. Moving one's family from one community to another has become quite commonplace throughout the Nation, especially since the end of World War II. These moves may have taken place because of unemployment, layoffs, health, reduction in the labor force, desires, or unsatisfactory working conditions. Surely, I believe, you will agree that the reasons for moving cannot be considered a part of this discussion. However, most families do not consider moving lightly. Few would choose to uproot family and community ties without serious reason. Therefore, I feel that the emotional and mental upset caused by moving and its accompanying readjustment is sufficient cause not to add additional financial burdens by the imposition of a tax upon moving expense.

2. Moving expenses which are paid for an employee by an employer cannot in any way better the employee's economic status. That is, no additional money is received by the employee which can be used to pay debts, purchase a car, or put a downpayment on a home. In fact, if an employee were to accept a position with a new employer at the same salary, the employee might have to receive a

10-percent salary increase to maintain the same standard of living. Is this not an inequity which should be terminated?

3. Beginning with World War II, the decentralization of industry was recognized as being desirable, if not mandatory. Through direct and indirect Federal efforts, defense industries, in particular, recognized this fact and erected plants in remote areas which may have been uninhabited. As you know even better than I, contracts granted to defense industries are usually of short guaranteed duration. This means for many that after some period of time, positions should no longer exist. Contrary to their desires, few employees in such industries can seriously believe that they could be employed for more than about 3 years. Yes, this is a serious change from the time prior to World War II, and, I suggest, that part of the reason necessitating moving has been directly due to governmental preference. That is, I feel that the Government must bear the overwhelming responsibility. This is more evidence why gross income should eliminate moving expenses from tax.

4. In my own personal case, as well as that of a vast majority of my colleagues, I have never broken even in moving. In fact, I have had to sustain serious losses. I feel that you can understand that moves usually mean forced selling of one's former home. It is not unusual that an employee may be required to carry payments on two mortgages for some indefinite period of time until the house is sold in an effort to salvage some equity in the investment. This is compounded by the fact that most people sell their personal residence after they have moved, and that a customary 6-percent fee is levied by a real estate broker to sell the home. In addition to this fee is added the numerous State and Federal taxes assessed upon the selling price, as well as possible mortgage payoff penalties. Does this not give adequate proof that the present tax upon moving expenses is inequitable?

5. In addition to the above potential losses involved, an employee who moves customarily and of necessity gives away and/or sells numerous possessions with little or no return on the dollar. However, it is not unusual that upon arrival in the new community, articles which have been abandoned and/or sacrificed must be replaced at par value. Of course, this helps the economy of the country as a whole, but, for the individual employee, additional losses are suffered. Is it not apparent that this tax is being applied where the only result can be added hardship upon the employee? Should not the tax on moving expenses be repealed?

6. In many areas of the country, especially where unemployment is prevalent, encouragement to move would appear to be mutually beneficial from many standpoints—from the standpoint of employment of the person, from the employee talent contracted for by the employer, from the tax advantages gained by the State and Federal Governments through employment of the individual, and from the elimination of the need of payment of unemployment insurance. Is it not enough that taxes could be paid through employment without levying additional tax assessments on moving expenses? These additional tax losses to the employee could be so severe that the employee's savings could be liquidated and might not permit his children to finish the education for which they might mentally and physically be qualified. Need this tax on moving expenses be continued?

7. I suggest that the uncertainty of such a position, let alone the necessity of living only from day to day, gives added credence to your giving the most prompt and serious attention to the elimination of moving expenses from the definition of gross income.

8. The overall effect of the necessity of moving and the tax on these moving expenses is progressively making itself felt by fewer homes being purchased. It is generally accepted that purchase of a home is advantageous to the Nation as a whole and also tends to increase family stability and well-being. But I suggest that the itinerant employee will give ever-increasing evidence of mental problems. Would not the effect of eliminating tax on moving expenses allay some of these problems and also aid industry and the Government in getting qualified personnel to maintain efficient industries, among others?

9. The overall result of the present tax on moving expenses most usually causes a higher percentage of tax on this amount than on the actual employee income. It seems evident that insult is added to injury by having to pay an even greater tax percentage on moving expense than on usable income. I maintain that this constitutes another important reason why exclusion of moving expenses from gross income is warranted.

10. It is important to add that taxes are levied upon the money paid to the mover based upon the cost of the move by both Federal and State Governments. This tax money aids the economy of the Nation and States. So why does any more tax need be assessed upon this moving expense money, especially on an employee ill equipped to pay this tax? Does not this triple taxation cause a further inequity?

I hope that with the foregoing presentation you will agree with me that my contention of an inequity has been comprehensively substantiated. I shall appreciate any action you can take to rectify this inequity.

Thank you for your interest in this matter.

Sincerely,

ALBERT P. HARCLERODE.

STATEMENT OF COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK, INC., CONCERNING H.R. 8363, BY ARTHUR M. ARNOLD, TAX COUNSEL, NOVEMBER 26, 1963

Commerce and Industry Association is the largest service chamber of commerce in the United States. Its more than 3,500 members represent a true cross section of American business and industry both as to size and nature of enterprise. Referred to editorially as the "Voice of New York Business," the association expresses views of the composite business community.

Dedicated to its principal purpose—"to foster the trade and welfare of New York"—the association is sensitive to the importance of the business climate at the local, State, and National levels, and to the major role that taxes at each level play in establishing that climate.

H.R. 8363 is supported by its proposers for its potential influence on the economy. The provisions which would establish lower income tax rates for individuals and corporations can provide economic stimuli of great and permanent benefit to national welfare. But they can produce an exactly opposite result. If Government spending is not controlled, resulting budget deficits could foster inflation instead of national economic health. Improperly handled, the force of this legislation can cripple the object it seeks to benefit.

Commerce and Industry Association earlier this year issued a four-point declaration of policy concerning income tax rate reduction and its potential. That statement reads:

"1. We believe that existing corporate and individual tax rates are too high, that an immediate and substantial reduction of present rates is required to promote the necessary growth of the economy of the United States, and that higher levels of revenue to the Government will result from such economic growth.

"2. We believe that rate reduction should be divorced from other changes in the tax laws because the proper consideration of proposed structural changes, many of which are highly controversial, will unduly delay the necessary rate reduction.

"3. We view with concern the large deficit contemplated for the forthcoming fiscal year, the steady growth from year to year of the Federal budget, the steady increase in the number of Government employees, and the continuing expansion of Government activities into new fields. We regard continuing Federal deficits as unwise, contributing to inflation, to a decline in the value of the dollar, and to the balance-of-payments problem.

"4. We believe that it is imperative that the Government furnish convincing evidence of its firm determination to curtail Government spending sufficiently to assure a balanced budget in the near future. Unless it does, the great benefits of a substantial tax rate reduction will be nullified by the increase in the deficit attributable to the tax rate reduction. Any possible growth in revenues cannot achieve a balanced budget if expenditures grow at an equal or greater pace."

The same viewpoint is expressed in the statement of intent in section 1 of the bill.

If the Members of this Congress and their successors support and effectuate the policy expressed in section 1, the benefits will be assured. The faithful performance of its mandate will be more effective than any statutory restriction on spending or any system for conditioning rate reduction on levels of Government expense. This association places its faith in legislative and executive restraint rather than in statutory prohibition or limitation which can always be amended or repealed.

The bill pending before you in many respects appears to move in opposite directions simultaneously. Merely by combining rate reduction and substantive

change in a single measure it earns that criticism. These two major aspects of the bill could be evaluated more clearly without assuming their interdependence. As will be noted more particularly later, some of its substantive proposals are inconsistent with its basic goals.

Notwithstanding that criticism of the bill, Commerce and Industry Association approves more of the bill than it opposes.

Tax rates and payments [*secs. 21, 122*]

The reduction of maximum corporate rates to 48 percent combined with a reversal of normal and surtax rates is approved. The reversal feature would be of particular benefit to small corporations. Their immediate saving would be 8 percent of their incomes up to $25,000. All corporations earning more than that amount would obtain a flat $2,000 reduction of tax. While favoring small business, reversal does not lessen materially the rate reduction available for corporations with incomes over $25,000.

The bill also provides for acceleration of estimated corporation income tax liabilities in excess of $100,000. Although the problems of corporations subject to the provision are normally more involved than those of individuals, pay-as-you-go taxation for them, in accord with the reasonable standards for estimating provided in the bill, should not impose greater hardships than now borne by individuals subject to that requirement. Accordingly, the proposal is approved.

Tax on consolidated returns [*sec. 222*]

Repeal of the 2-percent penalty tax on consolidated returns of corporations is approved. No economic justification for that penalty exists. Moreover, in the context of the bill's proposals regarding controlled corporations it would be unconscionable to force those corporations to elect one of three optional tax methods, each of which carries a penalty of some kind. However, repeal of the 2-percent penalty tax should not depend on the final determination by the Congress regarding a provision on controlled corporations.

Controlled corporations [*sec. 223*]

The bill proposes to establish a three-way option for corporate groups controlled by corporations and two-way for those controlled by individuals, estates, and trusts:

1. File a consolidated return. This option is not available to brother-sister corporations.
2. File separate returns and allocate a single $25,000 surtax exemption among them.
3. File separate returns, each claiming a full surtax exemption and pay a 6-percent penalty tax on the first $25,000 of net taxable income.

The control test would be met by ownership of 80 percent of the value or voting power. For corporations the rule would apply directly or in the case where the controlled corporation is owned by another subsidiary.

In respect to brother-sister corporations attribution rules would apply for the control test.

The provisions concerning controlled corporations are less harsh and less complex than the proposal first offered by President Kennedy. Nevertheless, the complexity of the pending proposal alone militates strongly against its adoption.

In addition, the proposal is objectionable because it would create new tax considerations as substitutes for business judgment and discourage the expansion of the national economy which the bill is intended to promote.

Existing law requires that a separate member of a corporate group be formed for a business purpose in order to be taxed separately. Under the bill, although still required, business purpose would yield to mathematics as the principal determinative. The considerations which prompted the Congress to adopt the law's present provision and to disapprove at a later date a more onerous substitute have been disregarded.

Two examples demonstrate the proposal's inequity:

The sole stockholder of a corporation operating a metal products fabricating plant decides to undertake a new venture in an unrelated retail field. He decides to limit his risk and liability by incorporating the new enterprise and retaining the stock or distributing it to his family. The bill would impose a penalty on the success of the new venture. Should it fail, however, a corresponding tax recovery would not be obtained. The penalty margin might be sufficient to establish a competitive advantage for a competitor not subject to these provisions

and in some cases, would make the proposition unattractive. Obviously, expansion by small businessmen would be discouraged.

A retail chain operating through separate corporations, established to limit liability or because of legal requirements of States within which it operates, would find itself in a similar disadvantageous competitive position in respect to competitors not subject to the penalty provisions. In some instances tax benefits under existing law obtained by the separately incorporated units of a chain fall far short of equalizing advantages enjoyed by their independent competitors. For this class of business the bill also would discourage expansion.

In essence this proposal is intended to impose a penalty on particular forms of business and degrees of ownership without regard to the factors or motivation which led to their establishment. If legitimate methods for avoiding the penalty are adopted generally, these complex provisions, like many others in the code, would become only a trap for the unwary until a new and probably even more complex provision is adopted to penalize those methods. The revenue aspects of section 223 fall short of meriting its enactment as the first step in eradicating a fancied abuse. This penalty principle should not be adopted.

The basic purpose of H.R. 8363 is economic growth. The proposal regarding controlled corporations violates that underlying goal. Accordingly, it is disapproved and should be excised from the bill.

Capital gains [*sec. 219*]

The treatment of capital gains under the bill follows a principle advocated some years ago by Commerce and Industry Association that lower taxes be imposed on gains realized on sales of capital assets held for longer periods of time. Specifically, it would achieve a step in that direction by establishing a 40-percent inclusion ratio and a 21-percent alternative tax rate for gains of individuals on sales of capital assets held more than 2 years.

This amendment would reduce the "lock-in" compulsion promoted by existing law and ameliorate in part the taxation of those gains which are not gains in an economic sense. In approving the proposal, the association also recommends that it be made applicable to capital gains of corporations.

Employee stock options [*sec. 214*]

The bill would impose new limitations on beneficial tax treatment of restricted stock options. Another departure from the bill's basic goal of stimulating the economy, those restrictions would negate experience proving options issued under the present tax law valuable in promoting employee incentive and contributing to business growth and economic expansion.

The new restrictions would make stock options less effective for encouraging employee interest and efficiency. The proposed 3-year holding period requirement alone would make options so much less attractive that their exercise would be curtailed materially. The proposal is disapproved.

Investment credit [*sec. 202*]

The law establishing the investment credit mandates an equivalent adjustment of basis of qualified property. As a result, in the long run, the taxpayer achieves an actual credit lower than 7 percent depending upon the income tax rate paid. That requirement in fact compels a taxpayer to claim the credit in order to avoid a tax loss through reduced depreciation. However, since its application is not limited to taxpayers with sufficient net income to obtain the full benefit of the credit, it would mean that some would indulge in extensive and costly bookkeeping exercise without realizing a tax saving.

In some circumstances, those who overlook both the credit and the basis adjustment can find themselves confined to a lower basis for depreciation but unable to claim the credit.

Bookkeeping for taxpayers doing business in States using a basis for depreciation which does not conform to Federal becomes more involved. On the other hand, in States which conform with regard to depreciation, taxpayers lose an additional part of the basic tax credit.

H.R. 8363 would avoid those problems and pitfalls by eliminating the requirement to adjust basis.

The bill would equalize the tax treatment of manufacturers and distributors with regard to investment credit on leased property. Existing law treats manufacturers more favorably.

Another change would qualify elevators and escalators for the credit in recognition of their similarity to accessory assets and their importance in plant modernization.

These amendments are in line with the economic goals of the bill and would effectuate more fully the policy underlying investment credit. At the same time unintended pitfalls, discrimination, and burden would be eliminated. Accordingly, the proposal is approved.

Depreciable real property [*sec. 220*]

The abusive recapture of accelerated depreciation of real property at capital gains rates through sales after a short holding period would be prevented by an amendment of the tax treatment accorded such gains.

Basically, the amount by which depreciation claimed exceed straight line depreciation would be taxed as ordinary income. The margin so taxed would decline 1 percent per month, commencing with the end of the 21st month of ownership, until the end of 10 years, after which no ordinary income would be realized.

Under a law adopted in 1962, 100 percent of recaptured depreciation on sale of personal property is treated as ordinary income. According to the House committee's report, the diminishing percentage treated as ordinary income in the case of real property recognizes the effect on real property values of the rise of the general price level. However, justification for the more favorable treatment of gains on real property sales lies in differences in the nature, use, and marketability of real and personal property, as well as variations in their respective price-determining factors.

Since the amendment would eradicate the unwarranted advantage now available to speculators without imposing on serious investors, the amendment is approved.

Moving expenses [*sec. 212*]

Presently, employees required to change residence in order to work at a new location may exclude reimbursement of moving expenses by their employers. Newly hired employees must include such reimbursement in gross income and are allowed no deduction. Under the bill both classes of employees would obtain fair treatment of moving expenses caused by change of situs of employment.

Because of its contribution to employers' recruiting programs and its aid to employee morale, the proposal is approved.

Reimbursement of loss on sale of an employee's residence recently has been under fire by the Internal Revenue Service. Since such loss is a part of moving expense, Commerce and Industry Association urges that the bill specifically provide that reimbursement of losses on sales of employees' homes is excludable.

Income averaging [*sec. 221*]

The income-averaging provision of the bill would offer relief from the high rates normally applicable for taxpayers who earn disproportionate amounts of income in 1 year. While the provision adds no new tax benefit with respect to large amounts of capital gains realized in a single year, it nevertheless embraces capital gains within the computation for determining the applicable averaging rate. Those requirements have the effect of limiting the benefits which otherwise would be accorded a taxpayer who earns an unusual sum in a single year even though the capital gains realized in that year are equally unusual and unexpected and completely unrelated. Accordingly, Commerce and Industry Association approves the income-averaging proposal but recommends that it be modified to eliminate capital gains both in the qualifying test and as part of the computation which determines the taxpayer's measure of relief.

Excludable sick pay [*sec. 205*]

The existing provision regarding sick pay would be amended only in respect to the waiting period. Instead of permitting the exclusion to commence on the first day of absence due to accident and on the eighth if due to illness, a 30-day waiting period would apply in both cases.

The amendment would establish more realistic balance between needs and benefits by permitting exclusion for long-term illness when real financial hardship occurs. For this reason, the amendment is approved.

Deduction of charitable contributions [*sec. 209(a)*]

Because no justification appears for limiting contributions to certain charities to 20 percent of adjusted gross income while allowing 30 percent for others, the

amendment which would establish equality of deductibility at the 30-percent level for all public charities is approved.

Care of dependents [*sec. 211*]

Expanded deductibility of expenses for the care of dependents is approved because it would tend to expand the labor force and reduce welfare needs.

Dividend exclusion and credit [*sec. 201*]

In addition to reversing national policy, which recognizes that in an economic sense dividends are taxed twice, the proposal to eliminate the 4-percent dividend credit for individuls would violate the basic philosophy of H.R. 8363.

On the other hand, enlargement of the dividend exclusion from $50 to $100 would effectuate the existing principle and constitute an economic stimulus similar to rate reduction and two-stage long-term capital gain treatment.

As a companion to the higher tax rate which would be paid on dividends it would do no more than enlarge the unused exclusion of taxpayers receiving less than $50 of dividends and minutely reduce the aggregate additional tax of taxpayers with substantial dividend receipts. As a result the merit of a larger dividend exclusion is insufficient to overcome the detrimental aspect of repealing the dividend credit. As a single amendment coupling these divergent and conflicting proposals, it is disapproved.

Group term insurance [*sec. 203*]

The proposal to tax premiums on group term life insurance in excess of $30,000 face amount purchased by employers for employees is another departure from the basic purpose of the bill.

Encouragement of employee incentive and efficiency is an essential of any plan for stimulating the economy. Similar, closely related, but in some respects less direct are devices which relieve employees in some degree from their normal concern for the economic well-being of their families. The latter class includes group term life insurance for employees. Alone or in combination with employee stock option, retirement, or similar plans such insurance aids employees to meet their financial obligations to their families.

Besides social benefits and employee incentive each of these methods helps to stabilize employment and the labor market and to curtail potential need for welfare assistance.

The bill would establish a ceiling on the effectiveness of group term life insurance to accomplish those beneficial purposes. While directed at middle and upper level executives, it can be expected to apply to lower levels of employees as a result of the same inflationary forces which have enlarged the average amount of individual employee insurance. At such time amendment to raise the arbitrary standard now under consideration would accentuate the discrimination which the current bill would establish.

The benefits obtained by employees, by employers, and by the general public pursuant to existing law have proved its value. With that background, neither revenue considerations nor fancied abuse sustains the proposed amendment which is in all respects disapproved.

Deduction of casualty losses [*sec. 208*] *and State and local taxes* [*sec. 207*]

The amendments which would limit deductions of taxes and casualty losses are disapproved.

Nonbusiness casualty losses would be deductible only to the extent that the loss with respect to each casualty exceeds $100. The casualty loss deduction is intended to take care of an unexpected event with unhappy consequences. The amendment would add a second degree of happenstance by allowing most of a large loss in a single casualty to be deducted while disallowing equal aggregate losses in a series of casualties.

Minor State and local taxes, such as those on gasoline, cigarettes, tobacco, and alcoholic beverages, and for drivers' licenses and automobile registrations would not be deductible. That intent would be accomplished by an amendment limiting deductibility to State and local income, property, and general sales and use taxes.

The principal reason cited for the proposal is the difficulty of documenting the taxes which would not be deductible. However, the proposal is not as simple as it appears and would present many new problems in classifying taxes, particularly in cases where those taxes would be claimed partly or entirely as business deductions. At best the change would substitute one difficulty for another. Accord-

ingly, it is disapproved even though it would produce a revenue gain of more than a half billion dollars.

Personal holding companies [*sec. 216*]

The personal holding company was developed as a device for avoiding the high rates imposed on income of individuals. Tax saving is obtained when a corporation to which income-producing assets are transferred pays a lower tax than the individual. To prevent that practice the law provides for a high level tax on undistributed net incomes of personal holding companies. Nevertheless, by carefully balancing the proportions of income from different income sources it has been possible to avoid the personal holding company stigma and penalty tax. The revisions would narrow that margin of use materially. Not only would it be extremely difficult to establish investment levels which do not incur penalty but, in addition, many holding corporations now excluded would find themselves subject to this special tax, including some not organized with tax-saving intent. Furthermore, corporations which would not be classified as personal holding companies under the new law could, through change in receipt patterns, fall into that category.

With due regard for the impropriety of inequitable tax avoidance devices, the change proposed is disapproved because it would add much greater complications to an already extremely complex area of the tax law. The way to eliminate the use of this tax-saving device is to bring tax rates down to a level that would make it unnecessary.

Conclusion

A stable tax structure does not necessarily bar change. However, it argues strongly against reversal of tax policy unless the need is clear.

In general, H.R. 8363 would establish agreement with the popular observation that high income tax rates are detrimental to the health of our Nation's economy. In fact, concern for the economy motivates most of the changes included in the bill.

Other amendments would revise existing tax policy and fly in the face of the principle which the bill would establish. Included in that group are the amendments this association disapproves. The case made for those changes has not been established with sufficient strength. Commerce and Industry Association urges that each of the disapproved items be reconsidered and eliminated or revised in accord with existing national tax policy and the principal goal of the bill.

Except for that limitation, Commerce and Industry Association approves H.R. 8363, the reduced income tax rates it would provide, and its stated policy for curtailing Government spending in order to make it an effective economic stimulant and to prevent its accelerating the forces of inflation.

(Whereupon, at 12:05 p.m., the committee recessed to reconvene at 10 a.m., Monday, December 2, 1963.)