INVESTIGATION OF BUREAU OF INTERNAL REVENUE

HEARINGS

BEFORE THE

SELECT COMMITTEE ON INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE UNITED STATES SENATE

SIXTY-EIGHTH CONGRESS

SECOND SESSION

PURSUANT TO

S. Res. 168

AUTHORIZING THE APPOINTMENT OF A SPECIAL COMMITTEE TO INVESTIGATE THE BUREAU OF INTERNAL REVENUE

DECEMBER 1, 2, 3, 4, 5, 6, 9, 10, 17, 19, AND 30, 1924

PART 6

Printed for the use of the Select Committee on Investigation of the Bureau of Internal Revenue

WASHINGTON
GOVERNMENT PRINTING OFFICE
92919 1925

SELECT COMMITTEE ON INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

JAMES COUZENS, Michigan, *Chairman*

RICHARD P. ERNST, Kentucky.
JAMES E. WATSON, Indiana.
ANDRIEUS A. JONES, New Mexico.
WILLIAM H. KING, Utah.

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

MONDAY, DECEMBER 1, 1924

UNITED STATES SENATE,
SELECT COMMITTEE INVESTIGATING
THE INTERNAL REVENUE BUREAU,
Washington, D. C.

The committee met at 2 o'clock p. m., pursuant to adjournment, in room 410 Senate Office Building, Senator James Couzens (president.)

Present: Senators Couzens (chairman), Jones of New Mexico, and Ernst.

Present also: Earl J. Davis, Esq., and L. C. Manson, Esq., of counsel for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, solicitor Internal Revenue Bureau; Mr. S. M. Greenidge, head Engineering Division; Mr. W. C. Tungate, chief Consolidated Audit, section H.; Mr. W. S. Tandrow, valuation engineer.

Mr. MANSON. The next group of matters to be presented to this committee will deal with the matter of amortization of war facilities, and that the committee may have before it the provision of the law and some provisions of the regulations which apply generally to all cases of this character, I will read them at this time.

Senator ERNST. What are you going to read first?

Mr. MANSON. I am going to read section 214 (a) (9) of the act. This is the act of 1921:

That in computing net income there shall be allowed as deductions:

(9) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the war against the German Government, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of such war, there shall be allowed, for any taxable year ending before March 3, 1924 (if claim therefor was made at the time of filing return for the taxable year 1918, 1919, 1920, or 1921) a reasonable deduction for the amortization for such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous act of Congress as a deduction in computing net income. At any time before March 3, 1924, the commissioner may, and at the request of the taxpayer, shall, reexamine the return and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the income, war-profits, and excess-profits taxes for the year or years affected shall be redetermined and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252."

I now desire to call the committee's attention to article 183 of Regulations 262, issued by the Treasury Department governing amortization allowances:

The taxpayer may deduct from gross income a reasonable allowance for amortization of the cost of buildings, machinery, equipment, or other facilities constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war against the German Government, and of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of such war.

The allowance may be deducted only by taxpayers who after April 6, 1917, have constructed or otherwise acquired plant or other facilities for the actual production of articles contributing to the prosecution of the war. It is not sufficient, to entitle the taxpayer to the allowance, that the nature of his business is such as to contribute to the production of articles. For example, a taxpayer, such as a railroad, whose business activities are confined to transportation (other than water transportation) is not entitled to the allowance. A taxpayer, the nature of whose business is the actual production of articles, however, may claim the allowance with respect to the cost of all buildings, machinery, equipment, or other facilities which were constructed for use or which were used in connection with the production of such articles, both in the acquisition and transportation of raw material, the actual process of manufacture or other conversion, and the transportation and marketing of the finished product.

In the case of facilities the construction, erection, installation, or acquisition of which was commenced before April 6, 1917, and completed subsequent to that date amortization will be allowed with respect only to that part of the cost incurred on or after April 6, 1917, and which was (or should have been) properly entered on the books of the taxpayer on or after that date.

Article 184 reads:

The total amount of the amortization allowance is the difference between the original cost of the property, if constructed, erected, installed, or acquired on or after April 6, 1917; or if acquired partly before and partly after April 6, 1917, then that part of the cost incurred on or after April 6, 1917, and properly entered on the books of the taxpayer on or after that date, less any amounts deducted for depreciation, losses, etc., prior to January 1, 1918, and the value of the property on either of the bases indicated below:

(1) In the case of property which has been sold or permanently discarded, or which will be sold or permanently discarded before March 3, 1924, the value shall be the actual sale price or estimated fair market value as of the date when the property was or will be permanently discarded plus a reasonable allowance for depreciation in case the property is used in the taxpayer's business after the close of the amortization period. Such fair market value shall be established by investigation of engineers of the Bureau of Internal Revenue, if such investigation is deemed advisable.

(2) In the case of property not included in (1) above, the value shall be the estimated value of the taxpayer in terms of its actual use or employment in his going business, such value to be not less than the sale or salvage value of the property and not greater than the estimated cost of replacement under normal postwar conditions less depreciation and depletion. Upon the basis of the costs prevailing at the latest pre-war date at which a reasonaably normal market existed, the commissioner shall in respect of basic material and labor costs determine and publish ratios of estimated postwar costs of replacement, and a taxpayer shall use such ratios in computing a claim for a tentative allowance for amortization. Such tentative allowance may be redetermined on or before March 3, 1924, at the request of the taxpayer or by the commissioner.

Special record of all property falling in (1) above, must be preserved by the taxpayer, and the commissioner must be notified with the next tax return (a) if, after having been in good faith permanently discarded or dismantled, property shall in any case be restored to use because of conditions not foreseen or anticipated at the time it was discarded; or (b) of the selling price, is sold.

In order to make clear what that regulation means, referring to Regulation 184, counsel have prepared a few simple illustrations which it is believed may help the committee or anyone else reading this record to understand it.

1. Suppose, in 1917, a manufacturer of automobiles installed equipment for the production of soldiers' helmets. This equipment is of no use for the postwar production of automobiles. It is sold for scrap. The difference between the cost and the scrap value of this equipment is a loss which is deductible as amortization.

2. A manufacturer of motor trucks increases his factory capacity during the war by the addition of buildings and machinery which can be used for the postwar production of trucks. The pre-war equipment is sufficient to meet the postwar demand for production, and the war equipment is not used for postwar business. In this case the additional war investment is unnecessary and is a deductible loss down to its salvage value.

3. In the latter case, assume that the demands for this manufacturer's trucks is such that one-half of the additional war facilities are useful to him for postwar production, the loss of the useful value of the war facilities is 50 per cent.

4. If the cost of these facilities during the war was 20 per cent higher than the postwar cost of reproduction, this manufacturer has suffered a loss of 20 per cent of the cost, regardless of the extent to which they may be useful for postwar purposes.

5. Suppose war facilities costing $100,000 can now be reproduced for $80,000, and the postwar business of the manufacturer required but 50 per cent of the additional capacity, a $40,000 investment would meet his postwar needs, and his loss is $60,000, less the residue value.

The first of the amortization cases which will be brought to your attention is the claim of the Berwind-White Coal Mining Co. This case was originally brought to the attention of the committee by Mr. J. P. Moore, who appeared as a witness before the committee, and whose testimony is given in Part I, beginning on page 184.

From Mr. Moore's testimony it appears that he was an employee of the Bureau of Internal Revenue, as an engineer in the appraisal section, that he was one of two engineers to whom the investigation of this claim was assigned, and that he made a field examination, as a result of which he and his associate engineer found the property to be in full use, and recommended that the entire claim be disallowed.

Mr. Moore made some other statements in his testimony at that time which appear to be hearsay, and I will therefore not again call them to the attention of the committee.

Before calling Mr. Parker, the engineer of this committee, to give the details of this examination of the records of the department, I wish to call the committee's attention very briefly to the ultimate facts which your counsel expect to establish.

This claim is for the amortization of an electric power plant of 10,000 kilowatts capacity, the construction of which was started in June, 1918, and which was finished and put into operation in the spring or early summer of 1920. The cost of this plant was $825,722.44. The amount of amortization allowed was $373,401.12. This allowance was based upon the theory that but 52.6 per cent of the

capacity of this plant was required by the Berwind-White Coal Mining Co. to meet its postwar needs. We expect to show you that 70, and more likely 80, per cent of the capacity of this plant was in actual use at the time the amortization was determined.

The prewar equipment of the taxpayer consisted of three power plants, with an aggregate capacity of 9,000 kilowatts. These three power plants were antiquated and had reached the end of their usefulness, as is shown by several facts. The first is that, as soon as the new plant was finished and put into operation the old plant was abandoned and written off the books down to scrap value. The second fact is that, based upon the rates of depreciation allowed on this plant during the war period, the plant would have been written off the books long before the construction of the new plant was started. In other words, this company, if allowed depreciation at the rates at which it was actually allowed over the life of this plant, would have been compensated for this plant before they built the new plant, or what is known as the war plant. Immediately upon the war plant, the plant upon which amortization was allowed, going into operation, the company added another 10,000 kilowatt unit to this plant. In other words, subsequent to the war and after the plant on which depreciation was allowed had been completed, another plant of equal size was installed by the company and put into operation as a reserve plant for the war plant, and the original pre-war plant was entirely discarded.

Mr. MANSON. I will call the attention of the committee at this time to the fact, which will be established, that prior to the building of the third unit——

Senator ERNST. Mr. Chairman, Senator Watson asked me to say to you that the Committee on Committees meets this afternoon, and there are so many Senators wishing to see him with reference to their places on that committee that he can not possibly get away to attend this session.

The CHAIRMAN. That is all right. Proceed, Mr. Manson.

Mr. MANSON. Subsequent to the examination of this plant by the first team of engineers, of which Mr. Moore was one, a reinvestigation was made by two other engineers, one of whom was a man named Swaren. They made a detailed report of their findings, which is the last field examination made on behalf of the Bureau.

According to their findings, they determined that the connected load on this plant at the date of their examination was 18,198 kilowatts. I would call the attention of the committee to the fact that after the abandonment of the pre-war plant, the total capacity of the war plant and the postwar plant was 20,000 kilowatts, and that the estimated peak load as of March 3, 1924, was 9,500 kilowatts. If I do not make myself clear as to what I mean by that, I shall be very glad to go into it further. But this fact goes to show that the peak load to be expected of this 10,000 kilowatt war plant was within 500 kilowatts of its rated capacity.

The CHAIRMAN. In other words, 95 per cent?

Mr. MANSON. Ninety-five per cent.

Mr. Swaren and his associate engineer also found that there was a constant annual increase in the amount of current requirement, or in the amount of electrical energy required by the Berwind-

White Coal Co., which averaged 450 kilowatts per annum; so that as of March 3, 1924, the date as of which amortization must be determined, this plant had already reached a peak load of 95 per cent of its rated capacity, and its entire rated capacity could be expected to be reached within one year.

We expect to establish that it would not be good business or engineering practice to install any smaller unit under those conditions than a 10,000-kilowatt unit, leaving war conditions entirely out of consideration.

The fact that the total capacity of the generating equipment of this company as of the date amortization was fixed was 20,000 kilowatts is due entirely to the fact that subsequent to the war and subsequent to the completion of the plant on which amortization was allowed, an additional 10,000-kilowatt unit was installed by the company.

At this point I desire to call the committee's attention to a ruling by the Treasury Department which deals with this question. I do not know that I am exactly accurate in calling this a ruling. It is headed I. T. 2101. What does that mean?

Mr. HARTSON. That is an income-tax ruling, Mr. Manson.

Mr. MANSON. I see.

Mr. HARTSON. Promulgated by the Income Tax Unit of the Bureau of Internal Revenue for the guidance of the employees in that unit, and also for the information of persons dealing with the unit. It is not a Treasury decision, promulgated by the commissioner, with the approval of the Secretary.

Mr. DAVIS. It is acted upon like a decision, is it, Mr. Hartson?

Mr. HARTSON. Yes; it is generally used by the unit as authority for guiding them in subsequent cases of a like nature.

Mr. MANSON. The ruling that I have referred to reads:

> In determining the value in use for the purpose of amortization deduction, it is necessary to determine such value as to the specific facilities erected or acquired for production of articles contributing to the prosecution of the war, and in doing so it must be determined, first, whether the specific facilities are being used to their full, normal capacity, and, second, whether such capacity is needed for the postwar business.
>
> When a taxpayer has and uses in postwar years not only the facilities acquired during the war but additional facilities subsequently acquired for the same uses and purposes and of substantially the same character as those acquired during the war years, it is prima facie evidence that any reduction of value in terms of use of the war facilities was caused by the overexpansion in postwar years, and not as a result of facilities not being useful and needed to full, normal capacity for postwar business.

If the committee desires, I will read this whole ruling, but it is my opinion that the meat and substance of it is stated in that portion of the syllabus which I have read.

Counsel maintain that this ruling applies to the situation in the Berwind-White Coal Mining Co. case.

To recapitulate briefly our position, we maintain that the facts show that the pre-war plant of the Berwind-White Coal Mining Co. had reached the point where good business required it to be scrapped at or about the time the war plant went into operation; that the total capacity of the war plant was required to meet the demand existing as of March 1, 1924, and that demand, which could be reached in such a near future, would require under good prictice the

installation of a unit of this size, and that any excess capacity, in the electrical generating equipment of the Berwind-White Coal Mining Co., is due to overexpansion subsequent to the war.

We do not believe there is any excess capacity. In every power plant where a constant demand is being made upon the plant, as in the case of a mine where current is required for ventilation and pumping, as well as for mining operations, the plant can not be closed down, and reserve units, even though not constantly in operation, are just as essentially a part of power-plant equipment as units that are actually revolving and producing electric current in order that they may be there to supply the required current in case of a breakdown of one of the operating units.

It appears that the war plant consisted of two 5,000-kilowatt units. The third unit added after the war was a 10,000-kilowatt unit. It appears that an effort was made to buy a 5,000-kilowatt unit for this third unit, but it was found that a 10,000-kilowatt unit could be purchased at that time, under the conditions existing, as cheaply as a 5,000-kilowatt unit, and for that reason the 10,000-kilowatt unit was installed.

Under all of these conditions, the last installation was a mere installation of the necessary reserve capacity to take care of a case of accident or shutdown to a plant which was only adequate to meet the peak load which it was then carrying and such additional peak load as could be expected to be placed upon it within one year.

I will ask Mr. Parker to be sworn.

The CHAIRMAN. At this point I would like to ask whether it is the counsel's contention that no amortization should be allowed, or only a part of it?

Mr. MANSON. It is my position that this taxpayer was entitled to amortization equal to the difference between the war cost of this plant and the post-war cost. It is not my opinion that this taxpayer is entitled to any amortization due to lack of use or loss of use.

The CHAIRMAN. Have you reduced that to dollars and cents?

Mr. MANSON. I have not. I expect the engineers can do so.

TESTIMONY OF MR. L. H. PARKER, ENGINEER

(The witness was duly sworn by the chairman.)

Mr. MANSON. State your name, Mr. Parker.

Mr. PARKER. L. H. Parker.

Mr. MANSON. You are a resident of Philadelphia, I believe?

Mr. PARKER. Yes, sir.

Mr. MANSON. You are an engineer?

Mr. PARKER. Yes, sir.

Mr. MANSON. What school did you graduate from?

Mr. PARKER. Massachusetts Institute of Technology.

Mr. MANSON. How long have you practiced engineering?

Mr. PARKER. Nineteen years.

Senator ERNST. Are you actively engaged in business now in Philadelphia?

Mr. PARKER. No, sir.

Senator ERNST. Where are you now?

Mr. PARKER. I am with the Senate committee. I took leave of absence from my business. I was in a partnership there, engaged in valuation work. We have discontinued the partnership, in fact.

Mr. MANSON. You are now engaged solely as an employee of this committee?

Mr. PARKER. That is correct.

Mr. MANSON. As its chief engineer?

Mr. PARKER. Yes, sir.

Mr. MANSON. Have you made an examination of the records and files in the engineering division of the Income Tax Unit with reference to the amortization allowance made to the Berwind-White Coal Mining Co.?

Mr. PARKER. Yes, sir.

Mr. MANSON. You have made a report to the attorneys of this committee as to your findings in that connection, have you?

Mr. PARKER. Yes, sir.

Mr. MANSON. Will you refer to that report and describe the pre-war power plant of the Berwind-White Coal Mining Co., and the plant which was installed during the war and the subsequent installation?

Mr. PARKER. Yes, sir. The taxpayer's pre-war power equipment consisted of three separate and distinct plants in three separate power houses, with a combined capacity of 9,000 kilowatts.

Power house No. 36, built in 1904, boilers installed in 1904, two 400-kilowatt generators installed in 1908, and one 1,000-kilowatt generator installed in 1911, bringing the total of this power house to 1,800-kilowatt.

Power house No. 40, built in 1906, six boilers installed in 1906, two boilers installed in 1910, one 1,000-kilowatt generator installed in 1911, two 350-kilowatt generators installed in 1906, a total of 1,700 kilowatts.

Power house No. 35, built in 1909, eight boilers installed in 1909, four boilers installed in 1913, two 1,000-kilowatt generators installed in 1909, and one 3,500-kilowatt generator installed in 1913, a total of 5,500 kilowatts. Total kilowatts in pre-war plants, 9,000.

Mr. MANSON. Now, give us the amortized plant.

Mr. PARKER. In June, 1918, the taxpayer began construction of a new power house and ordered certain boilers and generators necessary for the construction of a 10,000-kilowatt power plant consisting of two 5,000-kilowatt generators and six 823-horsepower boilers. The total cost of this new plant, which is the plant on which amortization is claimed, was $825,722.44. The date of completion is not found on the record. The date of last payment for equipment was October 29, 1921, and on December 31, 1919, there was $26,290.09 of expenditures not yet entered on books. We assume plant was ready for practical operation about the spring of 1920.

We concede that taxpayer increased his plant at least partly, although not wholly, for anticipating war demands; undoubtedly, he also had in mind that his pre-war plant would soon be worn out, as shown by age of same. He also produced coal, an article admitted to be essential for the prosecution of the war.

Some time in 1920 another new unit, capable of producing 10,000 kilowatts was installed. No amortization is claimed on this unit.

Mr. MANSON. Will you describe to the committee what engineering investigations were made, as disclosed by the records of the unit?

Mr. PARKER. After the filing of the second amended schedule by the taxpayer for $519,077.55 as shown above, Engineers Woolson and Moore, of the Income Tax Unit, were assigned to the case, and after a field examination handed in a report, under date of May 19, 1922, recommending a total disallowance of this claim on the basis that the facilities on which amortization was claimed were one hundred per cent in use.

The taxpayer protested this determination and requested a redetermination on the basis of brief, noted above, dated August 21, 1922. Engineer J. W. Swaren was then assigned to the case and after a field examination reported on October 1, 1922, recommending that taxpayer be allowed a total amortization for years 1918 and 1919 in the sum of $176,953.25, based on 80 per cent in use.

On November 18, 1922, without a new field examination, a very brief supplemental report was filed by Engineer Swaren, containing no new facts, except the discovery of an error of approximately $9,000 recommending the allowance of $373,401.12 as the total amount for 1918 and 1919, based on 52.6 per cent in use. This is the last and final value in the case and was used by the auditors in making final audit.

Finally a certificate of overassessment was issued by the bureau, allowing a total overassessment of $501,111.02 in tax. We are advised by auditors that this refund has probably been made since the certificate was signed by the commissioner on March 26, 1924, but we have not verified this. In this refund is included the amortization adjustment and other changes.

Mr. MANSON. I would like to ask whether that certificate of overassessment is among the papers that the bureau has here.

Mr. HARTSON. I think, certainly, a copy of it, Mr. Manson, would be in the files. You referred to the certificate of overassessment?

Mr. MANSON. Of overassessment; yes.

Mr. HARTSON. Yes.

Mr. MANSON. I would like to have that produced.

Subsequent to these reports to which we have referred, there is a record of a conference, is there not?

Mr. PARKER. Yes, sir.

Mr. MANSON. Will you state what that record discloses?

Mr. PARKER. There is a conference report in the record, which states that:

> The taxpayer also contends that the plant as a whole is only 70 per cent in use as against 80 per cent computed in the engineer's report. On this point it was agreed that additional data would be submitted and if the information is as claimed by the taxpayer's representatives, the conferees will recommend that the value in use be reduced to 70.

Mr. MANSON. Does the record show who attended that conference?

Mr. PARKER. Yes, sir. The above conference was held under date of October 30-31, 1922. The taxpayer was represented by R. G. Wilson, attorney in fact; C. W. Parkhurst, consulting electrical engineer; A. C. Middleton, treasurer; and D. Badger, accountant, of Ernst & Ernst.

The department was represented by J. C. Hering, conferee; J. W. Swaren, engineer; and C. F. Rhodes, conferee.

Mr. MANSON. Now, did you find that any additional evidence was submitted to the Income Tax Unit relative to the percentage of this plant in use after that conference?

Mr. PARKER. The only such evidence was a brief submitted by the taxpayer, the only new matter in which was included the following quotation:

> It was early recognized after the erection of the two 5,000-kilowatt units that the three plants covering the 9,000 kilowatt equipment could not be economically operated in connection with the additional capacity as represented by the central station, and therefore a 10,000-kilowatt machine was installed in the central station to replace, upon completion, the three old plants, which, as stated before, had a combined capacity of 9,000-kilowatt. Not until the 10,000-kilowatt machine was installed ready to operate were the three old plants abandoned. Thus, is is obvious that the normal power plant capacity was 9,000-kilowatt and the war capacity 19,000-kilowatt.

Mr. MANSON. Read what is stated on page 9 of your report.

Mr. PARKER. We have quoted above from a brief from the taxpayer dated November 8, 1922, that states in substance that he installed the new 10,000-kilowatt unit in 1920 to replace the old 9,000-kilowatt pre-war plant. Yet he states on page 17 of his amended claim, submitted October 1, 1921, that—

> The operating costs of the three old plants made it prohibitive to maintain them for reserve power, necessitating three crews in readiness to operate, therefore, as a provision for spare capacity the Berwind-White Coal Mining Co. planned to install an additional 5,000-kilowatt unit which would have been ample with the available flexibility of operation at hand. * * * The installation of the additional 10,000-kilowatt generator being made solely because this unit could be bought from the Norfolk & Western Railroad Co. for less than the price of a new 5,000-kilowatt machine.

Further, see page 3 of Exhibit D, in which taxpayer states, in re the 10,000-kilowatt machine, "which machine was purchased by us as a 'spare'".

It would seem apparent that when the taxpayer in April, 1920, discarded his 9,000-kilowatt pre-war plant, which was practically worn out, and in addition to the 10,000-kilowatt plant (which it is desired to amortize) built an addition to this new power house and installed another unit of 10,000-kilowatt, it would be the very best of evidence that this war plant, which he claims is only 36.8 per cent in use, was very nearly, if not fully, in 100 per cent use. The only possible claim being on difference in war and post-war prices and a possible slight change due to inadaptability of size of units. It is a recognized fact in proper power plant design that considerable spare or reserve capacity must be available so that one unit at least may be shut down.

To sum up: From the above consideration, and others which we omit through hope of reasonable brevity, it appears from the data that the taxpayer had an old 9,000-kilowatt pre-war plant nearly worn out (as proved by his own rates of depreciation given later). He built a new 10,000-kilowatt plant, which he completed after the war period. This plant replaced, or could have replaced, his old plant, and in fact was put in immediate use (see Exhibit A, p. 7), "because of better operating efficiencies, as rapidly as the new units were ready for operation, the load was shifted, and the old stations were shut down. Plant No. 35 was the last shut down." Also, certain plans were made in 1920 for electrification of mining proper-

ties, which plans were subsequently abandoned, but which influenced the purchase of the new 10,000-kilowatt unit, in addition to the advisability of spare capacity.

Further, the old pre-war plant, as proved by auditor's report, was written down to salvage value in April, 1920, at about the time the plant on which amortization is claimed was completed—a write off amounting to $139,545.70.

Mr. MANSON. I now call your attention to the allowances for depreciation as stated by you on page 9 of your report. Will you state at what rate depreciation was allowed to this taxpayer for the years 1918 and 1919 on power plants? (See supplement following case, p. 1332.)

Mr. PARKER. They allowed the taxpayer on steam plants a rate of depreciation of 10 per cent, on electric plant 15 per cent, and on the buildings 5 per cent.

Mr. MANSON. As a practical matter, does the building housing a power plant exceed the life of the power plant itself?

Mr. PARKER. Well, that is pretty hard as a general question, because other things come into it. I would not say always, but usually the buildings do not have any longer life than the equipment if it is a growing business. It makes all the difference in the world whether it is a growing business or whether you can install new units in the old house or type of construction.

Mr. MANSON. Is it customary to install new electrical generating units in old buildings, even though the buildings are in good condition?

Mr. PARKER. I think it is if they are large enough, but that is not generally the case.

Mr. MANSON. Electrical generating equipment is increasing in size very rapidly, is it not?

Mr. PARKER. It usually is. It is the exception rather than the rule, I would say, where you do not build a new power house when you are putting in completely new electrical units.

Mr. MANSON. From the size of the units in the old power plant, are you able to form any opinion as to whether or not those old power houses would have been fit for use for the new units that were installed during the war?

Mr. PARKER. In this case they would obviously not have been fit for use for the new units, because there were three separate power houses, any one of which did not have a capacity equal to one unit of the new plant.

Mr. MANSON. In that case the life of the buildings would not exceed the life of the electrical installation, would it?

Mr. PARKER. No, sir.

Mr. MANSON. Now, applying the electric power plant rate of 15 per cent to the life of the equipment in the old power plant, would the old power plant have been written off the books before the war?

Mr. PARKER. Yes, sir.

Mr. MANSON. I believe you stated that the report of Engineer Swarin is the last engineering report of an examination made on this property by the bureau?

Mr. PARKER. That is correct.

Mr. MANSON. Have you prepared a summary of that report, giving verbatim such parts of it as you deemed material to the matters of amortization?

Mr. PARKER. Yes, sir. I have collected those extracts that seemed pertinent.

Mr. MANSON. Will you now read them into the record?

Mr. PARKER. These are the extracts from the report on the redetermination of the amortization claim of the Berwind-White Coal Mining Co., Philadelphia, Pa., submitted October 21, 1922, by J. W. Swarin, engineer:

Amortization claims: In its original 1918 tax return the taxpayer took a deduction under Schedule A–19 of $257,668.16, and in its 1919 return took a deduction under Schedule A–26 of $66,906.10.

Senator JONES of New Mexico. What are those schedules, so that we may have that information in the record in this connection.

Mr. PARKER. Those schedules refer simply to the record form of return, as required, by every individual, as well as corporation, in reporting income tax.

The CHAIRMAN. It is for depreciation?

Mr. PARKER. Some schedules cover depreciation.

The CHAIRMAN. Yes; but the Senator wants to know what this schedule covered. Did it not cover depreciation?

Mr. PARKER. Well, this schedule, A–19, I believe, covers amortization, does it not?

Mr. HARTSON. Yes; that is correct.

Mr. PARKER. And A–26 in 1919 is also amortization. They are only different numbers in the different years. It covers amortization.

Senator JONES of New Mexico. That is what I was after.

Mr. PARKER. Yes. It filed an amended claim under date of October 1, 1921, in the sum of $519,077.55. Engineers Woolsen and Moore, on the basis of this amended claim, submitted a report under date of May 12, 1922, recommending a total disallowance of amortization.

In a brief received in this office August 21, 1922, the taxpayer requested a redetermination of its amortization claim, submitting a schedule based on present-day replacement costs, from which, on a basis of value in use it computes a claim for amortization in the sum of $476,991.79 on a basis of salvage value; and by another method of computation based on value in use, makes a claim in the sum of $546,737.92. This schedule is abbreviated, and in computing the post-war replacement costs the engineer has used segregated costs displayed in the schedule submitted with its amended claim of October 1, 1922, which show the same total costs as in the brief requesting a redetermination. No contractual amortization was received by the taxpayer from contracting departments of the Government.

Amortizable costs: Power from this installation is distributed to a number of companies and individuals, and may be segregated as follows:

1. Power for companies reported on the consolidated return of the Berwind-White Coal Mining Co.: (*a*) Employed for production of coal; (*b*) distributed by the Windber Electric Co., a public-service corporation.

2. Power for other companies not reported on the consolidated return of the Berwind-White Coal Mining Co.: Installation of facilities for supplying power

in class 1-A above is clearly within the intent of the amortization law and the regulations as specified in article 183, regulations 62, edition 1922.

Mr. MANSON. You can omit that portion. We have already read the law for the record.

Mr. PARKER (reading):

Power supplied under class 2 above likewise is paid for on a definite commercial basis, and the receipts returned as income by the taxpayer. Facilities installed for supply of such power are not amortizable for the same reasons stated in the preceding paragraph.

The item covered by purchase order No. 5661-B (18), comprising a switchboard in station No. 35, is used for controlling power supplied to the Windber Electric Co.; amortization should be disallowed on costs of $1,276.

On the remainder of costs, $824,446.44, amortization should be computed on the basis of its necessity for supply of power in accordance with article 184 (2), regulation 63, edition 1922, as segregated in the classification given above. This will be discussed from two points of view: (a) Connected load; (b) power generated since this plant has been in operation.

The work which an electric generating station may be required to do is determined by the apparatus connected to its lines, commonly termed "connected load"; and the frequency and length of time such apparatus is operating, usually expressed by the term "diversity factor."

The taxpayer has submitted a schedule of connected loan based in part in kilowatts installed and the remainder in horsepower of motors connected. Horsepower has been converted into kilowatts on a basis of 85 per cent efficiency of the motors in order that uniformity of computation may be obtained.

Following is table showing connected load: Class 1-A, 16,225 kilowatts; class 1-B, 818 kilowatts; class 2, 1,155 kilowatts, making a total of 18,198 kilowatts.

On basis of connected load amortizable costs are 16,225 divided by 18,198, or 89.5 per cent.

Mr. MANSON. Now, just a minute at this point. That means 89.5 per cent of the output of this plant was for certain uses that could be considered subject to amortization, does it not?

Mr. PARKER. That is correct, the other 10.5 per cent being power sold to an electric company for other purposes.

Mr. MANSON. Go ahead.

Mr. PARKER (reading:)

Under heading of "Future development" below, it is shown that the normal increase in load has been uniform and will not exceed 450 kilowatts per year, equally divided between class 1 and class 2 power, which is not sufficient to affect the above percentage computations applied to conditions as of March 3, 1924.

The following table shows the distribution in kilowatt-hours of power generated on the entire system since the new power house was started: For the year 1920, class 1-A kilowatt-hours, 23,677,924; for the year 1921, 23,971,814; for the year 1922, 7,068,522.

Mr. MANSON. 1922 there refers to only seven months.

Mr. PARKER. Yes, sir; 1922 is for the seven months from January to July.

Class 1-B kilowatt-hours for the three years, as in the first case, are 2,631,610, for 1920, 2,751,141 for 1921, and 3,134,429 for 1922.

The CHAIRMAN. In the latter case, you again mean that 1922 covers seven months?

Mr. PARKER. Yes, sir. The total of class 1-A, class 1-B, and class 2 for the three years is as follows: 26,309,534, 26,722,955, and 10,203,951 for seven months.

Senator JONES of New Mexico. Those are for what three years?

Mr. PARKER. 1920, 1921, and 1922.

The CHAIRMAN. I do not get the point as to just what you intend to prove by that.

Mr. PARKER. I am reading from Mr. Swaren's report the figures that he puts in there on the total kilowatt hours as actually used. As a matter of fact, he does not use those figures in arriving at his final value.

Mr. MANSON. This is the basis from which he does determine, however, how much of this plant is allocated or should be allocated to amortizable cost, is it not?

Mr. PARKER. That is correct, and the last column of these figures, and which is really what he is after, is this:

Per cent allocable to amortizable costs, 1920, 90 per cent; 1921, 89.8 per cent; and 1922, 69.4 per cent.

Pre-war power records of the taxpayer are not complete, as accurate station logs were not kept in the old plants.

The low percentage allocable to amortizable costs in 1922 is the result of strike conditions when only necessary equipment was in service. Normal conditions are reflected in the years 1920 and 1921 when the percentage of power distributed agrees closely with the percentage of connected load. As connected load is an exact measure of possible demand, it is recommended that amortizable costs be determined on this basis, and amortization be computed on 89.5 per cent of $824,446.44, or $737,883.44.

It now goes to the determination of value in use:

Production basis: In mining operations as conducted by the taxpayer, a large part of the power is required for driving fans, lighting, pumping, and drainage, and other uses, which continue even when no coal is being mined. The taxpayer was unable to supply data showing exactly what percentage power is required for these purposes, but other data showing the general situation was supplied.

The log sheet for Sunday, May 7, 1922, when very little coal was mined and the load in class 1-B and 2 was light, shows total generation of power was 61,500 kilowatt-hours, while on February 28, which was a day of normal production, total generation was 120,300 kilowatt-hours.

Records kept by taxpayer over a series of years showing the kilowatt hours per ton of coal produced afford another check on this relation.

Mr. MANSON. He did not take that fact into consideration in determining his load, did he?

Mr. PARKER. No, he did not.

Mr. MANSON. We will just pass that, then.

Mr. PARKER. I think we can pass that. He next takes up "Plant suitable for post-war needs," and says:

Inasmuch as the connected load is a determination of the possible maximum use, and the diversity factor is determined by experience and previous operation is an indication of probable use, an analysis of these factors, combined with a study of probable future development, will enable the determination of size and type of plant suitable for the taxpayer's postwar needs.

Development program: At the time this plant was installed, the taxpayer had under consideration the sinking of shafts, and hoisting tonnage handled through certain long entries. A change in the field management has resulted in definite abandonment of this plan and reconstruction is now in progress on the mine trackage.

All the engineering work has been completed for the electrification of one shaft of the Maryland Coal Co. This will require 800 horsepower on the main hoist and 300 horsepower on the auxiliary hoist, or an increase in connected load of 965 kilowatts. No authorization has been made for this work and it will not be undertaken before March 3, 1924.

All the mines are fully equipped for ventilation, and there will be no increase in this load from additional development.

All pumping for drainage and unwatering is done in a central pumping station. Five units are installed, but three are sufficient for present drainage requirements. The veins in this area are reasonably uniform in bedding, and

a flooding fracture has never been encountered. There is little probability that additional pumping equipment will be required.

The principal increase of load will be the result of longer haulage as mining progresses. This increases the average haul about one-fourth mile per year, and will be taken care of by additional heavy locomotives and tandem locomotives. This increase is estimated as one 35-ton (250 horsepower) locomotive in both class 1 and class 2 power, or a total load increase of not more than 450 kilowatts per year in connected load. This would mean an estimated total connected load on March 3, 1924, of 18,873 kilowatts.

Before the taxpayer began erection of this plant it endeavored to purchase power from the predecessors of the Penn Public Service Corporation, which supplies power in this territory, but was unable to secure it. Since that time the Penn Public Service Corporation has installed additional equipment, and is able to supply any need for power that may arise in this locality. Its energy is distributed at 60 cycles, and all of the mines that are adding to electrification install 60-cycle equipment. With the exception of the small additional growth of power demand on the lines of the Windber Electric Co., the only avenue for sale of power is to the Penn Public Service Corporation. To do this would require installation of frequency changers. The taxpayer could not contract for sale of a larger block of firm power than 5,000 kilowatts and still have sufficient reserve for its own needs. The heavy capital outlay would increase fixed charges to a point that such a small block of power could not be sold at a profitable rate. It is evident future increase of sold power will be small.

The CHAIRMAN. Why is it necessary to go into all of that, Mr. Manson?

Mr. MANSON. This is the basis of the findings on the part of the engineers for the unit that 80 per cent of this plant was in use. By reason of the figures which I quoted from my statement, it is the basis of my conclusion that there was 100 per cent use of this plant.

The CHAIRMAN. Well, do we need to go into all of these details to prove that?

Mr. MANSON. I think the next two pages, down to the end of the first paragraph on page 9, are necessary to substantiate those statements.

Mr. PARKER (reading):

Units necessary: An uninterrupted supply of power is necessary at all times and reserve capacity must be available to avoid interruption due to any ordinary accident that may occur.

Examination of normal load curves shows that the power demands for nine hours of the day is approximately two times the demand for the remainder of the day. Most economical operating conditions would be obtained with two units in service at or near full load during the period of heavy load, and one unit in service during the remainder of the day. With two units installed there would be no reserve in case of accident to either unit. A third unit in reserve would provide sufficient assurance of operation under any conditions that might be foreseen in the taxpayer's normal operations.

Use of old plants as reserve units: Because of better operating efficiencies, as rapidly as the new units were ready for operation the load was shifted, and the old stations were shut down. Plant No. 35 was the last shut down. After plant No. 35 was shut down, a full crew was kept on duty and full steam pressure maintained in the boilers as a reserve unit to the new station. This was an inefficient arrangement, and as soon as practicable the installation of a third unit was authorized.

A high price was asked for a duplicate of the units installed, and the taxpayer bought a 10,000-kilowatt (12,500 K. V. A. Unity P. F.) unit built for another firm, but never installed. The total cost of this larger unit was practically the same as a duplicate of the original units, and gave the taxpayer the advantage of increased reserve, with a better water rate for its day load if carried on this unit. No amortization is claimed on this third unit.

Estimate of load: An examination of the station logs since the new power plant has begun operating shows that the maximum peak which has ever

been carried was on March 13, 1922, at 2 p. m., the load reaching 9,200 kilowatts at 99 per cent P. F., or 50.6 per cent of connected load. February 28, 1922, was selected as an average or normal day, when the maximum peak was 8,800 kilowatts at 97 per cent P. F., or 48.5 per cent of connected load, from 10 a. m. to 11 a. m. and again at 2 p. m. at 95 per cent P. F.

The lighting load will never coincide with the power peaks, and these may be taken as the extreme load to be expected.

As shown under "Development program," the connected load on March 3, 1924, will be approximately 18,873 kilowatts and assuming the same ratio of peak loads developed above, loads as high as 9,500 kilowatts at 99 per cent P. F. may be expected.

Suitability of present plant: The two units on which amortization is claimed are rated at 5,000 kilowatts each at 80 P. F. equivalent to 6,250 K. V. A. at Unity P. F. The taxpayer has submitted water-rate curves of these units which show that at 4,000 kilowatts (which is the average operating load per unit under normal conditions) the water rate is 15 pounds, while at full load the rate is 14.8 pounds, or less than 2 per cent better. From a point of view of steam economy, the present plant is entirely suitable for any present or future needs.

Suitable size of units: Normal day load is approximately 8,000 kilowatts at 95 per cent P. F. or 4,000 kilowatts per unit during the period of high load, and 3,800 to 4,000 kilowatts at 80 to 85 per cent P. F. during the period of light load. The next smaller size of unit of the types on which claim is made is 5,000 K. V. A. at Unity P. F., or 4,00 kilowatts at 80 per cent P. F. Should units of this size replace the present units, normal loads would be carried at the maximum points of efficiency on the water-rate curve. Peak overloads because of high P. F. would impose no unusual strain on the electrical end of the equipment, but the mechanical end would be loaded beyond an efficient operating point, and the load carried by by-passing steam to the low pressure stages of the turbines. These conditions will not prevail more than two hours per day, and the excess cost of the power generated under overload conditions would be less than the increased fixed charges on a plant with units of larger size.

The size of the generating units is the controlling factor in determination of sizes of other parts of the plant, and the same ratio of use is applicable.

Ratio of units as measure of value in use: As a result of the above analysis, the ratio of units of the smallest suitable size to the units installed, or 4,000 divided by 5,000, which is 80 per cent, is considered a fair measure of the value in use and is recommended.

Do you want to read these figures, Mr. Manson?

Mr. MANSON. No.

Mr. PARKER. I can just state the total amount of amortization recommended in this report.

Mr. MANSON. If you will; yes.

Mr. PARKER. The total amount of amortization allowance recommended for the years 1918 and 1919 by this report is $176,953.25.

Mr. MANSON. And what was the total allowance as you stated it before?

Mr. PARKER. That is the same as I had stated in my report before. Of course, there is a supplemental report to this that changes that.

Mr. MANSON. Yes. Now, what was the next step in the handling of this claim?

Mr. PARKER. They had a conference on October 30-31, from which I have already quoted one paragraph in the previous remarks, where the taxpayer seemed to be willing to accept a 70 per cent value in use instead of 80 per cent.

Mr. MANSON. Was there any further report made by the engineer, or were there any further reports made by engineers?

Mr. PARKER. There was a further supplemental report made by the engineer on November 18.

Mr. MANSON. Have you that report?
Mr. PARKER. Yes, sir.
Mr. MANSON. It is a short report, is it not?
Mr. PARKER. It is a very short report.
Mr. MANSON. Yes; just read that.
Mr. PARKER (reading):

This supplemental report is based on a report submitted by the engineer under date of October 21, and conference held in this unit October 30-31, November 7, and November 13.

In these conferences the taxpayer submitted data to show that the pre-war plants of 9,000 kilowatts installed capacity had been increased during the war period by 10,000 kilowatts, making a capacity of 19,000 kilowatts, and that units of 9,000 capacity are surplus for post-war needs.

On this basis the value in use becomes 10,000 divided by 1,900, or 52.6 per cent.

Mr. MANSON. Which was the percentage used in finally determining amortization?
Mr. PARKER. Yes, sir.
Mr. MANSON. Did you find any report of any evidence submitted or any further examination made by any of the engineers of the bureau which became the basis of their changing their estimate of the amount of use of this plant?
Mr. PARKER. No, sir. Do you want the amount of this redetermination?
Mr. MANSON. Yes; the amount of the redetermination.
Mr. PARKER. On this supplemental report?
Mr. MANSON. Yes.
Senator JONES of New Mexico. I would like to know what that supplemental report is, and by whom it was made. Was it made by the same engineer that made the other report?
Mr. PARKER. Yes, sir.
Senator JONES of New Mexico. And was it made after this so-called conference?
Mr. PARKER. Yes, sir.
Senator JONES of New Mexico. How soon afterwards?
Mr. PARKER. His original report was on October 24. There was a conference on October 30-31, of which I found a copy; also November 7 and November 13, of which I did not find a copy, but which possibly the department can find. This supplemental report is dated November 18. That is a little less than one month from his first report.
Senator JONES of New Mexico. Then, the effect of this conference was to develop a new basis for computation of the percentage not in use of the plant?
Mr. PARKER. I would hardly call it a new basis. It was the basis originally brought up in the taxpayer's original claim.
Senator JONES of New Mexico. They changed the percentage, then?
Mr. PARKER. They did change the percentage; yes, sir.
Senator JONES of New Mexico. On what evidence?
Mr. PARKER. I can find no new evidence that was not shown at the time of the first report.
The CHAIRMAN. Go ahead, Mr. Manson.
Mr. MANSON. Did you give the amount of the final allowance based upon the 52.6 per cent?

Mr. PARKER. The first allowance, as I stated, in round figures was $176,000, and in the supplemental report it was changed to a total of $373,401.12.

Senator JONES of New Mexico. I would like to know just what that last standard of computation meant, in plain language, and not in engineering terms.

Mr. PARKER. In brief, it is this: He said that before the war they had a plant that would produce 9,000 K. W. That is simply a term, of course, of electrical energy.

Senator JONES of New Mexico. Yes.

Mr. PARKER. You might say 9,000 tons, if you want to.

Senator JONES of New Mexico. I understand the term "K. W."

Mr. PARKER. All right. Then, before the war they had a plant that would produce 9,000 K. W. During the war they built one of 10,000 K. W. They claimed that 9,000 K. W. was all that they needed. Therefore, they claimed that the total capacity of their plant when they completed their war equipment was 19,000 K. W.; so, in their first claim, they divided 9,000 by 19,000 to obtain a value in use, and that is what they claimed in their brief; but the engineer has changed it to 10,000 to 19,000 to get a ratio, because he knew that they were using the two 5,000 K. W. units and that the 9,000 K. W. units were not in use.

Senator JONES of New Mexico. And for purposes of amortization they assumed that the original plant of 9,000 K. W. was 100 per cent efficient, and they built a new 10,000 K. W. plant, making a total of 19,000 K. W., 100 per cent efficient, and inasmuch as they only needed nine or ten thousand, they wrote off the balance. Is that about the substance of what occurred?

Mr. PARKER. That is it, Senator. They did it just as you said. They wrote off the old plant, and, in addition to that, they have taken the amortization on it, too; that is, they are amortizing the new plant and writing off all the old plant.

Mr. MANSON. Now; if this latter basis of computing amortization is to be accepted, the basis whereby they arrived at the 52.6 per cent value in use, they must of necessity ignore the fact that they have scrapped the old plant; is not that correct?

Mr. PARKER. I should think so, though they practically stated it in their papers. It is easy to see that they have done so.

Mr. MANSON. Well; they must ignore that fact in arriving at that percentage; is not that true?

Mr. PARKER. That would be my understanding, and I can not see any other way.

Mr. MANSON. Yes. They also proceed on the assumption that they do not need any reserve power. Is not that also true?

Mr. PARKER. That is correct.

Senator JONES of New Mexico. And they ignore the fact on their books for depreciation of the old plant they had practically written it off before this new plant was being constructed?

Mr. PARKER. They had not written it off, Senator; that is, they had written off a certain amount up to 1918. In 1918, they increased their rates of depreciation, and our previous statements have been to the effect that if they had used the same rates that they had used during 1918 and 1919 for the whole period, the plants would have

been entirely written off before the war commenced. They did not actually use those rates in those pre-war years. That left a balance which, in April, 1920, at the time the new plant was finally completed, they did write off their books, and that sum of money represented $139,000.

Senator JONES of New Mexico. That is, what they were carrying on their books in April, 1920, for the old plant was $139,000?

Mr. PARKER. That is not all they were carrying; no, sir. They were carrying something over that, but the $139,000 represents the write-off of the plant down to its bare scrap value. They left a value equal to scrap on their books.

Senator JONES of New Mexico. Oh, yes.

Senator ERNST. Mr. Parker, when was it that you first had any personal knowledge or information about this Berwind-White Coal Mining Co. case?

Mr. PARKER. When I read the printed report to the committee, of last year's sessions.

Senator ERNST. You knew nothing up until the time that you saw the record here?

Mr. PARKER. No, sir; and it seemed a case that was not too large to try. It was the first one that I looked at, to go into to any extent.

Senator ERNST. How did you select this case, why did you select this case, rather than others?

Mr. PARKER. Purely by chance. It did not seem as large as some of the others in the record, and I hesitated to try the ones running up into big millions for the first case. I simply took it at random, from reading the record. It seemed to be worth looking into.

The CHAIRMAN. I might say to the Senator at this point that I asked the staff to go over the hearings of our last sessions and pick out the cases where complaints had been made to the committee.

Senator ERNST. That is what I am trying to get at.

The CHAIRMAN. Yes; and this is one of the cases and the other cases, the Aluminum Co. of America, the Standard Steel Car. Co., and some other manufacturing concerns mentioned in the complaint formally made before this committee.

Mr. MANSON. Will you refer in your report to the part where you discussed the spread of amortization?

Mr. PARKER. Page 9.

Mr. MANSON. Will you just read that?

Mr. PARKER (reading):

Your engineers were at a loss to check the spread of amortization over the years 1918 and 1919. It appeared from the record that the engineers had accepted the taxpayer's claim of allocation of costs over the two years, but had called, as is customary, for a check of their costs by the auditor.

A conference was held with Mr. Hering, conferee auditor, who is familiar with the practice of the department.

An examination of the record makes it appear that this has not been done. The taxpayer has obviously thrown all his costs into the year 1919 by taking the dates of his purchase orders or commitments.

The result is that, while his actual expenditures for the war plant alone were only $218,653.27 up to January 1, 1919 (see Exhibit E), he has been allowed to take $333,200.95 amortization in that year. Mr. Hering stated he believed an error had been made and it might make a difference of $180,000 in the tax, if the costs had been allocated on the basis of actual expenditures,

as should have been done in case of a facility not completed or used until after the war period.

We again call attention to the fact that a letter of overassessment of over $500,000 has been issued, and probably a cash refund made.

Mr. MANSON. At this point, I wish to read in the record article 185 of Regulations 62.

Senator ERNST. Was not that given a little while ago?

Mr. MANSON. No.

Senator ERNST. That was 183, was it?

Mr. MANSON. Yes; this is 185.

Senator ERNST. All right.

Mr. MANSON (reading):

The amortization allowance shall be apportioned (*a*) in cases where the property was employed in the production of articles contributing to the prosecution of the war, over the respective accounting periods of the taxpayer, having reasonable regard to his gross and net income, and where separately ascertainable the income from the facilities upon which amortization is claimed, between January 1, 1918 (or if the property was acquired subsequent to that date, January 1 of the year in which acquired), and the actual or estimated date of cessation of operations as a war facility, and (*b*) in cases where the property was not completed in time for use in the production of articles contributing to the prosecution of the war, on the basis of the expenditures made on account of which amortization is allowed.

I now call your attention to page 9 of your report. Had the allowances for depreciation for the years 1918 and 1919 been applied to the former years, you have already stated that it would have wiped out this property long before the war?

Mr. PARKER. Yes, sir.

Mr. MANSON. I now wish to call the committee's attention to the regulations with respect to depreciation allowances. Article 161, among other provisions, contains the following:

The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate) by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, and having due regard for expenditures made for current upkeep, at the end of such useful life to provide in place of the property its original cost (not replacement cost), or its value as of March 1, 1913, if acquired by the taxpayer before that date.

Have you that certificate of over-assessment [addressing Mr. Hartson].

Mr. HARTSON. That is a copy, Mr. Manson. I think the original certificate, if I am not mistaken, goes out to the collector.

Mr. MANSON. I do not believe this is the one. I would like to know definitely on what date the Commissioner signed the certificate of over-assessment disposing of this amortization matter.

The CHAIRMAN. Has the Bureau that here in its files?

Mr. PARKER. It is there, because I have seen it.

Mr. MANSON. Can you ascertain from any records that you have here upon what basis that certificate was signed?

Mr. GREENIDGE. I find the following in the memorandum, which states as follows:

The over-assessment was applied as a credit against taxes due for other years in the amount of $249,005.40, and the balance of $252,105.62 was refunded by check mailed June 3, 1924.

The CHAIRMAN. May I ask you what the date of that is that you are reading from?

Mr. GREENIDGE. This is dated June 3, 1924, when the check was mailed.

Mr. MANSON. But what I want is the date that the Commissioner signed the certificate of over-assessment finally disposing of this matter.

Mr. NASH. The Commissioner does not sign the certificate of over-assessment. He signs a schedule on which will be entered maybe a hundred of these certificates of over-assessment, going out to a certain collection district.

Mr. MANSON. Well, have you any record there to show that was done?

Mr. GREENIDGE. Yes, sir; on June 3, 1924 it was mailed.

Mr. MANSON. That is when they sent out the check.

Mr. GREENIDGE. Yes, sir.

Mr. MANSON. This matter was finally disposed of before that date.

Mr. GREENIDGE. Yes, sir.

Mr. MANSON. I would like to know what date it was when this matter was finally disposed of.

Senator JONES of New Mexico. And who disposed of it.

Mr. MANSON. Yes.

Senator JONES of New Mexico. And by what, what sort of a memorandum or opinion?

Mr. GREENIDGE. That would not be in this file, gentlemen.

Mr. NASH. This, I might say, was approved in the solicitor's office on January 14, 1924, and from that point on it is a matter of mechanical procedure. It is entered on a schedule and the commissioner signs that schedule. The schedule then goes out to the collector of internal revenue of this district, and he checks the items there against his books to see whether or not the taxpayers were back in their taxes for any other years.

Senator JONES of New Mexico. What I would like to know is who fixed as a finality the basis for this assessment?

Mr. NASH. The deputy commissioner in charge of the Income Tax Unit signs this certificate of overassessment, and it is reviewed by the solicitor in cases of over $50,000.

Senator JONES of New Mexico. Now, you say "this." To what do you refer?

Mr. NASH. The certificates of overassessment.

Senator JONES of New Mexico. It is that certificate——

Mr. NASH. It is a carbon of the original certificate.

Mr. MANSON. When is that dated?

Mr. NASH. No date appears on that, Mr. Manson, but here are the dates of approval.

Mr. MANSON. Would it be subsequent, then, to the 14th of January, 1924, that this matter would be passed on by the deputy commissioner?

Mr. NASH. The commissioner would approve the schedule. This is approved by Alexander, head of the division, on November 8, 1923, and the deputy commissioner would approve it after that, and then that would be as a matter of form. The solicitor's office has approved here January 14, 1924.

Senator JONES of New Mexico. What is that that was approved, that you are talking about and pointing to?

Mr. NASH. The certificate of overassessment, showing an overassessment of $501,111.02, to the credit of the Berwind-White Coal Mining Co., Philadelphia.

Senator JONES of New Mexico. Does that contain any memorandum or opinion or decision as to the basis on which the calculation was made?

Mr. NASH. This is the auditor's computation in arriving at that figure.

Senator JONES of New Mexico. Well, let us get that in the record, so that we may know what it is. Somebody explain what it is and what was the foundation for it.

Mr. MANSON. That is the final closing document in the matter, is it not?

Mr. TUNGATE. Yes.

Senator JONES of New Mexico. By whom was that paper prepared?

Mr. TUNGATE. This paper was prepared by an auditor, Craig L. Reddish.

Senator JONES of New Mexico. What was the authority for his preparation of that paper?

Mr. TUNGATE. This audit is based upon data in the file, taking the taxpayer's net income as disclosed on this return, making an adjustment, debit and credit, and, of course, working in this amortization allowance.

Senator JONES of New Mexico. Well, what is the basis? What was furnished to that auditor as the basis for the amortization allowance?

Mr. TUNGATE. There is a report made by the amortization engineer, which has been read by Mr. Parker.

Senator JONES of New Mexico. This supplemental report, which is the product or the result of the conference referred to by the witness, Parker?

Mr. TUNGATE. Yes, sir.

Senator JONES of New Mexico. And all that the auditor did, then, was to take that so-called supplemental report, of a date subsequent to the conference and use that as a basis for making those calculations to which you refer?

Mr. TUNGATE. Together with the revenue agent's report, which was made.

Senator JONE of New Mexico. Well, the revenue agent simply furnished the amount which the taxpayer owed, I take it, and he had nothing to do with the amortization allowance?

Mr. TUNGATE. The revenue agent had the report made by the amortization engineer when he made the investigation of the taxpayer's books and submitted quite an extensive report on the taxpayer's net income and invested capital. The auditor, Mr. Reddish, takes the revenue agent's report and the report made by the amortization engineer and compiles or fixes the tax liability which is set forth in these schedules.

Senator JONES of New Mexico. What did the revenue agent have to do with the amortization feature?

Mr. TUNGATE. In this particular case he accepted the report made by the engineers.

Senator JONES of New Mexico. With this supplemental report?

Mr. TUNGATE. Yes, sir.

Senator JONES of New Mexico. To which we already have had reference?

Mr. TUNGATE. Yes, sir.

Senator JONES of New Mexico. So that the revenue agent made the first calculation on the amortization allowance referred to in this suplemental report?

Mr. TUNGATE. Yes, sir.

Senator JONES of New Mexico. And then the auditor merely checked that work of the revenue agent?

Mr. TUNGATE. Yes, sir.

Mr. MANSON. Who was it that determined that amortization should be finally allowed on the basis of this supplemental report?

Mr. TUNGATE. Are you speaking to me?

Mr. MANSON. Yes.

Mr. TUNGATE. The engineer's allowance on his report which states or recommends that a certain amount shall be allowed, is accepted by the auditors as fixing the amount, subject, of course, to che- on the costs, which is done by the revenue agent in the field.

The CHAIRMAN. I want to get that clear. I understand from these answers that there was no further review made of the case after the supplemental report of the engineer? Is that correct?

Mr. TUNGATE. You are referring now to amortization only, or in general?

The CHAIRMAN. Why, certainly; that is what we are talking about—the amortization.

Mr. TUNGATE. Amortization?

The CHAIRMAN. Yes.

Mr. TUNGATE. The revenue agent, it is assumed, made a review of the costs; yes.

The CHAIRMAN. No; I am not talking about the costs. I am talking about the engineer's supplemental report which was read by Witness Parker, and in which the percentage used was 52.6 per cent. I ask you if you know whether anybody reviewed that case as affecting the amortization after that time?

Mr. TUNGATE. Not to my knowledge; no, sir.

The CHAIRMAN. Can anybody here tell me whether it is customary for anybody to review those figures?

Mr. GREENIDGE. Yes; they are all reviewed.

The CHAIRMAN. Then, I would like to know who reviewed it after that time?

Mr. GREENIDGE. The particular report that we are talking about now, if you will give me the date of it, Mr. Parker——

Mr. PARKER. November 18, 1922, I think.

Mr. MANSON. Are you talking about the supplemental report now?

Senator JONES. I think what we are all after is to find out who assumed responsibility of fixing that amortization rate at 52.6.

Mr. MANSON. And on what date it was done.

Senator JONES of New Mexico. Yes; and when it was done.

Mr. GREENIDGE. I think I can get that in a moment, Senator.

Mr. PARKER. November 18, 1922. The review engineer was J. R. Bolling.

Mr. GREENIDGE. The report to which Senator Jones is referring was dated November 18, 1922, signed by Engineer Swaren, reviewed by Engineer Booling, signed by De La Mater, chief of section.

Senator JONES of New Mexico. Now, let us get that paper in the record here. What did that paper contain?

Mr. GREENIDGE. Mr. Parker has read most of it, sir. Have you not, Mr. Parker?

Mr. PARKER. Yes, sir; I have a copy of it right here.

Senator JONES of New Mexico. Well, does it contain an order or opinion fixing that as the basis for amortization?

Mr. GREENIDGE. It is the equivalent of an order, sir. It is the report which is taken as the basis.

Senator JONES of New Mexico. Then, are we to understand that Mr. Swaren made one report—when was this first report made?

Mr. PARKER. October 21, 1922.

Senator JONES of New Mexico. October 21, 1922, and then did he make any further investigation of the plant itself, or where did he get any additional information for his second report, which was dated what date?

Mr. PARKER. November 18, 1922.

Senator JONES of New Mexico. Of November 18, 1922.

Mr. GREENIDGE. The taxpayer filed a brief subsequent to his first report. I think I am correct.

Mr. PARKER. That is correct.

Senator JONES of New Mexico. And then Mr. Swaren changed his report, did he?

Mr. GREENIDGE. No; the taxpayer then came before the department and presented his case orally on two occasions, I think, or at least on one occasion.

Senator JONES of New Mexico. Then, as a result of that oral argument, the engineer changed his report, or made a new one?

Mr. GREENIDGE. No; as the result of the presentation of the brief and the oral argument.

Senator JONES of New Mexico. He did what?

Mr. GREENIDGE. He wrote his report dated November 18, 1922.

Senator JONES of New Mexico. Then a conference was held?

Mr. GREENIDGE. No; the conference was held before the report.

Senator JONES of New Mexico. Perhaps, I am in error. Did he file more than two reports?

Mr. GREENIDGE. You mean the taxpayer, sir?

Senator JONES. No; I mean this engineer.

Mr. GREENIDGE. Yes, sir; more than one. I do not know whether he filed more than two.

Mr. PARKER. He filed two.

Mr. GREENIDGE. He filed two. I do not know that he filed more than two.

Senator JONES of New Mexico. He only filed two reports, then?

Mr. PARKER. That is all; yes, sir.

Senator JONES of New Mexico. One in fixing the basis of amortization on 80 per cent efficiency or use?

Mr. PARKER. Value in use.

Senator JONES of New Mexico. Value in use.

Mr. GREENIDGE. Which was subsequently changed to 70, I think.

Mr. PARKER. Not officially. It was simply mentioned in the conference report that they were trying to agree on 70.

Mr. MANSON. This may straighten it out. Did not that conference report show that the taxpayer was to produce evidence showing that it should be reduced from 80 to 70.

Mr. PARKER. That is correct.

Mr. GREENIDGE. But there is also a report showing that it was recommended by the conferees that it should be reduced to 70.

Mr. MANSON. Provided the taxpayer produced that proof.

Mr. PARKER. I can quote exactly from that one paragraph.

Mr. GREENIDGE. What is the date of that conference?

Mr. PARKER. October 30–31. Do you want me to read that?

Mr. MANSON. Yes; just read that paragraph, so that we will have it straight.

Mr. PARKER (reading):

Taxpayer also contends that plant as a whole is only 70 per cent in use as against 80 per cent computed in the engineer's report. On this point it was agreed that additional data would be submitted, and if the information is as claimed by the taxpayer's representatives the conferees will recommend that the value in use be reduced to 70.

Senator JONES of New Mexico. After that they decided on a reduction to 52.6 per cent?

Mr. PARKER. Yes, sir.

Mr. GREENIDGE. After the presentation of the supplemental brief of the taxpayer and further conference.

Senator JONES of New Mexico. But the taxpayer himself only asked that it be reduced to 70.

Mr. GREENIDGE. Well, he may have developed additional information. I am speaking only in a very general way, because I know nothing of it.

Senator JONES of New Mexico. But I would like to have somebody speak here who was in that conference.

Mr. GREENIDGE. There is one man, Mr. Hering, who was in the division. He is in the department now, and there is another man, Mr. Bolling, who approved the final report. He is also at work in the department, but he is on sick leave just now. He is in Washington. Either of those men, of course, is available to the Senator.

Senator JONES of New Mexico. Well, from this report and from your familiarity with it, are you able to offer any explanation of it?

Mr. GREENIDGE. No, sir; I am not attempting to do so, sir.

Senator JONES of New Mexico. And this is one of the cases about which complaint was made before the committee at its sessions last spring?

Mr. PARKER. Yes, sir.

Senator JONES of New Mexico. And this reduction from even the claimed 70 per cent to 52.6 per cent has been made, and this matter settled since complaint was made before the committee?

Mr. GREENIDGE. Well, it certainly has been settled, Senator Jones, and in perfectly regular procedure, in the department.

Mr. DAVIS. The refund section went out on June 3, 1924, I believe you said?

Mr. GREENIDGE. Yes, sir; that, of course, is subject to verification.

Mr. DAVIS. Yes.

Mr. MANSON. I want to ask Mr. Parker a question at this point. You state in your report, Mr. Parker, "We are advised by the auditors that this refund has probably been made since the certificate was signed by the commissioner on March 26, 1924, but we have not verified this." To what document are you referring there as having been signed on March 26, 1924?

Mr. PARKER. As previously stated, I had a conference one day with Mr. Hering in connection with an apparent error in the spread of amortization and unfortunately I made note of that but I have not the paper. I thought it was on a copy of the certificate of overassessment, but I remember distinctly that on the side of the paper there were a lot of little squares to be filled in, to sign, and in one of them I asked him when the commissioner had signed it, and he said, "These are the commissioner's initials here." Perhaps some of these gentlemen know that paper, which was signed on the side of it, just by the initials.

Mr. DAVIS. Where did you get that date, Mr. Parker?

Mr. PARKER. That was right alongside the signature.

Mr. DAVIS. That date of March 26 that you are referring to.

Mr. PARKER. That was the date.

Senator JONES of New Mexico. Where is Mr. Swaren, this engineer?

Mr. GREENIDGE. He is not in the department now, Senator.

Senator JONES of New Mexico. Well, where is he?

Mr. GREENIDGE. We think he is in Cleveland, Ohio, Senator. We do not know.

The CHAIRMAN. You may proceed, Mr. Manson.

Mr. MANSON. I wish somebody connected with the department would ascertain whether any action was taken in this matter on March 26, 1924, and if so, I would like to have produced that document that Mr. Parker refers to.

Mr. PARKER. Mr. Hering could probably explain that because he was the one that I was talking with about it.

Senator JONES of New Mexico. Where is he?

Mr. GREENIDGE. In the department here in Washington, Senator. If you wish him you can have him here in fifteen minutes.

The CHAIRMAN. To-morrow will be all right for that, Senator.

Senator JONES of New Mexico. Yes; I think to-morrow will do.

Mr. HARTSON. I think it might be of interest to the committee to know the way the commissioner consummated these actions of refund, and approval of overassessment certificates. He has been referred to here as having approved the overassessment certificate. The commissioner, as Mr. Nash has pointed out, does not sign the overassessment certificate at all, but after overassessment certificates have gone through the usual procedure, having been O. K'd by the heads of divisions, the original auditor and the reviewers, and they all bear the initials of those who considered them, then the effect of the certificate is carried out on a schedule which groups on one schedule or one sheet the adjustment of many taxpayers' taxes, and that is what the commissioner signs. That becomes, in a sense, the assessment. It then goes forward to the collector, and

it goes on his books, and if the collector has an outstanding assessment against that taxpayer, against which this schedule appears to carry a refund, the two are credited and balanced against each other.

Senator JONES of New Mexico. Mr. Hartson, do I understand that this transaction was approved by the solicitor's office?

Mr. HARTSON. You understand, Senator, that these certificates of overassessment, when involving reviews in excess of $50,000, are approved in the solicitor's office.

Senator JONES of New Mexico. And this was approved in the solicitor's office.

Mr. HARTSON. That is correct. This overassessment was approved in the solicitor's office. The approval there, as the Senator will no doubt recognize, is not an engineering approval at all. It has no real reference and would not have, to the amounts that are carried in these schedules when some technical engineering subject is involved. In our office we attempt to make a review, having in mind the law itself, without attempting to dispute or question the figures that come up to us, nor any settlement of engineering questions that might be involved. We can not go into these questions at all and go through hundreds of them, but we do try to make a careful check, and if we come upon something which is apparently wrong, even though it does not involve any technical legal question, we will send it back, and object to it. We do constantly catch things of that character.

Senator JONES of New Mexico. Do you know anything about this conference that has been referred to?

Mr. HARTSON. There was no representative of the solicitor's office present at any conference. The action was moved over to the solicitor's office, the files indicate, not in conference, not in consultation with anybody in the unit.

Senator JONES of New Mexico. Then your office accepted this so-called supplemental report, I take it.

Mr. HARTSON. Oh, it would naturally, I should think, as a matter of course, because I think we would be in no position to question it. Those certificates of overassessment are signed by an assistant solicitor, who is a member of what is know as a claims committee in the bureau, and it is not signed in my name, nor is it signed for the commissioner. It was signed by the assistant solicitor, who is a member of the review committee, so appointed and designated by the commissioner, in order that a lawyer, a qualified man, may consider the rebate or refund from a legal standpoint.

The CHAIRMAN. Mr. Manson, how long will it take you to finish your side of this case?

Mr. DAVIS. We would like to have Mr. Hering called.

The CHAIRMAN. I think the committee would like to meet at 10 o'clock to-morrow morning, and at that time it would like to have Mr. Hering here, or any other representative of the bureau who can throw any light on this subject.

Mr. HARTSON. Mr. Nash has just secured the information that Mr. Manson is desirous of obtaining.

The schedule which ordinarily is approved by the commissioner, and which carries into effect this certificate of overassessment re-

ferred to in the Berwind-White case, was approved by him on March 26.

Mr. MANSON. That is the date I wanted to fix, and I would like to call the attention of the committee to the fact that that is just four days after the witness Moore called the attention of the committee to this case last spring. He appeared before the committee on March 21.

The CHAIRMAN. Can anybody explain what held this case up in the bureau from this engineer's report of November, 1922, to March 26, 1924?

Mr. HARTSON. I would not say that that is an unusual delay, Senator.

The CHAIRMAN. From 1922 to 1924 is not unusual?

Mr. HARTSON. Oh, 1922. The original report was in 1923, was it not?

Mr. PARKER. No; it was in 1922.

Mr. HARTSON. Then I have been misinformed.

Mr. PARKER. Not according to my record.

The CHAIRMAN. I hope the bureau will be prepared to straighten this matter out to-morrow, at our hearing, which will begin at 10 o'clock.

Mr. HARTSON. Yes, sir.

(Whereupon, at 4.15 o'clock p. m., the committee adjourned until to-morrow, Tuesday, December 2, 1924, at 10 o'clock a. m.)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

TUESDAY, DECEMBER 2, 1924

UNITED STATES SENATE,
SELECT COMMITTEE INVESTIGATING
THE INTERNAL REVENUE BUREAU,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to adjournment of yesterday.

Present: Senators Couzens (presiding), Jones of New Mexico, and Ernst.

Present also: Earl J. Davis and L. C. Manson, Esq., of counsel for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, solicitor; Mr. S. M. Greenidge, head engineering division; Mr. W. C. Tungate, chief consolidated audit, section H; Mr. W. S. Tandrow, valuation engineer.

Mr. DAVIS. Mr. Parker, will you resume the stand, please.

TESTIMONY OF MR. L. H. PARKER—Resumed

Mr. MANSON. I am through as far as Mr. Parker is concerned.

Mr. HARTSON. Mr. Parker, I believe you testified yesterday afternoon that had the company depreciated the plant and building which was in existence before 1918 at the same rate that it depreciated those properties on its books for 1918 and 1919 over the time that the building and plant had been in existence, they would have written off the total cost of the plant and equipment before 1918. Is that a fair statement of your testimony on yesterday?

Mr. PARKER. That is correct, except for the qualification that the building rate, which was only 5 per cent, as was brought out by the questions of Mr. Manson—that buildings of that type would not be any good if the equipment in them was worn out, being three separate and distinct buildings, which they wished to consolidate into one. In other words, it is obvious that at the 5 per cent rate they would not have been written off. That was simply applied to buildings on the electrical equipment—15 per cent was applied.

Mr. HARTSON. So that the statement that I made is correct, certainly in so far as the machinery is concerned?

Mr. PARKER. Yes, sir.

Mr. HARTSON. The power units?

Mr. PARKER. Yes, sir.

Mr. HARTSON. Do you know whether or not the company did depreciate on its books the machinery and equipment at the same rate that it used on those two war years or prior years? Let me state it this way: Do you know whether the same rate was used consistently by the company as a depreciation rate on their equipment that they used during the war years?

Mr. PARKER. I do not know what the actual rate was. All that I could find on the record—and you will understand that I did not go through all of the audit papers, which was physically impossible—was a total sum that was set up into the depreciation reserve, and it seems obvious from the age of the machinery that they could not possibly have taken off any such rate as 15 per cent.

The CHAIRMAN. Mr. Hartson, I think you would understand it better if I pointed out to you that on yesterday he testified that they did not use the same rate all through the same period, but if they had used the 1918 and 1919 rates they would have done it.

Mr. HARTSON. That was precisely my understanding, too, Senator, and I wanted to have the witness verify that and then to ask him whether it is a fact, from his observation and search of the records, that this machinery was actually written off and they had gotten their costs back prior to the building of this new plant.

Mr. PARKER. I found on the record a statement where they wrote this plant off as of April, 1920, amounting to $139,000, roughly.

Mr. HARTSON. Then, it is your judgment, based on your search of the records here, that the company did, in fact, write off the total amount of cost of machinery in the old plant prior to 1920?

Mr. PARKER. No, sir; in April, 1920—not prior to 1920.

Mr. HARTSON. Well, prior to April, 1920?

Mr. PARKER. Well, that was the date. April was the date.

Mr. HARTSON. Now, Mr. Parker, assuming that, as an accounting policy, the company had written off the cost of this machinery and equipment prior to May, 1920, that would not necessarily mean that in fact, the value of that machinery has been exhausted through wear and tear, would it?

Mr. PARKER. Well, I am not an accountant. I would say that, if the books were supposed to reflect the true condition of the company, and if they were written off to salvage value, there would be no reason to write them off for any other purpose, but to state the fact.

Mr. HARTSON. Well, you know, do you not, Mr. Parker, from your experience, that it is not unusual for a policy of accounting to be somewhat inconsistent with the actual facts? You know that, do you not?

Mr. PARKER. I know it often happens that the policy of accounting does not coincide with the fact, yes.

Mr. HARTSON. When the company started to construct a new plant in 1918, and that finally was completed—was it 1920?

Mr. PARKER. I could not find the exact date on the record. As near as I could locate it, it was in the spring of 1920.

Mr. HARTSON. Now, subsequent to that date, they installed another 10,000-kilowatt power unit, did they not, subsequent to the completion of the plant which is sought to be amortized?

Mr. PARKER. Yes, sir.

Mr. HARTSON. Do you know whether this new 10,000-kilowatt power unit was a separate plant, or whether it was another unit installed in the new plant which was erected in 1918?

Mr. PARKER. They built an extension onto the new power house and installed the new unit.

Mr. HARTSON. It was just an additional unit to the plant started in 1918 and completed approximately in 1920?

Mr. PARKER. That is correct.

The CHAIRMAN. Excuse me a minute there. What do you mean by building? I understand they extended the building also. A building is not a part of the unit.

Mr. HARTSON. If I understand Mr. Parker correctly, they started in 1918 to construct a central power plant, and the addition of that 10,000-kilowatt power unit subsequent to 1920 was an additional unit to their system, which had been centralized and concentrated there in that plant, which was started in 1918.

The CHAIRMAN. Well, but that statement leaves a doubt in my mind as to whether they had to extend the building also, and the witness said they had to extend the building; but the building is not a part of the unit.

Mr. HARTSON. If they extended their roof over a little additional area it would seem to me to be just an extension of the unit which was started in 1918.

Senator ERNST. Just let us understand the fact. What was the fact as it was done?

Mr. PARKER. They extended the building also.

Mr. HARTSON. I have no further questions of Mr. Parker.

Mr. MANSON. I have no further questions to ask him.

The CHAIRMAN. You have nothing further to say in connection with the settlement, so far as this witness is concerned?

Mr. HARTSON. I have nothing further to ask this witness.

Mr. MANSON. That is all, Mr. Parker.

I would like to have Mr. Hering take the stand.

TESTIMONY OF MR. JAMES C. HERING, AUDITOR, INCOME TAX UNIT, BUREAU OF INTERNAL REVENUE

Mr. MANSON. Mr. Hering, you are an employee of the Income Tax Unit?

Mr. HERING. Yes, sir.

Mr. MANSON. How long have you been employed by the Income Tax Unit?

Mr. HERING. Since November, 1919.

Mr. MANSON. In what capacity are you employed there?

Mr. HERING. As an auditor.

Mr. MANSON. Were you a member of the conference held on October 30–31, 1922, which considered the amortization of the Berwind-White Coal Mining Co.?

Mr. HERING. Yes, sir.

Mr. MANSON. And have you the minutes of that conference with you?

Mr. HERING. No sir; I have not them personally. They may be in the case.

Mr. MANSON. I will read from what purports to be a copy of the minutes:

"Taxpayer also contends that the plant as a whole is only 70 per cent in use, as against 80 per cent computed in the engineer's report. On this point it was agreed that additional data would be submitted, and if the information is as claimed by the taxpayer's representatives, the conferees will recommend that the value in use be reduced to 70."

Have you any recollection as to whether what I have just read conforms to what occurred at that conference?

Mr. HERING. Well, my memory has been recently refreshed by the conference report, and I have no reason to think that this report does not accurately state the fact.

Mr. MANSON. Well, is this the report, which I have just read?

Mr. HERING. I think it is; yes, sir. I have a copy of it here.

Mr. MANSON. Oh, you have a copy of it before you?

Mr. HERING. Yes; I have a copy of it before me. That corresponds to what I have.

Mr. MANSON. Were you a member of the subsequent conference on the same claim?

Mr. HERING. On what date do you refer to?

Mr. MANSON. Well, were there any subsequent conferences held on this claim?

Mr. HERING. It is my recollection that the subsequent talks about this claim were not what we call formal conferences, but the representatives of this company did come in and talk with the officers of the unit subsequently to this, concerning the claim.

Mr. MANSON. Now, on that point, what is a formal conference, as distinguished from an informal discussion of a claim?

Mr. HERING. Well, it is one which is specially appointed as to time, as a rule, and arranged for between the representatives of the taxpayer and of the unit.

Mr. MANSON. Is there anyone officially designated to attend a formal conference on behalf of the unit?

Mr. HERING. In a general way, yes.

Mr. MANSON. Who designated you to attend this conference on October 30-31?

Mr. HERING. I think I was the official conferee of the section at that time.

Mr. MANSON. What section?

Mr. HERING. The amortization section.

Mr. MANSON. Who was Mr. J. W. Swaren?

Mr. HERING. He was the engineer who made the report in this case, that is, the second report.

Mr. MANSON. Was he a conferee?

Mr. HERING. Yes.

Mr. MANSON. Who was Mr. C. F. Rhodes?

Mr. HERING. He was also a conferee.

Mr. MANSON. When you say you were a conferee for the section, do I understand you to mean that you were a sort of standing conferee; that is, you were the person specially designated to hold conferences on all or in a considerable number of cases?

Mr. HERING. I think I shall have to modify my statement about that. I was at one time the specially appointed conferee of the amortization section. Later I became assistant chief of the section, and I formally sat in conferences as assistant chief, and at this particular date I think Mr. Rhodes, whose name is also signed to the conference report, was the specially designated conferee.

Senator ERNST. Was he an engineer?

Mr. HERING. No, sir, he was an auditor.

Mr. MANSON. Mr. Swaren was the only engineer member of this conference, was he not?

Mr. HERING. He is the only one who has signed it, and I suppose the only one who sat in.

Mr. MANSON. Have you any recollection of any other engineer sitting in that conference on behalf of the bureau?

Mr. HERING. I have not any recollection of anyone sitting in the conference, but I think that some of the other engineers were consulted.

Mr. MANSON. During the conference or afterwards?

Mr. HERING. Possibly, afterwards.

Mr. MANSON. By you?

Mr HERING. I may have done so; yes.

Mr. MANSON. Have you any recollection of doing so?

Mr. HERING. My recollection is not distinct enough to assert it as a fact, except this, that there were these informal talks which I referred to subsequently in which the chief of the section participated, Mr. De La Mater, and probably other engineers, though I do not remember the others definitely now, were there.

Mr. MANSON. What was the subject of your discussion with the other engineers, subsequent to this conference with reference to the Berwind-White Coal Mining Co.?

Mr. HERING. Well, we discussed the claim in general, but the point most in controversy was the question as to the percentage of use to be assigned to these facilities.

Mr. MANSON. From these minutes of the last conference, it would appear that the dispute between the taxpayer and the bureau was as to whether the percentage in use was 80 per cent or 70 per cent.

Mr. HERING. Well, that does not fully state the facts. The taxpayer claimed even a less percentage than 70 per cent, and the dispute between the bureau and the taxpayer was as to what the percentage should be.

Mr. MANSON. Who made this memorandum of this conference on October 30–31?

Mr. HERING. I presume I did myself.

Mr. MANSON. Was the taxpayer contending at that time that the percentage should be less than 70?

Mr. HERING. Yes, sir.

Mr. MANSON. How did you happen, in your memorandum of the conference, to include this statement: "Taxpayer also contends that the plant as a whole is only 70 per cent in use"?

Mr. HERING. He had two or three claims. If you will go into his statement, he stated it alternately, one as one point, and one as another; but this, I think, was the maximum percentage that he claimed.

Mr. MANSON. Oh, then he did, under some of his forms, or at least under one of his forms——

Mr. HERING. One of his claims, I should say, or one of his contentions.

Mr. MANSON. I say, under one of his contentions as to the state of the use. He did contend that there was a 70 per cent use of his plant?

Mr. HERING. That is my recollection of it.

Mr. MANSON. Now, in view of the fact that the taxpayer conceded that he had a 70 per cent use of his plant, what influenced you to adopt a 52.6 per cent use as a basis for final settlement?

Mr. HERING. I do not know that I ever did adopt it.

Mr. MANSON. Were you at any time a party to any conference which did adopt any percentage lower than 70 per cent?

Mr. HERING. I have not any distinct recollection of having ever agreed to a lower percentage, though I may have been asked about it?

Mr. MANSON. Did you ever agree to less than 80 per cent?

Mr. HERING. Not that I distinctly remember.

Mr. MANSON. Was the evidence referred to in the minutes of this conference, to be furnished by the taxpayer to substantiate his 70 per cent claim, ever produced by him, so far as you know?

Mr. HERING. Well, he submitted some additional data, but I do not now recall what it was, nor what effect it had upon that contention.

Mr. MANSON. Do you remember anything about the nature of that data?

Mr. HERING. No, I do not.

Mr. MANSON. In your position as conferee, or in any other position, in fact, was it necessary for you to agree to the allowance that was finally made to the taxpayer in this case?

Mr. HERING. No, it was not. My recommendations were merely advisory.

Mr. MANSON. Whose agreement was necessary to put the 52.6 per cent basis of determination into force?

Mr. HERING. Naturally, the chief of section was the immediately superior officer, and he was subject to review by still other officers.

Mr. MANSON. Who was the chief of the section at that time?

Mr. HERING. Mr. S. T. De La Mater.

Mr. MANSON. That is all.

The CHAIRMAN. You may examine, Mr. Hartson.

Mr. HARTSON. Mr. Hering, the statement contained in that copy of the conference report, concerning which Mr. Manson has been interrogating you, to the effect that: "Taxpayer also contends that the plant as a whole is only 70 per cent in use, as against 80 per cent computed in the engineer's report" may refer, so far as you know, to the plant which was constructed in 1918, rather than refer to both plants, the old plant, which was constructed many years before, and the new plant which was started to be constructed in 1918?

Mr. MANSON. I do not quite understand that question. Will the reporter read it?

(The reporter read the questions as above recorded.)

Mr. HERING. Well, the statement is the plant as a whole, and I rather think that is the way it was intended. I may have misunderstood the taxpayer.

Mr. HARTSON. Is it not true that there were two separate plants, an old plant that we refer to, and the new plant which was constructed in 1918?

Mr. HERING. Yes; generally speaking that is true. The old plant consisted of three different units, as I understand it.

Mr. HARTSON. The old plant consisted of three different units?

Mr. HERING. Yes.

Mr. HARTSON. And the new plant, the construction of which was started in 1918, was separate from those units contained in the old plant?

Mr. HERING. Yes, sir.

Mr. HARTSON. Would you state as a fact, from the knowledge you now possess, that the reference in this report to 70 per cent value in use refers to both plants, speaking of the old and new plants as both plants?

Mr. HERING. Well, I think that was the customary method of engineers in valuing war time facilities, to determine the extent to which the whole plant was in use, and to assign that percentage to the war time facilities as well as to the others.

The CHAIRMAN. I would like to say at this point that, as I understand it, the previous testimony is that the old plant was abandoned when the new plant was put into use. Therefore, how could both plants be 70 per cent in use?

Mr. HARTSON. I do not know, Mr. Chairman, that the bureau is prepared to accept the contentions that are made here by counsel that the old plant was abandoned. I think we will be prepared to show that the old plant was in use, and capable of being used up until 1920, at any event, and, as I am informed, capable of being used now, and is at the present time held in reserve.

The CHAIRMAN. I misunderstood it then. I thought somebody had testified that way.

Mr. HARTSON. No; I think you understood it correctly. I think that statement was made here.

Senator ERNST. You are right.

Mr. HARTSON. Mr. Hering, now a word about the organization in the amortization section. I believe you testified that you were assistant chief of that section?

Mr. HERING. At one time; yes, sir.

Mr. HARTSON. And was the chief of that section an auditor or an engineer?

Mr. HERING. He was an engineer.

Mr. HARTSON. You, however, were an auditor?

Mr. HERING. Yes, sir.

Mr. HARTSON. And the cases which were referred to the amortization section, such as the Berwind-White case, were handled in what way, by the auditors and the engineers? If I understand you correctly, Mr. Rhodes was an auditor.

Mr. HERING. Yes sir.

Mr. HARTSON. And Mr. Swaren was an engineer?

Mr. HERING. Yes sir.

Mr. HARTSON. Now, they both participated, evidently, in those conferences. Will you tell the committee the functions of the auditors and the engineers working on these amortization cases in your section?

Mr. HERING. Well, the usual procedure, of course, was for the engineer first to determine the amortization. Then, his report was submitted and approved. After field investigation, the case would be assigned to an auditor to audit. Now, in sitting in conference on these cases the auditors, of course, would have in mind the features that would affect the audit of the case, and the engineers would be supposed to pass upon those features which were particularly engineering questions. I sat in many of them somewhat as a legal adviser. We found, as a matter of fact, in handling these cases from an engineering standpoint, that many times legal questions would be involved, on which the engineers would consult me for advice, I being a lawyer, as well as an auditor.

The CHAIRMAN. At that point, this thought occurs to me. Unless the taxpayer raises a question as to the engineer's report on amortization, there is no review after his report is made; is that correct?

Mr. GREENIDGE. I will answer that affirmatively.

The CHAIRMAN. You answer it affirmatively, Mr. Greenidge?

Mr. GREENIDGE. Yes sir.

Mr. HERING. If you would like me to make a statement on that I will do so.

Mr. HARTSON. Yes; I wish you would, because I do not know that I agree altogether with Mr. Greenidge's answer to that.

Mr. HERING. I will say at that time, in that section, there was not a further review, but before the case leaves the Unit as finally approved, there is a further review.

The CHAIRMAN. Who makes that further review?

Mr. HERING. At the present time, there is a Review Section in each division, I think. I am not sure: there is one in the Consolidated and in the Corporation Audit, and if a refund is involved, as there was in this particular case, of over $50,000, the cases go to the solicitor's office for a still further review.

The CHAIRMAN. Not on the engineering features, though, as I understand it.

Mr. HERING. Well, they are at liberty to question them if they want to, as I understand it.

The CHAIRMAN. I understood, Mr. Greenidge, that, as a matter of practice, unless there was a question raised by the taxpayer, there was no general review made of the engineer's report.

Mr. HERING. At that time, sir.

The CHAIRMAN. Yes.

Mr. HARTSON. Mr. Hering, as to these designations that you have referred to, of conferees to attend these conferences, were they made in writing?

Mr. HERING. The specially designated conferee was usually so designated in writing; yes. That is, not for that particular case, but as an employee.

Mr. HARTSON. He was given an assignment as being a conferee?

Mr. HERING. Yes.

Mr. HARTSON. Is Mr. Rhodes, the man you referred to as being in attendance on this conference, an auditor who has since been indicted for an alleged fraud?

Mr. HERING. I think he is; yes, sir.

Senator ERNST. What was Mr. Rhodes?

The CHAIRMAN. He was a conferee.

Senator ERNST. Was he an engineer or an auditor?

Mr. HARTSON. He was an auditor.

The CHAIRMAN. I would like to ask Mr. Greenidge at this point whether he was in charge of this section at that time.

Mr. GREENIDGE. No, sir.

The CHAIRMAN. Were you employed in this section at that time?

Mr. GREENIDGE. No, sir.

The CHAIRMAN. Do you know anything about this particular case yourself?

Mr. GREENIDGE. Only what I have read in the record, sir, and what I have heard in the testimony here, together with what I have discussed with the auditors and engineers when this case first came before this committee.

Senator ERNST. You did not get any first hand information concerning it?

Mr. GREENIDGE. No, sir.

The CHAIRMAN. On yesterday, there was an effort made, I think by Senator Jones, and perhaps by counsel, to find out who finally agreed upon this 52.6 per cent.

Mr. HARTSON. We have those people here, Senator.

The CHAIRMAN. You have what?

Mr. HARTSON. They are here to-day. In compliance with your request, we have those gentlemen here.

The CHAIRMAN. All right.

Mr. HARTSON. Mr. Hering, I believe you stated, in answer to Mr. Manson's question, that the taxpayer was contending for a lower percentage of value in use for his power plant than this report which you have referred to and which is dated October 30–31, 1922, conceded to them?

Mr. HERING. Yes, sir.

Mr. HARTSON. Is that correct?

Mr. HERING. Yes, sir.

Mr. HARTSON. That the taxpayer was dissatisfied with even the allowance of 70 per cent for value in use?

Mr. HERING. That is correct.

Mr. HARTSON. Which this report indicates on its face as being a percentage which might be satisfactory to them?

Mr. HERING. Well, that was what we had suggested might be satisfactory to them, but I do not think they ever formally indicated that it would be satisfactory to them.

Mr. HARTSON. In other words, this report may be a little misleading on that point.

Mr. HERING. It may be, if it conveys the idea that the taxpayer did it.

The CHAIRMAN. Well, as a matter of fact, the report says that. It does not indicate it.

Mr. HARTSON. The report says that the taxpayer also contends that the plant as a whole is only 70 per cent in use.

The CHAIRMAN. That is the point I make. That makes the broad statement. It does not make it by inference.

Mr. HARTSON. What I am trying to bring out by this witness is the fact that the taxpayer was not contending that the plant was only 70 per cent in use, that the taxpayer's contention from the beginning was a great deal lower percentage than that as being the proper percentage of value in use. Am I not right in that, Mr. Hering?

Mr. HERING. I think their brief will show that they had contentions that were lower than that. They made several different calculations, as I said before, some of them in the alternative.

The CHAIRMAN. I would like to ask how there can be any alternative to a plant in use. It is either in use or it is not in use.

Mr. HERING. That is true, but there are different methods of calculating how it is in use or to what extent it is in use. They have one calculation in the claim which shows a contention of 35.8 per cent.

Senator ERNST. You had that before you at the time did you?

Mr. HERING. I presume it was on file in the office, but I do not think I had it before me.

The CHAIRMAN. While you are on that point, are there any other percentages that they claim in use?

Mr. HERING. If you have their brief of the case, it will show what they claimed.

Senator ERNST. In any event, that file that you have just referred to was in the record at the time you prepared that minute of the conference?

Mr. HERING. Yes; it must have been.

Senator ERNST. That makes it clear, in any event, that prior to your preparing that report, they claimed a much lower percentage. That is what I am trying to make clear.

Mr. HARTSON. Here is the brief that you are looking for.

The CHAIRMAN. If the brief shows a variance in the percentages in use, as claimed, I would like to have a statement as to the various claims they made as to the percentages in use.

Mr. HERING. I am looking for that in the brief, and I think I can find it for you.

The CHAIRMAN. While you are looking that up, I would like to ask Mr. Greenidge if he now is the head of the division which deals with the percentages of these plants in use or the taxes upon them.

Mr. GREENIDGE. I am.

The CHAIRMAN. You use, as a method of arriving at the percentage in use, the average or the peak of the plant?

Mr. GREENIDGE. The present procedure is to use the average over a period.

The CHAIRMAN. Of how long?

Mr. GREENIDGE. I could not answer that definitely, Mr. Chairman, because it would depend upon the particular circumstances in each case. Of course, as long a period as practical is taken.

The CHAIRMAN. If you use the average, how could a plant be used for peak requirements?

Mr. GREENIDGE. Well, a plant must be designed and equipped for peak requirements, as, of course you know, so as to meet unusual conditions that are going to arise at times in its business.

The CHAIRMAN. I understand that. Therefore I do not understand how they could get along with a lesser investment.

Mr. GREENIDGE. Quite so, sir.

The CHAIRMAN. Then do you consider it fair to take the average rather than the peak, if he needs the total investment for the peak load?

Mr. GREENIDGE. Oh, no; you could not do that.

The CHAIRMAN. Why not?

Mr. GREENIDGE. Because he would have to have his investment in plant sufficient to meet the peak requirements, although his average requirements may be less.

The CHAIRMAN. That is the point I am making, that you are giving him credit for only requiring in use the average demands of the plant, rather than taking the amount of investment in use at the peak times.

Mr. GREENIDGE. Was my statement taken to mean that we would allow him the average value in use?

The CHAIRMAN. Your statement was that you arrived at the percentage of plant in use on the basis of the average rather than the peak demand of the plant.

Mr. GREENIDGE. Yes; that percentage in use would only be arrived at in that manner, Senator Couzens, as I understand your question.

The CHAIRMAN. I do not see how, for example, if the average demand upon the plant was 80 per cent, and if at times the plant was required to perform to 99 per cent of its capacity, how he could get along with a plant 20 per cent less in size.

Mr. GREENIDGE. He could not, sir.

The CHAIRMAN. Then why should not this plant be considered in use up to the maximum of its demands rather than up to the average?

Senator ERNST. Because it is not.

The CHAIRMAN. But you have to have the plant; you can not cut your plant down to 80 per cent when your maximum demand is 99 per cent.

Mr. GREENIDGE. I will ask Mr. Tandrow, who is a specialist in that line, to see if he understands your question differently from what I do, Senator. He has a different view from what I have. I can not see that I misunderstand you at all, and I can not see that my statement is incorrect; so I will ask Mr. Tandrow to answer the particular question, if he sees it any differently from what I do.

Mr. TANDROW. Yes; I do.

Mr. GREENIDGE. Then I wish you would state it to the committee.

Mr. TANDROW. In this case use is measured on a peak-load basis; and that plant, we will say, is designed for a capacity of 10,000 kilowatts. The peak-load requirements of that company are 8,000 kilowatts, so that you must take into account not the average condition, but the peak-load condition, the maximum kilowatt producing capacity that would be required under peak-load conditions.

The CHAIRMAN. I do not, still, see where the average come in if you use the maximum.

Mr. TANDROW. In this particular case we did not use an average.

The CHAIRMAN. Well, I asked Mr. Greenidge, if I remember correctly, what system he used now, whether he used the peak or used the average requirements, and I understood him to answer that he used the average requirements. Is that the practice in the bureau, so far as you know, Mr. Tandrow?

Mr. TANDROW. Well, it is in some lines of industry, but in the case of a power plant you have a different situation. A power plant, we will say, might carry a normal load of 5,000 kilowatts, but at times in the day, as for example, in the case of a street car company where all their cars are in operation between 5 and 7 o'clock, you would have a peak load. Now, the engineer in this case has based the use on the peak-load conditions. In other words, if the average load was 5,000, he has actually taken 8,000.

The CHAIRMAN. Do you not think that that is correct?

Mr. TANDROW. I do, in this particular case.

The CHAIRMAN. Well, will you describe a case to us where it would not be proper to use the peak instead of the average?

Mr. TANDROW. I will take a steel plant, for example. A steel plant is on a normal producing basis approximately 24 hours a day. They pour their steel at regular intervals. There is no peak-load condition apparent there, so that in order to comprehend an average condition you would take the average production per year for the period that the plant is in operation. In the operation of a blast furnace there is a very good example.

The CHAIRMAN. Well, suppose the steel plant that you have used as an illustration got a rush order, and it took them three months in the year to get it out, and they had to have excess plant facilities, so as to compete with other bidders, both in price and in delivery. Would not the maximum capacity of the plant, or at least the maximum that they used be a proper basis, rather than the average?

Mr. TANDROW. Well, I think not, Senator, for the reason that you can force a blast furnace to attain for short periods of time a production that would not represent normal operating conditions, or, in other words, the forced production and the cost of that production would not be consistent under normal conditions. I believe it is the general experience that a blast furnace can be forced up to about 25 per cent or more of their rated capacity.

The CHAIRMAN. Would that be true of a rolling mill?

Mr. TANDROW. Yes; you could speed up a rolling mill.

The CHAIRMAN. To any such capacity as you could a blast furnace?

Mr. TANDROW. I should say so. You see, you are dealing in one case with uniform production, while in the case of a power plant you have a definite peak-load period that is occurring regularly, from day to day.

The CHAIRMAN. In this case, I understand you to say that they did not use the average.

Mr. TANDROW. Right.

The CHAIRMAN. But used the peak.

Mr. TANDROW. Right.

The CHAIRMAN. I would like the witness to proceed, then, if that is the case.

Mr. HERING. With reference to these percentages I think, perhaps, I should explain a little more clearly the situation. The taxpayer in his revised claim claimed a percentage 35.8 as the utility value of the items which he wished to amortize. After the conference he filed, on November 8, 1922, a brief, in which he calculates the value of these facilities on one basis at 42.1 per cent and on another basis at 36.8 per cent. Now, I think the statement in the conference report of 70 per cent referred to the plant as a whole, and not especially to the amortizable part of it.

Mr. MANSON. Are you through with the witness, Mr. Hartson?

Mr. HARTSON. I would like to ask Mr. Hering another question.

Then it is a fact that the taxpayers' representatives never were contending for a percentage as high as 70 per cent; that they were contending for a percentage considerably lower than 70 per cent?

Mr. HERING. Yes, sir; with reference to the particular portions of the plant that were sought to be amortized?

Mr. HARTSON. Yes. Now, that brings out this situation. I think we are in agreement, then, on the question that I asked you some time ago, namely, that the 70 per cent figure used in that conference report, which is dated October 30–31, refers to the new plant?

Senator ERNST. I think we understand that now.

Mr. HARTSON. In the final adjustment had, Mr. Hering, wherein the percentage of 52.6 was allowed, that was the percentage based on the old plant and the new plant, was it not?

Mr. MANSON. Now, just a minute. This witness has testified that he did not know anything about that.

Mr. HARTSON. Well, if he does not know he can answer it that way. I do not want him to testify to anything that he has no knowledge of.

Mr. HERING. I testified that I never knowingly agreed to that percentage.

Mr. HARTSON. I did not ask you that, Mr. Hering; I asked you the basis, if you know, for the allowance of the 52.6 per cent.

Mr. HERING. I think it would be better to let the person who made that allowance explain it, rather than me. Perhaps he could do so better. I can only guess at it.

Mr. HARTSON. That is all. I have nothing further to ask.

Mr. MANSON. Now, Mr. Hering, at the time you were participating in this conference in October, 1922, you had before you the report of Engineer Swaren?

Mr. HERING. Yes, sir.

Mr. MANSON. And his associate, did you not?

Mr. HERING. Whom do you mean by his associate?

Mr. MANSON. Well, Engineer Swaren. I will modify that.

The CHAIRMAN. He was alone.

Mr. MANSON. Yes; he was alone. You were familiar with that report at that time, were you not, of Mr. Swaren?

Mr. HERING. To a certain extent; yes, sir.

Mr. MANSON. Yes.

Mr. HERING. Of course, I relied on Mr. Swaren, who was in the conference, and I presumed he was familiar with it.

Mr. MANSON. I see. That report states as follows; reading from page 10 of it:

Because of better operating efficiencies, as rapidly as new units were ready for operation, the load was shifted, and the old stations were shut down. Plant No. 35 was the last shut down. After plant No. 35 was shut down, a full crew was kept on duty and full pressure maintained in the boilers as a reserve unit to the new station. This was an inefficient arrangement, and as soon as practical the installation of a third unit was authorized.

Do you remember of that statement being disputed by the taxpayer at the conference?

Mr. HERING. No, I do not, but naturally, I would not pay much attention to the discussion of that point, as it is purely an engineering question.

Mr. MANSON. If it were true that the old station was shut down at the time of the conference, then the 70 per cent in use referred to in the minutes of the conference could not have referred to the combined old station and the new station, could it?

Mr. HERING. Yes; I think it could, even then.

The CHAIRMAN. At this point, I wish to have in the record a definition of "in use." If the engineer or somebody can enlighten us on that, I would like to have it, and I would like to know whether, if a plant is steamed up and held in reserve, it is in use, or whether it is not.

Mr. MANSON. Well, according to this statement, it was steamed up until the third plant was put into operation.

The CHAIRMAN. What is your contention, counsel, as to whether a plant is in use or is not in use when steamed up for reserve purposes?

Mr. MANSON. When one unit is steamed up, that unit is in use, whether a wheel revolves or not.

The CHAIRMAN. As a matter of fact, this report itself does show that the plant was in use.

Mr. MANSON. No; for this reason. It is shown that with that third unit the old station was kept steamed up until the third plant was built, that is, the addition was built on the war time plant, and that there were two plants in use at the time of the conference; the third unit had gone into operation at the time of the conference; and if the two plants were considered in use, it was the two 5,000 k. w. units installed as the war time plant, and the 10,000 k. w. units installed after the war, was it not?

Mr. HERING. They were, perhaps, the ones that were actively in use; yes.

Mr. MANSON. Now, at the time of this conference, the old plant had been written off the books, had it not?

Mr. HERING. I do not remember the exact date it was written off. I believe Mr. Parker testified it was in 1920.

Mr. PARKER. April, 1920.

Mr. HERING. If that is correct, it had been at that date.

Mr. MANSON. Do you know anything to the contrary?

Mr. HERING. No; I do not.

Mr. MANSON. Do you know whether the old plant had been abandoned when the third unit, the one that was installed after the war, went into operation?

Mr. HERING. Well, it is my understanding that it was finally abandoned at that time.

Mr. MANSON. Yes; when the third unit went into operation?

Mr. HERING. Yes, sir.

Mr. MANSON. Was not that prior to the conference held in October, 1922?

Mr. HERING. I presume so, but I do not know definitely.

Mr. MANSON. So that if you were considering the entire plant in October, 1922, as the basis of your 70 per cent, what you were considering was the war-time plant, consisting of two 5,000-kilowatt units, and the plant installed after the war?

Mr. HERING. Well, we considered the whole proposition.

The CHAIRMAN. I would like to ask Mr. Parker if he can tell me when this third unit went into service, according to the records?

Mr. PARKER. From the records, I could not give you the exact date. Understand, I had to go entirely from the papers. I looked for that, because I wanted to get the exact date, and when we found the date, I think it was the latter part of 1920. It was very late in the summer of 1920, as near as I can get any definite dates. If anybody could give me a better date I wish they would state it.

The CHAIRMAN. When was that engineer's report dated that you read from?

Mr. PARKER. October 21 and 22.

Mr. MANSON. That is the day before this conference was held.

Mr. PARKER. That is Mr. Swaren's original report.

Mr. MANSON. Yes.

The CHAIRMAN. When was the report of the other engineer dated, the engineer who testified before the committee at our last session?

Mr. PARKER. They testified that the plant was in full use. I can give you that date.

Mr. HERING. Their report was submitted on May 12, 1922.

The CHAIRMAN. I have that straight now.

Mr. MANSON. Did you not understand, Mr. Hering, that the third unit was installed because the old plant could not be efficiently operated as a reserve unit?

Mr. HERING. That was the taxpayer's contention, as I understood, yes, sir.

Mr. MANSON. You knew that was the taxpayer's contention before the conference?

Mr. HERING. Yes, sir.

Mr. MANSON. So that at the time of the conference it was understood that the old plant had been abandoned, and the new unit added after the war as a reserve for the two units added during the war, because the old plant had been discarded as inefficient?

Mr. HERING. I think that is a fairly accurate statement.

Mr. MANSON. Then, the percentage in use of 70 per cent that you referred to, if is applied to the two plants, or to the entire plant, would apply to the operating plant, would it not? What I mean by that is the new power house, with its two 5,000-kilowatt units and the 10,000-kilowatt unit.

Mr. HERING. I presume it would, yes.

Mr. MANSON. In this report of Mr. Swaren's, he states on page 11 that the peak load estimated to be developed by the 3d of March, 1924 is 9,500-kilowatt.

The CHAIRMAN. Are you asking the witness that question?

Mr. MANSON. Yes; I call your attention to this statement. Do you know anything about that?

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

Mr. MANSON. Have you a copy of Mr. Swaren's report before you?

Mr. HERING. Yes, sir.

Mr. MANSON. Do you find that statement in the report on page 11?

The CHAIRMAN. That has all been read.

Mr. MANSON. Yes. What I want to ask him is whether or not that fact was disputed at the conference.

Mr. HERING. I have no recollection that it was, but I have no recollection on the point one way or the other.

Mr. MANSON. Are you familiar with the manner in which amortization was spread in this case between the years 1918 and 1919?

Mr. HERING. To a certain extent; yes sir.

Mr. MANSON. Will you state the basis upon which it was spread?

The CHAIRMAN. I would like to ask whether that question indicates that there was an advantage to the taxpayer, or a disadvantage to the taxpayer, dependent upon which year it was spread on?

Mr. MANSON. Yes.

Mr. HERING. I do not recall how far it was spread, but I think it was spread only to December 31, 1918, which was fixed as the end of the amortization period, I think, but there were 1919 costs allowed, on which the amortization was allowed in 1919, and that amount, of course, was deducted in the year 1919.

Mr. MANSON. Is it not a fact that amortization was spread on the basis of commitments entered into instead of on the basis of actual expenditures?

Mr. HERING. The amortization was spread according to the way it was allowed in the engineer's report. It was allowed in that report according to the way it was claimed, but subject to the check of the costs by the auditor or the field agent assigned to investigate it. I do not think that the actual costs were the basis on which the allowance was made, nor the basis on which it was spread, but was spread, as I say, on the basis on which it was allowed, and that did include commitments.

Mr. MANSON. It appears that the actual expenditures up to January 1, 1919, were $218,853.27, while the amortization allowed as against that period was $333,299.95. That shows on its face that more amortization was allowed for 1918 than the total expenditures amounted to, does it not?

Mr. HERING. Yes; that allowance was made by the engineer, as I say, subject to verification of costs by the auditors, and the auditors apparently did not fully verify the costs, and an error, I think, arose as a result.

The CHAIRMAN. At that point I would like to put into the record my understanding that the allowance of amortization on commitments was not allowed under the law.

Mr. HERING. It was not intended to be allowed, I think.

Mr. MANSON. It was directly contrary to the regulations, was it not?

Mr. HERING. It was never the practice and never the intention to allow it on commitments alone. I think I should explain a little more fully what we understand by "commitments." That is, the taxpayer had made a contract, or had, perhaps, ordered articles to be delivered, and at the close of 1918 the contracts had not been fully

performed, or the articles had not been actually delivered, so that liability to pay for them had not yet fully accrued.

The CHAIRMAN. In other words, is that what we are to understand you mean by commitments?

Mr. HERING. Yes.

Mr. MANSON. The regulations are very specific as to how amortization is to be spread in case a plant is not completed so as to produce anything during the war period, are they not?

Mr. HERING. Yes, sir.

Mr. MANSON. And those regulations provide that the amortization allowance is to be spread in proportion to the expenditures?

Mr. HERING. Yes, sir.

Mr. MANSON. They are made on the property that is amortized, are they not?

Mr. HERING. Yes, sir.

Mr. MANSON. Now, can you state what the difference in the taxes would amount to by reason of this spreading of amortization in the manner in which it was spread in this case, and spreading it as the regulations require?

Mr. HERING. Well, if we assume that the same rate of amortization applied as was finally allowed, I made a rough calculation. As I recall it, it was something in the neighborhood of $122,000 difference in taxes, computing amortization on the actual expenditures as admitted by the taxpayer, in lieu of expenditures and commitments as made in the engineer's report.

The CHAIRMAN. Can you account for the fact that the auditors evidently did not discover the difference between the engineer's report and the general practice of the bureau, and in one instance allow only on expenditures and in this particular instance allow on commitments and expenditures combined?

Mr. HERING. Well, to a certain extent, I can. In the first place, the set-up of the taxpayer's claim was very unusual. I do not recall any other case in which a taxpayer actually claimed amortization in 1918 on contracts merely entered into in that year. It was unusual and I presume that is one reason why the auditors did not discover it. Another reason is that the taxpayer did actually make a journal entry in his books, setting up the amount of these contractual obligations in 1918. That means that unless an auditor went through and analyzed those journal entries he would not have discovered from an examination of the balance sheet or general ledgers, that these commitments had been included in with the expenditures.

The CHAIRMAN. I would like to ask you if it is your opinion now that the taxpayer ought to pay this $122,000?

Mr. HERING. No; under the law I do not think he can be forced to pay it. I think that there might be a moral obligation there, but I think it is legally barred.

The CHAIRMAN. Why do you think it is legally barred?

Mr. HERING. Well, the taxpayer has not been guilty of technical fraud, and the time in which an assessment can be made has elapsed; so I see no way of legally reopening the case and assessing a tax.

The CHAIRMAN. You do not consider it fraud to make a journal entry and cover the anticipated payments or expenditures on the cost of the plant, when it was not intended under the law, or cer-

tainly was not intended under the regulations of the bureau, to allow amortization on unexpended amounts?

Mr. HERING. Not when the taxpayers disclosed that journal entry. If he had covered it up, I would say it was fraud, but he stated that journal entry in his return, and also in his amortization claim; so the bureau was in possession of the facts.

The CHAIRMAN. And therefore this loss which has evidently been sustained by the taxpayer was no fault of the Government, but wholly the fault of the bureau?

Mr. HERING. I think so; yes, sir.

Mr. MANSON. That is all.

Mr. HARTSON. Mr. Hering, when did you first discover that this case was closed in a way that was not in agreement with your ideas?

Mr. HERING. I think it was first called to my attention by the investigator, Mr. Parker, for the Senate Committee.

Mr. HARTSON. Did you know the basis on which the case was closed in your amortization section when you were assistant of that section?

Mr. HERING. I do not think it was ever closed there.

Mr. HARTSON. Your section did agree on this 52.6 percentage of value in use of the plants, did it not?

Mr. HERING. Oh, yes.

Mr. HARTSON. As I understand you, you were not in the conference which finally settled that?

Mr. HERING. Well, that percentage has nothing to do with these costs.

Mr. HARTSON. No; I am referring now to the percentage question and not to this spread of amortization allowance.

Mr. HERING. I do not recall that I was at any such final conference.

Mr. HARTSON. Well, do you want the committee to understand that you disagree also with that percentage allowance that was given the company, as well as this error that you say has been made in the spread of the amortization allowance?

Mr. HERING. I think there is sufficient probability of error in it that if the case should be reopened, I would recommend that it be further considered.

Mr. HARTSON. When did you make up your mind on the error that was made in the allowance of the percentage?

Mr. HERING. Well, I have not finally made up my mind that there is an error in that. I say I merely think it should be further considered.

Mr. HARTSON. Well, did you think that at the time the case was closed out in the section of which you were assistant chief?

Mr. HERING. By "closed out" do you mean when the report was prepared?

Mr. HARTSON. I mean when the case moved out of your section to such other section as had to consider the case when your section was through with it, and final action was taken by your chief?

Mr. HERING. Well, I never made it a rule to question what my chief did. If he thought it was right, I did not have anything further to say.

Mr. HARTSON. I know, but if a case was clearly wrong, in your judgment, would you hesitate to call it to his attention?

Mr. HERING. I had already made my conference report in that case and said what my opinion was. I did not feel that I could be of any further assistance to him in the matter. If he did not agree with me, I did not object—I figured that that was an engineering question, and it was not my function to decide on that point, and I never attempted to.

Mr. HARTSON. I can recognize that, as an auditor, you would not interpose your judgment in conflict with engineers on an engineering subject, but you have volunteered your opinion as an auditor on this engineering question, and you think it is wrong, apparently, from your testimony here, and I would like to know, if you did think it was wrong, and thought it was wrong at the time it was passed on there, why did you not say something to somebody about it?

Mr. DAVIS. His answer to that, Mr. Hartson, is that he does say it in the conference report there.

Mr. HARTSON. Exactly, but at the time he made the report he did not know that that would be accepted.

Senator ERNST. Let us have the witness's answer, gentlemen.

Mr. HARTSON. Some subsequent action was taken after Mr. Hering put in the report on it, and, as I understand it, Mr. Hering is now protesting about that action, and there is nothing in the report whereby he called anybody's attention to it at the time it went through.

The CHAIRMAN. I would like to know at this point when it left this unit to which you are making reference in your question to the witness?

Mr. HARTSON. I think it it sufficiently accurate to put it at the date of the final approval of that engineer's report.

The CHAIRMAN. Then, you think it left this section about November 18, 1922?

Mr. HARTSON. I believe so; yes.

The CHAIRMAN. You asked the witness, as I understood it, if he made any protest or made any report indicating his disopproval at or about that time?

Mr. HARTSON. That is correct.

The CHAIRMAN. Can the witness answer the question?

Mr. HERING. I did not make any further report than my conference report.

Mr. HARTSON. Now, about the other matter, the question of the spread of the amortization allowance. That is an accounting problem, is it not, an accounting question?

Mr. HERING. That has been considered an accounting question.

Mr. HARTSON. And you are an accountant?

Mr. HERING. Yes, sir.

Mr. HARTSON. And you were assistant chief of that section at that time?

Mr. HERING. Yes, sir.

Mr. HARTSON. Did you disagree with the spread that was made in the amortization allowance in your section at that time?

Mr. HERING. The point as to the cost was left open, and I did not rule on that.

Mr. HARTSON. Well, it was left open in what way, Mr. Hering?

Mr. HERING. I thought the costs would be verified by the field auditor who investigated the case.

Mr. HARTSON. Do you know whether they were or were not verified?

Mr. HERING. So far as I know, they were not. I only know what appears on the records in the case.

Mr. HARTSON. Would you say that they were not?

Mr. HERING. I could not find any evidence that they were.

Mr. HARTSON. Then, in the absence of evidence that they were not verified, the assumption must be that they were; is not that correct?

Mr. HERING. No; I would hardly like to agree to that.

Mr. HARTSON. Is there evidence in that file, so far as you know, that they were never verified in the field?

Mr. HERING. Yes; I think there is.

Mr. HARTSON. That they were never checked by the revenue agent?

Mr. HERING. Yes, sir.

Mr. HARTSON. It is clear, is it not, that they were sent out to be checked by the revenue agent?

Mr. HERING. It is clear that the case was sent out to be investigated in the field; yes, sir.

Mr. HARTSON. Is it not also evident from the files that the revenue agent was specifically instructed in that memorandum transmitting the case to the field to make these checks against costs?

Mr. HERING. I do not recall. That may be true, but I am not sure.

The CHAIRMAN. In view of the question asked by the solicitor, I would like to ask if a review was had or an audit was made, would it not be of record in the bureau?

Mr. HERING. Certainly; the revenue agent's report is on file in the bureau.

Mr. HARTSON. It was sent out to the field for investigation by the revenue agent, and the files do indicate, beyond any question, that the revenue agent reported after an investigation in the field. I think the revenue agent's report does not specifically state that he checked these items of cost. I think that is the state of his report, but it did go to the field on other items also. Of course, there were many other disputed items which required investigation besides this amortization allowance, and it was all checked in the field.

The CHAIRMAN. What I wanted to get clear was that you seem to indicate that if the records show nothing the assumption should be that it was done; is that correct?

Mr. HARTSON. Well, I think, in the absence of a showing that there was no check made, it must be assumed that there was a check made, because he was instructed to make a check, and I think our records here will bear out his definite instructions to check those costs.

The CHAIRMAN. Can you lay your hands on those records?

Mr. HARTSON. Yes; I think Mr. Tandrow has them.

Mr. MANSON. Mr. Hartson, do you wish to lay the inference that he did check those costs, and he found that amortization was spread in accordance with costs?

Mr. HARTSON. I find, Mr. Chairman, that the engineer's report, dated November 18, 1922, which went with the case, transmitted to the field for investigation, carried this notation:

All costs and contractual amortization are subject to check by the auditor or revenue agent assigned to the field investigation of this case.

That became, of course, a part of the instructions to the revenue agent, because that was one of the purposes of sending the case out to the field for investigation.

The CHAIRMAN. May I ask you right there why you used the expression "contractual" amortizations, when contractual commitments were not permitted to be amortized?

Mr. HARTSON. Why this memorandum used that?

The CHAIRMAN. Yes.

Mr. HARTSON. Because I believe, Senator, that good accounting practice recognizes the accrual of certain items, and I believe that there was in this case a practice, a consistent practice on the part of this company to have accrued on its books, not for purposes of amortization but because of a consistent policy of accounting which they were following, certain obligations which they had bound themselves to carry through, and it set them up on the books in 1918, although the actual payment may not have been made until the following year. You will recognize that all through the enforcement of the income tax laws, the right to accrue items and charge on the books certain expenditures that you have not made, but that you are obligated to pay——

The CHAIRMAN. I justify the book entry but do you justify the allowance by the Government in view of the regulations?

Mr. HARTSON. I do not know. I think there is authority for doing it. Whether it is the best practice or not, I do not know.

The CHAIRMAN. Well, it was not done uniformly, was it?

Mr. HARTSON. It was not done uniformly, but I think there is precedent for having done it the way it was done here. This was not an isolated case and an irregularity which occurred which had never occurred before, because of the method by which the taxpayer in this case treated these items.

The CHAIRMAN. Now, you are getting at something which interests me very much. If a corporation has a good auditing system and a shrewd lot of accountants, it may set up a system of charging itself or journalizing commitments, and getting credit in amortization, whereas a corporation which did not set up these commitments would not get credit for amortization?

Mr. HARTSON. I think that the practice that was followed would have had a more favorable result in one case than in another; but I do feel that you cannot charge this company with having consciously gone ahead and entered those items in the manner that they did, having amortization in mind, because this occurred in 1918, and we did not have any law authorizing amortization at all until the fall of 1918. This was a consistent policy of the company.

The CHAIRMAN. I want to point out right here that we are not investigating the Berwin-White Coal Mining Co. We are investigating the bureau to see how uniform it is in its practices, and from this particular exhibit it is shown that it has not been uniform in its practice, because, in one case it allows depreciation on commitments, and in other cases it does not.

Mr. HARTSON. I do not claim, of course, to be an accountant, and have no real knowledge of accountancy at all, but I recognize the regulations, and the force of them, as Mr. Manson has read them into the record here. On the other hand, I believe that the accountants in the bureau, who are constantly dealing with these questions, recognize that this spread of amortization in this case was not wrong—just not wrong. There has not been an entirely consistent policy about it, but it can not be said that this was an irregular closing here, so far as the spread of amortization was concerned.

Mr. MANSON. These regulations are supposed to apply to all taxpayers uniformly, are they not?

Mr. HARTSON. Oh, yes.

Mr. MANSON. And the regulation as to how amortization shall be spread in a case where the facilities are not completed within the war period is very specific, is it not?

Mr. HARTSON. Yes, sir.

Mr. MANSON. There are no exceptions to it noted in the regulations, are there?

Mr. HARTSON. No; there are none.

Mr. MANSON. Has there ever been any official ruling?

Mr. HARTSON. Just read again, Mr. Manson, what you have particular reference to.

Mr. MANSON. What I have particular reference to is the last part of article 185, which I read into the record yesterday, and which I will now read again:

> In cases where the property was not completed in time for use in the production of articles contributing to the prosecution of the war, based on the expenditures made on account of which amortization is allowed.

In other words, to go back here to the beginning, "Amortization allowance shall be apportioned"—that should precede what I have just read. Now, there has never been any official ruling in any way modifying this regulation, has there?

Mr. HARTSON. No; I do not see that it is essential to modify that to recognize the thing that was done here.

Mr. MANSON. Yes; but other taxpayers similarly situated would have no means of knowing that exception might be made to this rule, so that they could spread their amortization on the basis of commitments rather than on the basis of expenditures, in the absence of some modification in this regulation, would they?

Mr. HARTSON. No; they would not. On the other hand, if other taxpayers had followed the same system that this taxpayer did, they would be dealt with in the same way that this one was in the bureau.

Mr. MANSON. Now, if this regulation had been modified, do you not think that this might influence taxpayers to make their claims upon another basis, if it was to their advantage to do so?

Mr. HARTSON. They would be required then to go back and change something that they had already done, because, as was pointed out here a moment ago, these entries were made in 1918, and there was no law authorizing any allowance of amortization until late in the year 1918.

Mr. MANSON. Then, as solicitor for the bureau, do you take the position that a man's rights or a corporation's rights under this law

depend upon his bookkeeping methods rather than upon what he actually spent and the time he spent at it, in order to produce articles which would contribute to the prosecution of the war?

Mr. HARTSON. Mr. Manson, the law itself recognizes the right of a taxpayer to keep his books in any way that clearly reflects the income, and if that policy adopted is consistently followed, then, though it has a very favorable result to him as distinguished from other taxpayers, it is recognized by the bureau.

Mr. MANSON. I want to ask Mr. Hering another question.

The CHAIRMAN. Just a minute, as I am interested in this. Wherein does the law recognize that the taxpayer may be more or less favorably dealt with, dependent on the condition that he keeps his books in?

Mr. HARTSON. I have not the section in mind, Senator, but it may readily be pointed out here, and I can cite an example which no doubt the Senator would be interested in.

There are two methods of keeping books, as recognized by the statute itself; namely, the accrual system of keeping books, and what is known as the cash receipts and disbursements method. The ordinary individual receives income when the cash is paid to him or property is received by him, and he keeps no books, or if he keeps books on the basis of cash receipts and disbursements, income is charged him in that year. On the other hands, most corporations keep their books, as the Senator knows, on an accrual basis. Even though they get no cash income or receive no property, they charge themselves on their books with income which has not been received, but which has been, in a sense, constructively received, and as against that income not received, they make deductions of actual expenditures that were made during the year. There are cases when there are no expenditures made, but they accrue an expenditure, or there is a commitment or a contract which they obligate themselves to pay, and they charge it on their books in this accrual system.

That has a very favorable result to the taxpayer, who is farsighted enough, if he is an individual, to keep his books on an accrual system. If he has, for instance, a long term contract, and starts to accrue income from that contract over a period of years, he then spreads the amount, which is not going to be paid to him until the contract is completed, over the years of the life of the contract.

If, on the other hand, he has the cash receipts and disbursements basis, and he gets income all in one year although he may have to work for two years, he has to pay the income tax on that one year, and it costs him money. The law recognizes that, yet he was farsighted enough in the one instance to protect himself against it.

The CHAIRMAN. I do not know whether he was or not.

Mr. HARTSON. It works out that way.

The CHAIRMAN. It may not work out that way. For instance, I accrue this year an income which I do not actually receive, and I pay an income tax on it of 50 per cent, and I reduce my tax by 25 per cent. I would have been better off if I had kept it on a cash receipts and disbursements basis, would I not?

Mr. HARTSON. Yes; and of course this could be said there, that the method which is followed by the taxpayer must be consistently followed. It can not be used one year one way and another year another way.

The CHAIRMAN. But the testimony in the previous hearings showed that the famous accountants, Ernst & Ernst, took the books of a corporation and rewrote them completely over a period of many years, for the very purpose of securing for their clients the benefits that you have pointed out here. As a matter of fact, if that is done, the bureau does not know whether they have consistently followed that system or not. The books that they produce to the bureau, of course, show that they have consistently followed it, because they have written up an entirely new set of books.

Mr. HARTSON. Of course, Senator, I should say in the instance that mention has been made of here that they did follow consistently a given policy, because they went back and carried it out over a period of years, and the result of that is that in some years it hurts them and in some years it helps them. But the policy is a consistent one. Even if they go back and change, if they cover a sufficient number of years, the true effect of that system of keeping books is reflected in income, and is shown in the tax.

Senator JONES of New Mexico. Do you want us to understand that the bureau recognizes as proper the instances just referred to by Senator Couzens?

Mr. HARTSON. Well, I do not speak for the department when I make any comment on the instance that Senator Couzens refers to.

Senator JONES of New Mexico. What is the practice in the department regarding such a thing as that?

Mr. HARTSON. There are some instances, Senator, where the department recognizes the right of the taxpayer to go back and file an amended return, and change the manner in which an item has been carried on its books. There are other instances where that is specifically prohibited. For instance, we say in regard to depreciation of a patent, that unless there has been a practice followed of depreciation on the March 1 value of a patent, we will not let them go back and take advantage of that, if they did not take advantage of it during the years that were involved. I have in mind a number of examples that might be mentioned here as to the different changes in books that might be made. They are not made fraudulently. They are made with the full knowledge of the bureau when it is done.

Senator JONES of New Mexico. Now, it is just that, that I want to get at. With that full knowledge of what the taxpayer is permitted to do, how far is he permitted to go back and rewrite his books and distribute receipts and depletion, and all that sort of thing?

Mr. HARTSON. I do not know how far that practice has been carried. Personally, I can not see that there is any very great harm done if they go back over a sufficient number of years to have the real effect of it borne out. If for one year you followed one system and for another year another system, that certainly would not truly reflect the income, and you would have an inconsistency there.

The CHAIRMAN. I would like to ask if you think this amortization is analogous with continuing the income and corporation tax; is it not a fact that this amortization has a definite ending?

Mr. HARTSON. Oh, yes.

The CHAIRMAN. Therefore, much greater advantage can be gained from following the system, when they claim it comes to an end, as you have specified, than the system where the man's books show that he takes a chance on whether it goes up or down. In other words, in this case they knew that amortization came to an end, and therefore they could take advantage, with that specific knowledge in mind, of fixing their books so as to get the advantage that this taxpayer got; but I do not believe that that is comparable with the cases that you have recited, based on income taxes, where the taxpayer may elect to use the cash receipts and disbursements system, or whether it uses the accrual system. I do not think they should be discussed in the same sentence.

Mr. HARTSON. I do not want the Senator to get the idea that in this case these people consciously followed this method of keeping their books with the idea of gaining some advantage on amortization.

The CHAIRMAN. As I said before, the taxpayer is not under investigation. We do not charge that. I do say that the department, if this is a typical case, has followed a very inconsistent policy of allowing the taxpayer to select his own system, and thereby take advantage, as they did in this case, of over $100,000, and in another case, where the taxpayer was not so shrewd, to be required to pay it.

Mr. HARTSON. Would not the Senator resent the Government's coming in and telling the Senator how to keep his books and the methods by which he should keep his books? The law does not do it.

The CHAIRMAN. Certainly not. I do not say that you should tell him how to keep his books. That is not a material factor in the case. The point is that it was your duty to collect the tax.

Mr. HARTSON. That is right.

The CHAIRMAN. On a certain basis, regardless of how he kept his books, and your auditor himself points out that he believes, as I think any fair-minded man should believe, that the taxpayer should not get the advantage of this accrual basis because he happened to keep his books that way. His keeping of his books is not recognized by the law on the question of amortization. It is recognized by the law in connection with the income tax, but that is not an income-tax case. It is an amortization case and has no relation to income.

Mr. HARTSON. Of course, I can not agree with you that this is not an income case. That is just what amortization is. Amortization is an allowance against income and has no relation to anything but income.

The CHAIRMAN. Yes; but it has no relation to the question of keeping books, as quoted by the solicitor, because this is set for a specific time, and certainly neither the law nor Congress intended them to have the advantage in amortization as they have given them in the question of keeping their books on continuing income returns.

Mr. MANSON. Mr. Hering, how long were you assistant chief of the amortization section?

Mr. HERING. I do not recall exactly, but I think it was about a year.

Mr. MANSON. Were you assistant chief up to the time that that section was abolished?

Mr. HERING. I was at the time it was abolished; yes, sir.

Mr. MANSON. And you had been for about a year before that?

Mr. HERING. Yes, sir.

Mr. MANSON. Do you know of any other cases where amortization was spread on the basis of commitments, instead of on the basis of expenditures?

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

Mr. MANSON. If there had been any such case, which went through that section during the year that you were assistant chief, and such a spread had been made, would it have been considered an error?

Mr. HERING. I think it would; yes, sir.

Mr. MANSON. In other words, such a spread of amortization as was made in this case could not have gone through your section, except as an error?

Mr. HERING. I think that is correct; yes, sir.

Mr. MANSON. That is all.

Mr. HARTSON. Mr. Hering, I understand that you passed this, or it went out of your section, with instructions for the revenue agent to check costs?

Mr. HERING. Yes, sir.

Mr. MANSON. Did it ever come back to your section, so that someone in your section could determine whether the instructions had been carried out by the revenue agent?

Mr. HERING. It did not.

Mr. HARTSON. Where did it go?

Mr. HERING. The engineer's report went to the consolidated returns audit division, and the case was audited in that division. I think, in the meantime, the amortization section was abolished.

Mr. HARTSON. When did it first come to your attention that this method of spreading the amortization allowance had been followed in this case?

Mr. HERING. It was about a month ago, I guess, when it first came to my attention.

Mr. HARTSON. How did it come to your attention?

Mr. HERING. Mr. Parker called it to my attention.

Mr. HARTSON. He called it to your attention?

Mr. HERING. Yes.

Mr. HARTSON. And you were working in that section at that time; I mean working in the section that Mr. Parker was working in at that time. How did he call it to your attention and not call it to someone else's attention?

Mr. HERING. I do not know. I was called in. He called me in and asked me about it, possibly because my name was signed to some of the papers.

Mr. HARTSON. That probably accounts for it.

Mr. PARKER. I can account for it. I am not an auditor, as I stated before, and in going into this work, naturally, as Mr. Hering was highly recommended as a man understanding the auditing proposition, I called him in, not because his name happened to be on the conference report, but because I thought he had the best knowledge of auditing as relating to amortization.

Mr. HARTSON. That is all.

The CHAIRMAN. Have you any other witness here? You were going to put somebody else on, were you not?

Mr. HARTSON. Yes; we have Major De La Mater here and the engineer who signed this second report which has been referred to.

The CHAIRMAN. I think that, as long as the Senate will convene in 15 minutes, we had better not put on another witness to day.

Mr. MANSON. I would like to inquire at this time of Mr. Hartson, he having made the statement that this method of spreading amortization was not exceptional in this instance, to supply the committee at the next session with a list of the other corporations to which amortization was allowed, and in whose cases it was spread upon the commitment, rather than on the expenditures basis.

Mr. HARTSON. I will be glad to furnish that, if I am abel to do it. Of course, my statements are largely predicated upon what the auditors of the bureau tell me. I have no personal knowledge of the way these audits are adjusted, but I shall be glad to attempt to furnish that information, Mr. Manson.

Mr. MANSON. Well, if you can not furnish it, I would like to be referred to somebody who can.

Mr. HARTSON. I should like to add this, Mr. Manson, if I may be permited to do so——

Mr. MANSON. Yes, surely.

Mr. HARTSON. That if I am wrong in the statement, I shall be glad to frankly state that my information has been incorrect.

Mr. MANSON. I would assume that; yes.

The CHAIRMAN. Then, we will adjourn here until to-morrow morning at 10 o'clock. Is that satisfactory to you, Senator?

Senator JONES of New Mexico. Yes.

(Whereupon, at 11.45 o'clock a. m., the committee adjourned until to-morrow, Wednesday, December 3, 1924, at 10 o'clock a. m.)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

WEDNESDAY, DECEMBER 3, 1924

UNITED STATES SENATE,
SELECT COMMITTEE INVESTIGATING
THE INTERNAL REVENUE BUREAU,
Washington, D. C.

The committee met at 10 o'clock a. m., puruant to adjournment of yesterday:

Present: Senators Couzens (presiding), Watson, Jones, of New Mexico, and Ernst.

Present also: Earl J. Davis, Esq., and L. C. Manson, Esq., of counsel for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, Solicitor Internal Revenue Bureau; Mr. S. M. Greenidge, head engineering division, Internal Revenue Bureau; Mr. W. C. Tungate, chief consolidated audit, Section H; Mr. W. S. Tandrow, valuation engineer.

The CHAIRMAN. Proceed, Mr. Manson.

Mr. MANSON. I would like to ask whether there is in the file a letter dated April 7, 1922, from C. W. Parkhurst, consulting engineer for the Berwind-White Coal Mining Co. to the Commissioner of Internal Revenue, specifying the property which was abandoned and the date of its abandonment?

Mr. HARTSON. Mr. Reddish, will you try to find that?

(Mr. Reddish handed a paper to Mr. Hartson.)

Mr. HARTSON. Here is the letter that you refer to, Mr. Manson.

Mr. MANSON. During the proceedings yesterday Senator Couzens asked when the old power plants were abandoned, and Mr. Hartson also stated that he did not accept counsel's statement that the property has been abandoned. In order to clear up that question I would like to read a portion of a letter on the letter-head of the Berwind-White Coal Mining Co., Electrical Department, Commercial Trust Building, Philadelphia, dated April 7, 1922, signed by C. W. Parkhurst, consulting electrical engineer, and addressed to the Commissioner of Internal Revenue, Washington, D. C., attention, Chief of Amortization Section. I will read as much of this letter as refers to that question.

Mr. HARTSON. Mr. Manson, I think you had better read the whole letter.

The CHAIRMAN. Read it all.

Mr. MANSON (reading):

Gentlemen, at a conference held March 27 with your Messrs. Woolson and Moore, regarding our amended claim of amortization of war facilities, we are asked to furnish additional information, which we are enclosing herewith.

The tabulation covering power generated at our various Windber power stations covers the years 1913 to 1921, inclusive, by months.

The numbered mines are from No. 30 to No. 42, inclusive. These are mines we are operating ourselves and which furnish the bulk of our Windber coal tonnage.

The "coal producers," to whom the current is listed as having been sold, are operators, other than ourselves, on our own coal property. A large proportion of their production was sold by us, and when this power station was being built, all of our own coal as well as all coal being mined by these other coal producers who depended upon us for power, was being used for war purposes and public utilities. Current sold to others includes chiefly current for lighting the town of Windber, and might be considered current used as an auxiliary to the mine operations.

The electric generating apparatus in the power stations which were abandoned late in 1921 after the installation of the 10,000-kilowatt spare turbine in the new No. 34 auxiliary power station was as follows:

No. 35 power station: Two 1,000-kilowatt turbines, which were installed in 1908, and one 3,500-kilowatt turbine, which was installed in 1913, making a total capacity of 5,500 kilowatts. The boilers in this station consist of eight 250-horsepower and four 591-horsepower, making a total boiler capacity in this station of 4364 horsepower.

No. 36 power station: Two 400-kilowatt engine generator units, which were installed in 1908, and one 1,000-kilowatt turbine, installed in 1911, making a total of 1,800-kilowatt capacity. The boilers in this station consist of six horsepower, making a total boiler capacity of 1,500 horsepower.

No. 40 power station: Two 250-kilowatt engine generator sets, installed in 1906, and one 1,000-kilowatt turbine, installed in 1911, making a total capacity of 1,700 kilowatts. The boilers in this station consist of eight 300 horsepower, making a total boiler capacity of 2,400 horsepower.

You will note that the total capacity of these three abandoned stations is therefore 9,000 kilowatts and the boiler capacity 8,264 horsepower.

If you desire any more information, please advise me.

If there is still any question as to whether or not the old power plants were abandoned and as to when they were abandoned, I would like to read into the record portions of the brief filed by Ernst & Ernst, representing this taxpayer. I do not care to encumber this record with cumulative evidence on this point.

The CHAIRMAN. I would like to ask Mr. Hartson if he thinks it is necessary to go into that, whether he still desires the committee to understand that the plant was not abandoned, as counsel contends?

Mr. HARTSON. I think it is unnecessary to go further into that point, Senator, for this reason, that it has been cleared up that the new plant became operative late in 1921.

Mr. MANSON. Which plant are you referring to, Mr. Hartson?

Mr. HARTSON. The third plant, the one that really has no pertinency here as to any points that are under discussion now at all, and it has no relation to the amount of amortization that should be allowed on the second plant, construction of which was started in 1918. This letter clears up the testimony of Mr. Parker on yesterday, when the question arose as to the date when the third unit went into service.

Mr. Parker answered the chairman as follows:

From the records I could not give you the exact date. Understand, I had to go entirely from the papers. I looked for that because I wanted to get the exact date, and when we found the date, I think it was the latter part of 1920.

It was very late in the summer of 1920, as near as I can get any definite dates. If anybody could give me a better date, I wish they would state it.

This letter, of course, states the fact to be, that late in 1921 the third unit went into service.

Senator ERNST. I would like to see that Ernst & Ernst letter. I do not care about having it read.

Mr. MANSON. It is the Ernst & Ernst brief.

Senator ERNST. In what part of the brief is that statement that you refer to?

Mr. MANSON. On page 3.

Senator ERNST. Have you it there?

Mr. MANSON. No; I have not the brief. It is in the files somewhere.

Senator ERNST. Never mind. Just go on.

Mr. MANSON. I would like to ask that Mr. De La Mater be sworn.

Mr. HARTSON. Mr. Chairman, before Mr. De La Mater takes the stand, I would like to request to be heard a little further on this very interesting point which was being discussed at the close of yesterday's session, namely, the point that arose in connection with the spread of amortization and the position taken by counsel for the committee, with which I disagree.

The CHAIRMAN. All right; proceed.

Mr. MANSON. Yes; that will keep that matter all together.

Mr. HARTSON. Mr. Manson read yesterday from article 185 of Regulations 62, the material portion of which is under subsection (*b*), which reads as follows:

* * * In cases where the property was not completed in time for use in the production of articles contributory to the prosecution of the war on the basis of the expenditures made on account of which amortization is allowed.

Now, it has been shown in this case, I believe, that a spread of amortization was made over the years 1918 and 1919, and there was, in a sense, allocated to 1918 certain liabilities which were not actually paid in that year. The cash had not been delivered to the other party to the transaction.

Mr. MANSON. Right at that point permit me to interrupt you, if you please, Mr. Hartson.

Is it not a fact that these commitments had not even matured to the point where they were liabilities? In other words, what appeared on the books was not a liability for property delivered but unpaid for, but the contract commitment for the purchase of materials and equipment to be delivered in the future?

Mr. HARTSON. In answer to that question I wish to say, Mr. Manson, that there were obligations to purchase. The files definitely show that the War Industries Board, then functioning, had issued priority orders for the delivery of something in excess of $300,000 worth of this property during the year 1918. Now, whether the property was, in fact, delivered before January 1, 1919, I am not able to inform the committee; but there were these two priority orders issued by the War Industries Board, authorizing the delivery of something in excess of $300,000 for the year 1918, which is very little less than the total amount that was allocated for that year, on which amortization was claimed.

I think it was perfectly proper for the bureau to assume in the face of that showing that the company was obligated to pay on the basis of that contract which was entered into by the company in the year 1918, and that then became the cost to the taxpayer. The very purpose of amortization was to relieve, or was intended to relieve, excessive costs, war costs, and permit them to be charged against war income. That was the idea of it, and when the money was paid on these contracts is really immaterial.

The CHAIRMAN. At this point, let me say that I am not disagreeing with that policy, but I am asking if that was according to the rules of the bureau?

Mr. HARTSON. I believe it was, Mr. Chairman.

The CHAIRMAN. Will you point out just where the rules applied to that case?

Mr. HARTSON. I have just read from article 185 of Regulations 62, in which the expression is used, "on the basis of expenditures made on account of which amortization is allowed." The crux of this question is, what is included in the term "expenditures," and I am prepared to show that the legal and accounting definition of "expenditures" is not limited to the delivery of the cash; that it may be an incurred expense, an accruable expense, an expense which the individual has become obligated to pay, rather than the consummated thing, of the actual transfer of the cash.

Mr. MANSON. Pardon me for interrupting you again, Mr. Hartson, but it was testified by the assistant chief of the amortization section, that is, the man who was assistant chief of that section until it was abolished, that he did not know of any other case in which amortization was spread upon the basis that you are now justifying, but that in all cases of which he had any knowledge it was spread on the basis of the expenditures actually made as distinguished from commitments entered into or liabilities incurred.

Senator ERNST. Mr. Manson, if that is true, that does not change the merits of the question. I am anxious to be informed now along the line that he is discussing.

Mr. MANSON. The point I have in mind, if the Senator will pardon me, is this, that, as Mr. Hartson stated yesterday, we have a very definite regulation which applies to all taxpayers, and the fact that I wish to bring out is that, regardless of the merit of the question, this taxpayer was treated in a manner different from any other taxpayer having a similar claim to his advantage to about $122,000.

Mr. HARTSON. If Mr. Manson will recall, I took very sharp disagreement with that suggestion, and I would like to continue my discussion to show you why it is not true.

Senator WATSON. That is to say, you believe what is untrue?

Mr. HARTSON. The statement of Mr. Manson that this taxpayer had received more favorable treatment on the particular point that he is discussing than any other taxpayer,

Senator WATSON. Is it true that he is the only one that was treated in this particular manner?

Mr. HARTSON. I believe it is not true.

Mr. MANSON. I asked you yesterday, after Mr. Hering had testified that this taxpayer was the only one whose case he knew of, to furnish us a list of any other cases in which a taxpayer had been allowed

amortization on property which had not gone into use prior to the end of the war.

The CHAIRMAN. Well, he probably will reach that if you will let him finish his story.

Senator ERNST. I think so.

Mr. HARTSON. I think it is perfectly proper for Mr. Manson to make the statement, but I will come to that in just a moment.

Now, the regulations, as I pointed out, permit the spread of amortization on the basis of expenditures made, on account of which amortization is allowed. I believe it can be shown, and I am prepared to discuss it in some detail, although I think there can be no serious controversy about it, that what "expenditures" means is not limited to the actual payments of cash, but it is broad enough in good acounting practice as well as within legal definition of "expenditures"——

The CHAIRMAN. As one member of this committee I am satisfied that that is correct.

Mr. HARTSON. The word "expenditures" only occurs in the regulations. The law refers to "costs." I think we can all agree that the "cost" is what the taxpayer is going to have to pay, and his obligation, if it is accruable and has been accrued, becomes a part of his cost, because it is on the basis of the date when the obligation was entered into that the amount of the cost is figured.

Let me illustrate: A contract entered into in 1918 is entered into at a time when the war was in progress, and the cost was probably excessive; at least it was a war cost. He may not have been obligated to pay under the contract until some future date, when the market price was reduced considerably, but the cost to him was the war cost, and it was that thing which the Congress had in mind when it provided some relief for taxpayers who had so expended money in an effort to aid the Government in the prosecution of the war.

The CHAIRMAN. I would like to ask Mr. Hartson if any of his staff here has actually determined whether this contract was carried out and the amounts which were allowed in amortization were actually paid on the basis of the contract by the taxpayer? In other words, it was well known that many of the contracts were not carried out after the close of the war; that concessions were made by sellers, and that the buyers did not always pay the full contract amount. I would like to know if there is any record to show that the taxpayer did actually pay the amount which was credited in the amortization.

Mr. HARTSON. I shall be very glad to have one of the engineers look that up.

The CHAIRMAN. Do, please.

Mr. HARTSON. I have this observation to make, that the contracts that the Senator refers to, which we all know were frequently altered subsequent to the conclusion of the war, were contracts, ordinarily, which had not been consummated to the point of the delivery of the goods. They called for future delivery, and here I think it will be shown that that portion which was allocated to 1918 was substantially completed—that the deliveries had been substantially completed during that year.

Senator WATSON. Let me ask you this question: You distinguish between the word "cost" as contained in the law and the word

"expenditure" as contained in the regulations. Why do not the regulations contain the same language as the law?

Mr. HARTSON. The regulations, Senator Watson, are explanatory of the law, and they are a little more liberal, and there is an attempt made to make the law more understandable. If the regulations were in the exact language of the law, the regulations would be of no assistance in interpreting the law. The regulations then would be merely a repetition of the law, which would be of little value.

Senator WATSON. Then you make a distinction between the "expenditures" and the "costs"?

Mr. HARTSON. I do. I think there is a distinction that may be made, but I am not urging that distinction as being material here.

Senator WATSON. Yes.

Mr. HARTSON. Because I think, in either event, "cost" is a broad enough term to include that portion of the amortization which was spread and allowed in 1918 in this case. In other words, I think what was done in this case does not violate a liberal, common-sense construction of the statute itself; nor do I think it is in violation of the specific language of the regulations, which use the word "expenditures."

Now, I do not care to go into that any further unless the committee desires to hear from me further, except to answer Mr. Manson's question about what was done and what was the practice that has been followed in other cases.

Mr. Manson asked me yesterday for a list of cases where a similar practice had been followed. I took exception to the statement of Mr. Hering, in that I did not believe, and do not believe, that this is the only case of this character that has arisen; but I am not prepared to show this morning a list of cases which have been treated in this way. I want to be given a further opportunity to do that, if that can be done; but I wish to state this, that taxpayers have frequently come in and made a showing of costs which were incurred in 1918, when a situation similar to this has been presented. There has been no segregation of costs by the taxpayer very often. The costs have been checked in the field.

Now, given that situation, if those costs were incurred and had been accrued on the books, there would not be this distinction made, and this segregation made between that portion of the costs which had been paid for in cash and that portion which represented an obligation to pay but in which no money had been transferred. So I find this, in discussing it with many men in the bureau since this question arose; I have yet to find a man who knows a case that was settled in which this question was raised in the way this was; nor do I find anybody who knows of a case, in which this issue was raised, settled in the other way.

The CHAIRMAN. I want to point out at this time that the engineer who has testified before this committee disagreed with this settlement.

Mr. HARTSON. Yes.

The CHAIRMAN. And that was the reason he brought it here. It was not only the auditor who was on the stand yesterday, Mr. Hering, who disagreed with it, but it was the auditor, Mr. Moore, if I remember correctly, who first brought the case to the attention of this committee, who also disagreed with it.

At this time I think it is appropriate to say that I hope no employee of the bureau who disagrees with the chiefs is going to be punished by the bureau. There was an inference yesterday that some of the staff here were inclined to be critical of any employee who expressed his views fearlessly before this committee.

Mr. HARTSON. Senator, I think I can give you the assurance of the commissioner and of Mr. Nash, the men who are in executive control of the bureau, that no punishment will result to any man who honestly states an opinion, no matter with whom he disagrees. I know their disposition, and I know that there is not any feeling on their part at all. There are differences of opinion, and I see no reason in the world why they should not be expressed.

The CHAIRMAN. I wanted to get that in the record, because there was an expression made to some of the members of the committee that you appeared to be a little bit hard with this auditor and seemed skeptical as to why and how he came to tell our investigators his views in this particular case.

Mr. HARTSON. Well, Senator, if my manner carried that impression I am sorry, because I had no such intention. When we get into the discussion of sharply conflicting opinions, I frequently state a thing in a way that may be misleading. I had no such intention, and I would have no control over this situation one way or the other, anyway, because I am not in an executive position in the bureau, except in my own office; but I think Mr. Nash and Mr. Blair would back me up in what I have said, and I am very sure that Mr. Hering and anyone else who comes here and honestly states his opinion to this committee will in no way be prejudiced as a result.

Mr. NASH. That is absolutely true, Mr. Chairman.

The CHAIRMAN. No one should be discouraged from frankly telling this committee his views and from frankly trying to help this committee in what it is trying to obtain in the way of improved legislation, and perhaps improved administration.

Mr. GREENIDGE. Mr. Chairman, I would like to state, as head of the engineering division, that internally we invite discussion of a great many points which come up by engineers who differ with other engineers, with their chiefs of section, and with the head of the division. On my desk now there are at least two subjects on which dissenting opinions have been written, and we find it is a helpful condition to have. I am sure that there would be no feeling against anyone who disagreed with us internally, or who appeared before the committee and disagreed with us.

The CHAIRMAN. That is what I am trying to get at, as to witnesses appearing before the committee—internally or externally.

Mr. GREENIDGE. By internal, I am referring to my small division. We find that these different opinions are just as necessary for proper functioning of our division as any other one thing, because, if all of us had the same opinion, or if we were forced to adopt one opinion, it is manifest that, in a number of instances, injustice would be done both to the taxpayer and the Government.

The CHAIRMAN. You may proceed, Mr. Hartson, please.

Mr. HARTSON. I have nothing further to say, Mr. Chairman, on the point which I was discussing.

The CHAIRMAN. I understand, then, that you have not given up hope, or you intend, at least, to make an effort to find other cases in which anticipated obligations, or where commitments were given the spread in the amortization division?

Mr. HARTSON. That is true, Mr. Chairman, and I tried to explain why I believe there may be difficulty in showing a list of such cases, because I believe this allowance was made—and I think others who are more familiar with just what has occurred in the income-tax unit in connection with these cases will bear me out—allowances have been made just the same as this, with the same result as this, all under the head of "costs."

The CHAIRMAN. I think the committee will be satisfied with a partial list, and I believe that is important, for this reason: Two of your employees have disagreed with this settlement and have said that this was an exceptional settlement.

Mr. HARTSON. Yes.

The CHAIRMAN. Both Mr. Moore and Mr. Hering, and if that is true we do not know how many other members of your staff may have that same view. It must be possible to secure at least a list of the cases which have been settled on that basis, when two of your employees sharply disagree with the statement that there have been other cases settled on that same basis.

Mr. HARTSON. I shall make a further effort to do so.

Senator JONES of New Mexico. I would like to ask a question here, in order that there may be cleared up in my own mind just what the attitude of the bureau is. Is it the contention of the bureau that this settlement has been in all respects a proper one?

Mr. HARTSON. Yes, sir; that is the contention.

Mr. MANSON. Is the auditor's analysis of this case in the file, in which is shown the set-up of the amount allowed on this power house for depreciation as well as for amortization?

Mr. HARTSON. Yes, sir; Mr. Reddish is here.

TESTIMONY OF MR. CRAIG L. REDDISH, RESIDENT AUDITOR, SECTION G, CONSOLIDATED RETURNS AUDIT DIVISION, BUREAU OF INTERNAL REVENUE

(The witness was duly sworn by the chairman.)

Mr. HARTSON. Mr. Reddish, state your full name to the committee.

Mr. REDDISH. Craig L. Reddish.

Mr. HARTSON. Where are you employed?

Mr. REDDISH. Resident auditor in section G of the Consolidated Returns Audit Division.

Mr. HARTSON. Of the Bureau of Internal Revenue?

Mr. REDDISH. Of the Bureau of Internal Revenue.

Senator ERNST. How long have you been there?

Mr. REDDISH. About two years and a half, I believe. I have been in the bureau longer, but not in that division.

Mr. MANSON. Will you refer to that set-up and tell the committee whether any depreciation was allowed on this war-time

plant, plant No. 34, for the years 1918 and 1919, and if so, how much?

Mr. REDDISH. Before I make any statement, I want to see what this is taken from; I want to see what agent's report this was taken from, if you will pardon me for a moment.

This is a schedule taken from the agent's report, who made the examination, and it is headed "Powerhouse"——

Mr. MANSON. What is the name of the agent?

Mr. REDDISH. The agents were Mr. Singer and Mr. Newton.

Senator JONES of New Mexico. What is the date of that report?

Mr. REDDISH. The report is dated January 15, 1923. This particular schedule is headed "Amortization and depreciation, powerhouse No. 34," and in a resume at the bottom of the page, he states the amortization as $333,289.95.

Mr. MANSON. That is for what year?

Mr. REDDISH. That is for 1918, $333,289.95, and depreciation, $4,432.97.

Mr. MANSON. How about 1919?

Mr. REDDISH. There is amortization in 1919 of $40,101.17 and depreciation $42,009.08.

Senator JONES of New Mexico. The amount of depreciation in 1918 was $4,000, you say?

Mr. REDDISH. $4,000 is the amount that is indicated here.

Senator JONES of New Mexico. And $42,000 in 1919?

Mr. REDDISH. $42,000.

Mr. MANSON. That is all.

Mr. HARTSON. Mr. Reddish, you stated that you were reading those figures from the schedule included in a revenue agent's report?

Mr. REDDISH. Exactly.

Mr. HARTSON. Do you know whether that was the final figure on those items which you referred to, and used as the basis for the closing of the case?

Mr. REDDISH. It is my recollection that it was.

Mr. HARTSON. In other words, as the revenue agents reported, so was the case closed on those items?

Mr. REDDISH. Exactly.

Mr. HARTSON. Now, Mr Reddish, yesterday there was testimony by Mr. Parker, I believe, on the subject of depreciation, to this effect—and I now read from Mr. Parker's testimony:

> They had not written it off, Senator; that is, they had written off a certain amount up to 1918. In 1918 they increased their rates of depreciation, and our previous statements have been to the effect that if they had used the same rate that they had used during 1918 and 1919 for the whole period, the plant would have been entirely written off before the war commenced. They did not actually use those rates in those pre-war years. That left a balance which, in April, 1920, at the time the new plant was finally completed, they did write off their books, and that sum of money represented $139,000.

I will ask you, Mr. Reddish——

Mr. MANSON. Just a minute. We are getting into another subject than the one I have before the committee at this time. I wish to call the committee's attention to the fact that, according to the testimony just offered by Mr. Reddish, the bureau allowed depreciation

on an uncompleted power plant in 1918 and 1919, and which did not go into operation until 1920, and——

The CHAIRMAN. Just a minute. I think the testimony fairly showed that they went into operation in 1921.

Mr. MANSON. No; you are referring now to the third unit.

The CHAIRMAN. Oh, I see. I beg your pardon.

Mr. MANSON. And a practice that, I believe, can not be justified, and, furthermore, it is in violation of article 182 of regulations 62, which provides—

> The allowance for amortization will be inclusive of all depreciation during the amortization period of property subject to amortization. See article 186. Depreciation will be allowed, beginning at the class of the amortization period, upon property the cost of which has been partly amortized, but shall be limited to the value of such property after the amortization allowance has been deducted. Property which has been amortized to its scrap value shall not further be subject to depreciation.

Now, I take exception to this allowance on both grounds, which are entirely independent of each other.

Mr. HARTSON. Mr. Reddish, do you understand that the depreciation referred to in the report that you have just read from covers the same property that the amortization allowance covered?

Mr. REDDISH. I do not.

Mr. HARTSON. Will you state to the committee the difference?

Mr. REDDISH. There are costs in this, so I understand, which were not subject to amortization, and, of course, those costs of depreciatiable property are subject to depreciation.

Mr. MANSON. This refers to power plant No. 34.

Senator ERNST. Let him finish, Mr. Manson.

Mr. REDDISH. I have not the details before me and I do not know that I have sufficient engineering knowledge to know, but I do not understand that the entire cost of power plant No. 34 was subject to amortization. Was it?

Mr. MANSON. About 10 per cent that was not to be subject to amortization. Now, if but 10 per cent of this power plant, if 10 per cent of $800,000 was not subject to amortization, that would be about $80,000, and you do not contend that $80,000 on an uncompleted power plant would depreciate to the extent of $46,101 before they started to operate?

Mr. REDDISH. If that is the corrected figure, that probably would be an exorbitant rate.

The CHAIRMAN. You may proceed, Mr. Hartson.

Mr. HARTSON. The $800,00 figure given by Mr. Manson as the cost of the plant may not have included the entire expenditure which was made by the taxpayer on that property?

Mr. REDDISH. That was my understanding.

Mr. HARTSON. Have you any recollection of the amount that was expended on the plant?

Mr. REDDISH. No; just a general understanding of my own that the plant itself cost more than $800,000. How much, I do not know.

Mr. HARTSON. That is all.

Senator JONES of New Mexico. Is there anything in the record to show what it did cost?

Mr. HARTSON. Yes, Senator; I can give you that.

Mr. MANSON. Even if that be true, it is an established fact, and I believe an admitted fact, that this plant was not completed until 1920, and whatever this depreciation may be applied to with respect to this plant, it is allowing depreciation upon a power plant which had not yet begun to operate.

Senator WATSON. Did this case finally come before you for decision, Mr. Hartson?

Mr. HARTSON. It did not, Senator. The certificate of overassessment, amounting to something in excess of $500,000, which included the adjustment of this taxpayer's liability for the year 1918, I think, having many different items, in which this amortization element and several others that have not been discussed here, came up to the assistant solicitor in my office. He is a member of the review committee which passes on these certificates of overassessment. It was reviewed there, and his name was signed to the certificate of overassessment before it was finally allowed; but the elements that are being discussed here never were submitted to the solicitor's office. As a matter of fact, it does not seem to me that there is anything that required its submission to the solicitor's office, because the main points of difference involve an engineering question, and an accounting question. At any rate, it did not come to the solicitor's office other than for the approval of the certificate of overassessment.

Mr. REDDISH. May I interrupt a moment. The item of $40,000 depreciation in 1919 I am not prepared to say whether that was allowed finally or not as to 1919. I think I can state that I did not handle the case for 1919, and would have to go to the record.

Mr. MANSON. Will you look that up?

Mr. REDDISH. I will do so. For 1919, the case has not yet been closed.

Mr. HARTSON. It has not been closed for 1919?

Mr. REDDISH. It has not been closed for 1919.

Mr. MANSON. On this particular point, I wish to call Mr. De La Mater.

TESTIMONY OF MR. STEPHEN T. DE LA MATER

(The witness was duly sworn by the chairman.)

Mr. MANSON. Mr. De La Mater, you are an engineer, are you not?

Mr. DE LA MATER. Yes, sir.

Mr. MANSON. Were you formerly employed in the Bureou of Internal Revenue?

Mr. DE LA MATER. Yes, sir.

Mr. MANSON. In what capacity?

Mr. DE LA MATER. I started in as an engineer, and finally became chief of the amortization section.

Mr. MANSON. How long were you chief of the amortization section, Mr. De La Mater?

Mr. DE LA MATER. About three years.

Mr. MANSON. When did you sever your connection with it?

Mr. DE LA MATER. In November, 1923—a year ago last month.

Mr. MANSON. Was it the practice of the engineers or the bureau to allow depreciation on uncompleted property, which had not gone into use.

Mr. DE LA MATER. Ordinarily, it was not the practice of the engineers who handled depreciation, and the allowance for amortization was inclusive of the depreciation, during the amortization period, in accordance with the law and regulations. It was not considered that depreciation should be allowed, and in general engineering practice it is not considered that depreciation should be allowed, on uncompleted structures, that there can be no depreciation or wear and tear during the time that the structure is in process of construction.

Mr. MANSON. That is all.

Mr. HARTSON. I have no questions.

Mr. MANSON. That is all.

Mr. HARTSON. You do not care to question Mr. De La Mater about the adjustment of this case? He is the man who was chief of this section that finally approved the adjustment of the Berwind-White case.

Mr. MANSON. Well, Mr. De La Mater told me that he had no personal knowledge of these figures.

Mr. HARTSON. Senator Jones asked me the other day to have present those men who O. K'd and approved the engineer's second report, which was dated, I think, November 18, 1922, and in which there was this 52.6 percentage of value in use allowed to this company. Mr. De La Mater was chief of the section; his name was signed to the report, and I want the committee to know that we have everybody here, and we want it discussed, if the committee cares to go into a discussion of it.

Mr. MANSON. Where is that report? Will you produce that report? There is one further question that I want to ask Mr. De La Mater.

Before you go into that, Mr. De La Mater, do you know of any cases where amortization was knowingly spread on the basis of commitments instead of actual expenditures?

Mr. DE LA MATER. I do not, but that does not mean that there were not others, because there might be dozens of others and I not know of them.

Mr. MANSON. Well, you were head of the section, were you not?

Mr. DE LA MATER. Yes; but in that capacity I did not go into the details of each case.

Mr. MANSON. No; but what rule did you enforce in that regard, as head of that section?

Mr. DE LA MATER. The only rule was the regulation which prescribed as to how the spread should be made.

Mr. MANSON. During the time you were chief?

Mr. DE LA MATER. And that spread was in the hands of the auditors, and it was simply understood that the regulations were followed. I do not think that point ever came up for discussion, as to the question of cost and commitments.

The CHAIRMAN. What is your interpretation of the word "costs" in the statute and the word "expenditures" in the rules, as to the question of commitments or actual payments?

Mr. DE LA MATER. Well, I have never given it any thought until I listened to it in this room here, because, as I say, it never came up. I have been listening here with a great deal of interest to the discussion of the subject.

Mr. MANSON. Do you know what the practice was?

Mr. DE LA MATER. I have a theory as to just how that might have happened, and why it was done that way, and how it could easily happen in dozens of cases, either rightly or wrongly, and that is that the taxpayer submits schedules of costs, and they are O. K'd by the engineer, and they are subjected to check in the field, book check, and it may have been checked or it may not have been checked.

Mr. MANSON. Well, assume a case where the taxpayer had informed the bureau that his claim was based upon commitments, and not upon actual expenditures.

Mr. DE LA MATER. Well, then, it is a question of interpretation of the law.

The CHAIRMAN. That is what we are trying to get at. How would you interpret it?

Mr. DE LA MATER. I do not know that I am qualified to interpret the law.

The CHAIRMAN. How would you have interpreted it, as chief of that section?

Mr. DE LA MATER. The solicitor's office had that prerogative on any legal question.

The CHAIRMAN. As I understand it, that question was never raised at the time you were chief of the section?

Mr. DE LA MATER. Well, it was never raised with me. If it had been, I would probably have given it some thought and study and rendered a decision. If it was adverse to the taxpayer, he would have appealed it to a higher authority, but I have listened to the argument, as I say, here, and I am inclined to feel that Mr. Hartson's opinion is right, that commitments are just as much of a proper basis for the spread as the actual expenditures or costs at the time the expenditures were made.

The CHAIRMAN. As far as I am concerned, I am satisfied to let this case rest until we get other evidence that cases have been settled in a like manner, and that that was the policy of the bureau in the settlement of cases. Are you satisfied with that, Senator?

Senator JONES of New Mexico. Yes.

The CHAIRMAN. Have you any other cases that you wish to proceed with now?

Mr. DAVIS. I have, Senator.

The CHAIRMAN. Do you want to ask the witness any further questions, Mr. Manson?

Mr. MANSON. No; I do not care to ask him any more questions.

Senator JONES of New Mexico. I have not the details of this matter before me, but I recall very well one point which was disturbing to me the other day, and that was the fact that there had been two or three different estimates by the engineers, and I have this impression, and if I am wrong about it I would like to be corrected, that we have an engineer's report here showing an efficiency in use of 80 per cent, that the taxpayer claimed that that should be 70 per cent, and, finally, in some conference, of which there does not seem to be any record, except the fact that a conference was held, the efficiency in use was put at 52.6 per cent. Now, I would like to have somebody who was in that conference explain here why and how that was done, and upon what basis it was done.

Mr. DE LA MATER. Well, I am still on the witness stand, and until asked questions I can not say anything.

Mr. MANSON. Well, can you explain it?

Mr. DE LA MATER. I will answer to the best of my ability. I do not know——

Senator JONES. Have you had any conferences?

Mr. DE LA MATER. I can tell you what I remember of the case.

Senator JONES of New Mexico. Well, if you were in that conference, I wish you would clear this matter up, if you can.

Mr. DE LA MATER. I was in a conference. Let me say, first, that there are honest differences of opinion, and always have been, in the determination of amortization allowances. The law is very meager. It says that the allowance shall be reasonable, and that is all it does say. Now, that means reasonable to the taxpayer and reasonable to the Government, as we interpreted the regulations, elucidating that law, stating that the basis of the determination of that allowance shall be the salvage value of sales value in the case of discarded property, but in case of property continued in use, the value in terms of use to that taxpayer.

Now, the bureau has never admitted the measure of use of a facility, in terms of dollars—return on the investment, which is the usual measure of value to a business man of his holdings, of his investments. The bureau has not recognized that, because we always contended that mismanagement, favorable markets, and delivery conditions, and various things of that kind affect that return on investment, regardless of the actual value of the facilities to the taxpayer, or "use" as expressed in the regulations.

Therefore, a physical means of measurement of that use had to be found, and the regulations did not go on to say what that measure should be, how that use should be measured. It was, therefore, up to the amortization section, from its infancy, to devise ways of administering the law and the regulations.

As we handled case after case we found new problems coming up. Hardly two cases were alike. It was essential, however, as you have insisted here, that all taxpayers should be treated as nearly equitably as possible, and with that idea in mind, as we progressed in the handling of amortization we learned more about it, and we formulated a policy. We had new cases coming up which had different angles to them, and we would talk them over and decide upon the equitable and proper way to handle the cases, in order to arrive at the proper value.

There is no definite, fixed way of finding the value in terms of physical use of every property on the same basis.

The CHAIRMAN. I understand. We are not talking about that. We have gone all through that, and I would like to ask, as has been asked by Senator Jones, if you can tell us how they arrived at 52.6 per cent in this conference.

Mr. DE LA MATER. Therefore, in this case, as in other cases, conferences were held when a taxpayer disagreed with the finding of the engineer. One engineer's finding would vary from another engineer's finding, and a conference was held, and the taxpayer would be given a hearing. At the conference in this particular case, the record of the conference shows what was done. Now, at those

conferences there was always an attempt made to close the case and come to some equitable solution.

Senator JONES. I do not understand that there is any record of what that conference did in this case.

Mr. DE LA MATER. This is the formal conference that I am speaking of, at which Mr. Hering presided. I am leading up to how I came into the case.

Senator JONES of New Mexico. All right, go ahead in your own way.

Mr. HARTSON. There is a record of the conference to which Mr. De La Mater has reference, but there is not a record of the one that Senator Jones has reference to.

Senator JONES of New Mexico. Yes.

Mr. DE LA MATER. At this formal conference, it was found impossible to agree, the taxpayer and the Government, as to an equitable adjustment. On questions of fact the taxpayer would disagree with the Government, and perhaps in its method of measuring value in use of that plant. Therefore, it would frequently happen that the conferees would come out of a conference and come to me and tell me the situation and ask me what should be done and what I would advise. It frequently happened that a taxpayer would come out of a conference, after the conference was over, and come into my office and say that they had come over here to Washington at considerable expense, with the idea that they were going to get their case settled up and adjusted; that they had not been able to get anywhere in the conference, and they would ask me if I could do anything. I would then call in the engineer or auditor, who sat in that conference. I would sit in my room, and I would see if we could not come to some equitable solution, some agreement, or common ground, on which the case could be settled.

We were under great pressure in those cases. The committee was swamped with work, and after consideration by one section, if possible, we tried to close the case in that section, with the idea of not swamping the committee. That is what happened in this case. After conference they came into my office, and they said that they had just been in conference and had not been able to get anywhere in conference, and asked me if I would not take the matter up personally.

It is my recollection that I then called Mr. Hering and Mr. Swaren and I think Mr. Rhodes—all of those who were in that conference. I am not just positive as to who were there. It was possible that I had a review engineer. I said to the treasurer of the company—I don't remember his name, but I remember he was one of them, and I think the attorney for the company was there—"Now, if you really want to close this case and come to some equitable conclusion of it, and if you want me to act in that capacity for the bureau, let us see if we cannot find some common ground." He said that that was just what he wanted to do. I then listened to tales, to stories of the case, by both sides.

Now, you will understand that I had to do that, because I personally had not gone into this case, and knew nothing of the details. I could not render any opinion without hearing both sides of the case.

After listening to it, it is my recollection that I made a suggestion that if the taxpayer would yield certain points, and if the Government would yield certain points, questions of fact, it was then figured out just what that would amount to. I personally never dealt in amounts. I dealt in principles, and let the dollars fall where they would. The final result was told to the treasurer of the company and he then said, "Well, I will have to take this matter up with the parties in Philadelphia, or the officers of the company. I can not give you an answer until after I do that." I said, "Why, I understood that you said that you could say yes or no to a proposition which might be made." He said, "Well, I can't do that to-day." I said, "Well, all right; then the thing is off."

Further than that, I have no recollection of what was done. I do not know whether they came back later and accepted the proposition or not. I have no recollection of any acceptance or any closing of the case.

The 70 per cent that you asked about, I do not recall the details of the case, but it must be a percentage of facilities or amounts other than the 52 or the 36 or the 48 which they claimed, because, as a proposition was put up to me, there was always a low figure and a high figure, a demand of the taxpayer, and the Government or the engineer's or auditor's idea.

Mr. MANSON. Can you, by referring to the engineer's supplemental report, refresh your recollection and tell us what brought about the change of decision of the Bureau from 80 per cent value in use to 52.6 per cent?

Mr. DE LA MATER. Well, that would be in the arguments of the taxpayer in the brief submitted, and in the oral testimony given by him in the formal conference there.

Mr. HARTSON. That brief, Major De La Mater, indicates the position that the Government took, and answers then from the standpoint of the taxpayer. That might be illuminating here.

Senator JONES of New Mexico. The brief, as I understand it, is one which contains the statement of the 70 per cent.

Mr. HARTSON. I think the Senator has a wrong idea of that 70 per cent value in use, which was mentioned. It seems to be true beyond any question that that was not a figure that the taxpayer was contending for, that he was always contending for something lower than 52 per cent, which he received——

Senator JONES. I have not seen anything in the record to indicate that, and that is what I would like to be shown, if there is anything in the record concerning it.

Mr. MANSON. Mr. De La Mater, have you the minutes of that formal conference before you?

Mr. DE LA MATER. Here is a sentence in a "Memorandum for files," made by me on October 31, which says:

Mr. Middleton engineer, and Mr. Wilson, representing the company, called on the writer to-day relative to taxpayer's claim for amortization, with special reference to certain items which are under dispute.

Mark that "certain item."

The writer conceded 70 per cent value in use, as asked by the taxpayer, instead of 80 per cent value in use allowed by Mr. Swaren in his report.

Mr. MANSON. Who made that memorandum?

Mr. DE LA MATER. I did.

Mr. MANSON. That was made contemporaneously with the occurrence, was it; it was made at or about that time?

Mr. DE LA MATER. This was dated October 31, 1922.

Mr. MANSON. What was your custom in reference to making memoranda of conferences?

Mr. DE LA MATER. This is a memorandum of a call made upon me by Mr. Middleton and Mr. Wilson.

Mr. MANSON. Is the document made on the same day as the call occurs?

Mr. DE LA MATER. Usually, yes sir, or maybe the next day.

Mr. MANSON. It was made while the transaction was still fresh in your mind?

Mr. DE LA MATER. Oh, yes.

Senator JONES of New Mexico. Does not that state that all they claimed was 70 per cent?

Mr. DE LA MATER. That says, "certain items which were under dispute."

Senator JONES. We are talking about this question of value in use now. That seems to be the basis of this whole thing here or, rather, the principal part of the thing, and that shows that they claimed 70 per cent.

The CHAIRMAN. On certain items, Senator; not all of them.

Mr. DE LA MATER. Were there not certain other items in this claim besides the power plant?

Mr. MANSON. No.

Mr. DE LA MATER. Then, there were certain items that came up and were dealt with on the cost of the power plant.

Mr. MANSON. Will you refer now to the minutes of the former conference.

Mr. DE LA MATER. Yes.

Mr. MANSON. Do you find any reference to that 70 per cent in that record?

Mr. DE LA MATER. Yes.

Mr. MANSON. Just read it.

Mr. DE LA MATER (reading):

> Taxpayer also contends that the plant as a whole is only 70 per cent in use as against 80 per cent computed in the engineer's report. On this point it was agreed that additional data would be submitted, and if the information is as claimed by the taxpayer's representatives, the conferees will recommend that the value in use be reduced to 70.

Mr. MANSON. Now, Mr. De La Mater, those minutes of the conference were made up at or about the time the conferences were held, were they not?

Mr. DE LA MATER. Yes; within a day or two after.

Mr. MANSON. The purpose of those minutes was to preserve a memorandum of what happened at the conference; is not that true?

Mr. DE LA MATER. Yes. Of course, let me add there that the conferees did not always render a decision in the conference with the taxpayer; they sometimes discussed it afterwards amongst themselves and stated what the recommendation would be before writing this report.

Mr. MANSON. What I mean is that the memorandum or minute of the conference was always made while the matter was still fresh in the minds of the conferees?

Mr. DE LA MATER. Yes; within a few days.

The CHAIRMAN. I would like to say at this point, though, that the actual record of the claims of the taxpayer makes no reference to 70 per cent.

Mr. DE LA MATER. I mean, those are the statements in the oral discussions, evidently.

Senator JONES of New Mexico. It is contained in the brief, as I understood it.

Mr. DE LA MATER. There is an element of replacement cost that enters in here in some way, I notice.

The CHAIRMAN. What does the brief of the taxpayer say concerning the value in use?

Mr. DE LA MATER. I have not read that.

Mr. HARTSON. That brief was filed away back in August, was it not, and all of these negotiations were subsequent to the filing of the brief.

The CHAIRMAN. I understand, but there is no statement submitted to this committee showing what the taxpayer claimed.

Mr. DE LA MATER. This says 35.8.

Mr. HARTSON. What are you reading from?

Mr. DE LA MATER. Power plant No. 34 of the schedule, total steam-boiler equipment, schedule of the claims of the taxpayer.

Mr. MANSON. What is the date of that brief; when was it filed?

Mr. DE LA MATER. It was received in the unit February 17, 1922.

Mr. MANSON. What is the date of that formal conference?

The CHAIRMAN. October 30–31, 1922.

Mr. DE LA MATER. October 30–31, 1922.

Mr. MANSON. Would it not appear, then, that between the time of the filing of the brief and the reaching of a conclusion by the conferees the bureau and the taxpayer had reduced their differences to one of between 70 and 80 per cent instead of one between 35 and 80 per cent?

Mr. DE LA MATER. No; it would not look that way to me. If that were the case, there would be something in there to indicate the reason for the change.

The CHAIRMAN. I think the point that Senator Jones and I still do not get straight is that nothing has been introduced to show how they arrived at 52.6 per cent.

Senator JONES of New Mexico. That is it.

The CHAIRMAN. I wish the department could, after all of this time that we have spent on it here, show us by what method you arrived at 52.6 per cent, and when, and who were present when it was arrived at.

Senator JONES of New Mexico. And who fixed it?

The CHAIRMAN. Yes.

Mr. HARTSON. Senator, I think it will not be difficult to show you how it was arrived at and the justification for the allowance of that percentage.

Senator JONES of New Mexico. We are not discussing the justification of it, but we want to know how it was arrived at, and when, and by whom.

Mr. HARTSON. We are trying to show you by the man who made the final decision, who signed the memorandum, and who approved that percentage allowance. It has already been pointed out that the files are silent as to a record of the conferences which Major De La Mater held.

Senator JONES of New Mexico. I think we have a memorandum of the conference.

The CHAIRMAN. Not of the final conference.

Mr. HARTSON. Not of the final conference.

The CHAIRMAN. Can you answer that question which has been propounded by Senator Jones and myself?

Mr. DE LA MATER. I have here the brief of the taxpayer, filed after that conference, dated November 8, 1922. That is about a week after the conference.

The CHAIRMAN. Read that part of it.

Mr. DE LA MATER. In which it states:

Now on the 10,000 kilowatts, or the two 5,000 units, the examiner in his compilations has found an 80 per cent value in use. The contention of the taxpayer, however, is that this original 80 per cent, or 8,000 kilowatts, must be applied to the 19,000-kilowatt war capacity, which in reality represents 42.1 per cent value in use. With the application of 7,000 kilowatts, or 70 per cent value in use of the 10,000, applied to 19,000 kilowatts, this percentage is reduced to 36.8 per cent, which figure represents the greatest possible limit of value in use.

The CHAIRMAN. By whom was that signed?

Mr. DE LA MATER. This is headed "Regarding value in use of the power station of the Berwind-White Coal Mining Co. at Windber, Pa." It does not seem to be signed.

The CHAIRMAN. Do you say it is the taxpayer's brief?

Mr. DE LA MATER. Can you answer that?

Mr. HARTSON. I understand it is the taxpayer's brief. It seems to be bound as legal documents are frequently bound, and does not bear any resemblance to what would ordinarily be written in the bureau.

The CHAIRMAN. Why would the taxpayer refer to himself as "the taxpayer"?

Mr. HARTSON. Oh, that is frequently done impersonally in arguing these cases to the bureau, by counsel. He refers to his client as "the taxpayer."

The CHAIRMAN. I can now see, I think, why this 70 per cent was arrived at.

Mr. HARTSON. You can see how it was arrived at?

The CHAIRMAN. Yes. The 70 per cent that they are talking about is the 70 per cent on the 10,000 power plant, and not 70 per cent on the 19,500 kilowatts. In other words, if you reduce the percentage to apply on two plants, it comes to about the original claim, or about 35 per cent; but if we confine the discussion to the one plant, of course, it comes up to 70 per cent. It seems to me that this discussion should develop the fact that they were not talking about two different things, and that this 52.6 per cent is probably a compromise between what the engineer said was 80 per cent in use and the taxpayer said was approximately 35 per cent in use. Is that your idea?

Mr. DE LA MATER. That is my recollection.

The CHAIRMAN. I think, though, when such a compromise as this is made, there should be some record of why it was made and who made it, because when the taxes are compromised, involving hundreds of thousands of dollars, there should be a complete record, not only to show these details but to exonerate the employee from any charge of favoritism that might be made.

Mr. DE LA MATER. Senator, I think these memorandums of mine in the files will disclose that fact, and that record was made.

Senator JONES of New Mexico. Let us have it, then.

Mr. DE LA MATER. What?

Senator JONES of New Mexico. Find it if you can, let us have it, and get it in the record.

Mr. DE LA MATER. I have not read it all through yet. It is dated October 31.

Mr. Middleton, engineer, and Mr. Wilson, representing the company, called on the writer to-day relative to taxpayer's claim for amortization, with special reference to certain items which are under dispute. The writer conceded 70 per cent value in use, as asked by the taxpayer, instead of 80 per cent value in use, as allowed by Mr. Swaren in his report, also an item of approximately $9,000 to typographical error should be corrected, and adjustment of the allowance on the basis of replacement cost submitted by taxpayer in the form of letters from manufacturers should be made in the case of the chimney, the roofing, the Lipton sash, the coal-handling equipment, the ash bin, the turbine, and the condensers, as it is conceded that these items are special, and not properly provided for in this case by the ratios.

Mr. Middleton stated that he would submit the additional information requested by Mr. Swaren in support of the taxpayer's contention that 70 per cent value in use was correct. He also advised that he could not to-day agree to settlement, but that after taking the matter up with their accounting representative he would again come to Washington and come to some agreement.

That confirms my recollection as to not being able to come to an agreement.

Mr. MANSON. Mr. Swaren's recommendation of 80 per cent applied to the plant to be amortized, did it not?

Mr. DE LA MATER. It applied to this 10,000, according to this memorandum.

Mr. MANSON. Yes.

Mr. DE LA MATER. Which is 36.8 per cent on the whole.

Mr. MANSON. Yes. Now, you have compared, rather, the 70 per cent which the taxpayer was contending for with the 80 per cent which Mr. Swaren had recommended.

Mr. DE LA MATER. Yes; on these particular facilities.

Mr. MANSON. Yes. Now, Mr. Swaren's recommendation referred to the properties to be amortized, did it not?

Mr. DE LA MATER. No; it referred to this same group of facilities, the same portion of the facilities.

Mr. MANSON. Well, if you will refer to Mr. Swaren's report, you will find a recommendation as to the power plant No. 34, the wartime power plant, in which he takes the position that the value in use of that property was 80 per cent. The comparison that you make in the notes you have just read is a comparison of the taxpayer's contention of 70 as opposed to Swaren's contention of 80 per cent.

Mr. DE LA MATER. On that particular group; yes.

Mr. MANSON. The only thing under consideration here was the property to be amortized, was it not?

Mr. DE LA MATER. I know, but, if it was taken up in groups, just as I have enumerated here, various things were to be given special ratios.

Mr. MANSON. The special ratios applied to reproduction costs, did they not?

Mr. DE LA MATER. Yes; but that shows that the thing was taken up in detail, not as a whole. It was gone into in detail, in arriving at the final figures.

Mr. MANSON. Was not the value in use, however, determined as a whole? You did not pick out certain items which entered into the construction of this power plant and say that they had a value in use different from other items in the same power plant?

Mr. DE LA MATER. No. That would not be usual; no.

Mr. MANSON. Now, I have never read that document, but it struck me that you were comparing the taxpayer's contention of 70 per cent with Swaren's recommendation of 80 per cent, and Swaren's recommendation of 80 per cent, according to his written report, referred to the entire power plant built during the war, and to nothing else?

Mr. DE LA MATER. I have not read Mr. Swaren's report on that.

Mr. MANSON. If you will refer to Mr. Swaren's report, I believe it is on page 13.

Mr. DE LA MATER. What is the date of that?

Mr. PARKER. October 31, 1922.

Mr. DE LA MATER. What is the page of his report?

Mr. PARKER. I think it is on page 13. It is where he has set up all the amortization computations. Do you find that?

Mr. DE LA MATER. Yes.

Mr. MANSON. He has an item there of $701,162.73, which is designated 89.5 per cent of replacement cost. Now, that 89.5 per cent refers to that portion of the plant which was subject to amortization, does it not?

Mr. DE LA MATER. It seems to; yes.

Mr. MANSON. I would call your attention in that connection to the fact that he had previously found that part of this plant, approximately ten per cent, was not subject to amortization, for the reason that it was used to produce current to be sold to public utilities.

Mr. DE LA MATER. Yes.

Mr. MANSON. In this set-up he takes the cost of reproduction after the war and takes 89.5 per cent of that, which gives him $701,162.73, does it not?

Mr. DE LA MATER. Yes.

Mr. MANSON. The $560,930.19 which he recommends as the value in use is just 80 per cent of that $701,162.73, is it not?

Mr. DE LA MATER. It is.

Mr. MANSON. Does not that show that his figures as to 80 per cent applied, then, to the entire plant subject to depreciation, and not to some portion of it?

Mr. DE LA MATER. I do not like to answer that question offhand, without studying this case. These matters are pretty intricate, and I do not remember anything about the details of this case at this date.

If I were to answer questions like that I think I should be allowed to study the case.

Mr. MANSON. Certainly; I do not want to be unfair.

Mr. HARTSON. The bureau has an engineer here who, I think, can clear that matter up. Mr. De La Mater is not familiar with all of the details of the case.

The CHAIRMAN. I think both sides have been rather negligent in looking through the files here, because, right here in these papers that have just been handed to me, this statement appears. The whole file is marked "Memorandum for files, In re Berwind-White Coal Mining Co., Philadelphia." "A copy of the engineer's report in the above case was this day handed personally to Mr. Robert G. Wilson, who has power of attorney for the above company." Among other things, it says:

A supplemental report on determination of the amortization claim in the Berwind-White Coal Co., Philadelphia, Pa., and it is marked "received November 2, 1922, I. T. S. A. S. M." It is submitted by J. W. Swaren, engineer, and it says, "Supplemental report on redetermination of the amortization claim of the Berwind-White Coal Mining Co., Philadelphia.

Mr. MANSON. That is already in the record.

The CHAIRMAN. I have not seen this in the record. It says:

This supplemental report is based on special report of the engineer in charge October 21, and conferences held in this unit October 30-31, and November 7 and 13.

Mr. MANSON. Yes; that is in the record.

The CHAIRMAN. Here is where they arrive at the 52.6 per cent. There was no information given to the committee as to how they arrived at that before.

Mr. PARKER. I read that, Senator.

The CHAIRMAN. We have been asking all along how they arrived at the 52.6 per cent, and nobody seemed to be able to show us.

Mr. NASH. That was discussed the other day, and Senator Jones asked us to bring in the man that signed it.

The CHAIRMAN. This shows how they arrived at the 52.6 per cent. I do not remember any testimony as to how they did arrive at that.

Senator JONES of New Mexico. Read it. I have not any recollection of it, either.

The CHAIRMAN. It says:

In these conferences the taxpayer submitted data to show that the pre-war plants of 9,000 kilowatts installed capacity had been increased during the war period by 10,000 kilowatts, making a capacity of 19,000 kilowatts and that units of 9,000 capacity are surplus for postwar needs.

On this basis the value in use becomes 10,000 divided by 19,000, or 52.6 per cent.

Senator JONES of New Mexico. Yes; I remember that.

The CHAIRMAN. Do you?

Senator JONES of New Mexico. Yes.

The CHAIRMAN. I did not remember how they arrived at that. I had overlooked that, then.

Mr. MANSON. Well, it is your recollection that the method adopted is the one that was just read, is it not?

Mr. DE LA MATER. Yes, sir; that is the result, yes.

Mr. MANSON. Now, is it not a fact that in adopting that method, the fact that the old pre-war power plant had been abandoned is ignored?

Mr. DE LA MATER. I do not recall anything about the plant being abandoned. That was the first time I heard anything about it, that I recall, when I heard it yesterday.

The CHAIRMAN. I think, perhaps, the testimony is somewhat conflicting upon that. It seems to me the question of whether a plant which was steamed up and ready to use could be considered as abandoned. In reaching the conclusion, they did not consider it abandoned, even though reference is made to the fact that it was abandoned, but still the record shows that it was steamed up and ready for use in reserve.

Mr. MANSON. I might be able to get that straight. After the war plants, consisting of two 5,000-kilowatt units, had been completed the load was shifted to the new plant, but one power house of the old plant was kept in use as a reserve. After the construction of the third unit, which was built after war, as I read this morning, the entire pre-war plant was abandoned. In other words, it was not kept up after the third unit had been installed.

The CHAIRMAN. I understand, but that third unit was not completed when they made this report.

Mr. MANSON. Oh, yes; that third unit was completed in 1921.

Mr. HARTSON. But it did not make any difference, so far as amortization for the war years is concerned.

Mr. MANSON. That is another question.

Mr. HARTSON. It is a very material question.

Mr. MANSON. The fact of the matter, as I thought I established this morning, and if not, I will submit more proof on that question, is, that it the time this amortization settlement was made the pre-war plant had been abandoned entirely, and was not in use, even as a reserve. I can see that a plant in which steam is kept up for reserve purposes is in use. The point I make is that the construction of the new plant after the war was to provide reserve capacity in case of breakdown, in place of the old pre-war plant, and that the construction of that plant, after the war, by the company, showed that, at least in the opinion of the company, they needed that reserve capacity.

The CHAIRMAN. Well, that may be so, Mr. Manson, but you can not tell—at least I do not understand how you can tell—that they knew that that condition was going to exist when they purchased the plant in 1918.

Mr. MANSON. When you go back to 1918, they were providing additional facilities, but the fact that they abandoned the plant showed, as I pointed out in my opening statement, that there were several considerations which justified the conclusion that the use of the old plant, even in 1918, was practically at its end; the first being the life of the plant, and the second being the fact that the company itself, as soon as the war-time plant was completed, shifted the load to the war-time plant and immediately started to construct the third unit as a reserve. I take it that the company would not have constructed a new reserve unit, if they could economically operate the pre-war plant for that purpose, and that the mere construction of it

shows the necessity for it, and that if there is any surplus capacity there, the surplus capacity is due, not to the construction of the war plant but it is due to the construction of the postwar plant. I do not maintain that there is a surplus capacity there, but I say that, if there is a surplus capacity, it is due to an overexpansion subsequent to the war, rather than the construction of the war plant, and that in determining the use of the war plant, it is necessary to take into consideration the age and condition of the pre-war plant, and the fact that the pre-war plant had reached the end of its usefulness, as is shown by the fact that it was actually abandoned and a new third unit added to take its place.

The CHAIRMAN. I think I could resolve myself to reach such a conclusion as you have, and I think, if I had been representing the Government, I would have reached such a conclusion, and assessed the taxpayer, and if he rebelled against that assessment I would let him take his procedure in the courts that are provided for that purpose. But that need not necessarily mean that, because I feel that way, everyone else has to.

Mr. MANSON. Well, I do not assume that everybody agrees with me.

The CHAIRMAN. My judgment is that the department has been too liberal. I still think it is too liberal in dealing with these things.

Mr. HARTSON. Senator, of course, this new plant to which Mr. Manson refers, which they built, as he argues, in recognition of the fact that the old plant was gone, was not begun to be constructed until 1920, and of course they did not move into it and actually operate it until the close of 1921. They did not know in 1918 that their old plant was going to wear out. It has not been pointed out, but this is one of the most important elements in the case, the fact that this company was one of the largest, if not the largest, coal producers in the country, and burned up their old plant, making coal and mining coal during the war for transportation to the seaboard to go across.

The CHAIRMAN. From which they got enormous profits, naturally.

Mr. HARTSON. Well, I do not know that they did, Senator. I think their profits were probably regulated at that time. I am just basing that on my general knowledge of what the conditions were as to coal producers. However, they operated the old plant to the point where it was burned up, and I think they showed to the satisfaction of the bureau that a large share of that was gone, as a result really, of attempting to promote the interests of this Government during the war.

Now, what happened to this third plant that they moved into in 1921 is entirely immaterial, as I see it, in determining what the amortization allowance should be for 1918 and 1919. The conditions that were material in considering this decision were not conditions that existed after the new plant, or the third plant, was under construction. We have a 1918 condition, where the old plant, as was recognized by counsel, was, if not in 100 per cent operation, available as a reserve plant to the plant, the construction of which was started in that year. Of course, the new plant, the war plant, was not completed until 1919; so that in the year 1918 the old plant had to carry the load, and it did, and then in 1919, when the second plant was constructed, it took over the old plant, held in reserve.

I believe that is the way the bureau approached this question and, under the law, as Major De La Mater has pointed out, it is necessary to do it. The law says, "a reasonable allowance." That is a general term. Here was a condition where a company that had aided and assisted the Government in the prosecution of the war had exhausted its facilities as a result of it, and constructed during the war, at the insistence of the Government, and by reason of pressure brought on it by the Government, this plant, to increase their capacity for coal production. In 1918, when this construction was started, we did not know whether they were going to have a five year war or a ten year war. So they went ahead and constructed this new plant. Now, the war suddenly terminated, and they had on their hands an old plant, and they had on their hands a new plant, with enough boiler capacity to operate another unit. That is what happened when they started the construction of the third plant, because they had so increased their boiler capacity in the war plant which was built that they could economically purchase another unit and operate it with the same capacity.

Mr. MANSON. I believe they put in boilers for the last unit.

Mr. HARTSON. I am informed by our engineer that my statement is correct, that they had boiler capacity due to the construction in 1918, which they desired to use in 1920 and 1921, and they added another unit, so that that boiler capacity could be used.

Mr. MANSON. Well, if the boiler capacity could be used it would be because it was not intended to operate the third unit, incurred by the operation of the other two units; is not that true?

Mr. HARTSON. I would have to confer with the engineer on that. I am informed that that is correct.

Mr. MANSON. Yes; and that the third unit was a mere spare unit at a period when one of the other units was shut down.

Now, I disagree with counsel—I do not know whether the committee cares to hear me on this point, but I disagree with counsel as to the conditions which are to be taken into consideration by the bureau in determining amortization.

The 1918 conditions are only important in determining the amortization allowance, as going to the question of the necessity of the extension. We concede that; we do not question that this property was subject to amortization. The question here is the amount of the amortization. In determining the amount of amortization, the question is, what use is this property to the taxpayer for postwar purposes?

The 1918 conditions have nothing to do with it whatever in determining the amount to be allowed for amortization. Take a simple little illustration.

Assume that a man has use for an automobile truck for war purposes. He has one truck that is about reaching the end of its usefulness. We will say that the strain that is put upon it for war purposes brings its natural life to an end. He buys a new truck for war purposes, which is the subject of amortization. When the war is over, he has a new truck. He has a worn-out truck. The conditions affecting his right to amortization depend upon the use that he has for the new truck after the war. If his old truck is useless to him his new truck is worth 100 per cent to him. It is not

only the capacity of the property he had during the war, but the condition of that property and the usefulness of that property subsequent to the war that must be taken into consideration in determining whether or not his postwar normal business requirements demand the use of the facility which was constructed for war purposes. If they be to the extent that his postwar normal business requires the use of such facilities, he is not entitled to amortization, under the policy laid down by these regulations.

Senator JONES of New Mexico. Is not that necessarily so, in view of the expression used in the language of the statute; it says:

> In the case of buildings, machinery, equipment, or other facilities constructed, erected, installed, or acquired on or after April 6, 1918, for the production of articles contributing to the prosecution of the war against the German Government, and in the case of vessels * * * there shall be allowed for any taxable year ending before March 3, 1924 (if claim therefor was made at the time of filing return for the taxable year 1918, 1919, 1920, or 1921), a reasonable deduction for the amortization of such part of the cost of such facilities of vessels as has been borne by the taxpayer.

Does not that clearly limit the amortization to the buildings, machinery, and so forth, constructed for these express purposes, and whatever other facilities the taxpayer may have are not included at all? It only related to the buildings constructed for these specific purposes.

Mr. HARTSON. And it was so limited in this case, Senator.

Senator JONES of New Mexico. Well, I do not think so, Mr. Hartson. If I have a correct understanding, they are taking into consideration the condition of the use of the old plant.

Mr. HARTSON. You say the percentage of the value in use of the new plant, when all the facilities are considered. We are not attempting to reduce any part of the cost or value of the old plant; we are limiting our amortization to the cost of the new plant, construction of which was started in 1918, but in determining the value in use of that single plant started in 1918 we consider their entire power facilities.

The CHAIRMAN. I think you could not reach any other conclusion than that that had to be done.

Senator JONES of New Mexico. Now, as to this plant which was constructed, we will say, for war purposes, is it actually in use, according to the record, and if so, to what extent?

Mr. HARTSON. The 1918 plant?

Senator JONES of New Mexico. Yes.

Mr. HARTSON. I think that is the plant that is in constant operation now, subject to the margin of excess capacity over the actual power used. I do not know just what that percentage is, what the postwar needs are to-day I do not know, but the showing was that after the war was over they had on their hands the 10,000-kilowatt plant, the construction of which was started in 1918. They also had this old plant, which they had fires under and which was available as a reserve plant. Now, that condition existed up to the close of 1921, when the new plant, the third plant, was substituted for the old antequated plant that had been burned out during the war.

There is the theory on which this percentage was allowed. Following the war, when hostilities had stopped, we had this company with a 10,000-kilowatt plant and the 9,000-kilowatt old plant. They had

not yet constructed the new plant, and they had not yet started to construct the new plant, but the construction was started in 1920. That was the capacity up to the time of the substitution of the third plant.

I believe, and I am contending here, that the construction of that third plant was immaterial in the consideration of what their postwar necessity was. Considering their postwar capacity they had 19.000 kilowatt and their postwar needs were something around half of that, or somewhere near it; at least, the bureau recognizes a value in use there of 52.6 per cent.

Senator JONES of New Mexico. When was it that the contract was made for this third plant?

Mr. HARTSON. In 1920. That is when construction was started, in 1920.

Senator JONES of New Mexico. And no amortization claim is made on account of that?

Mr. HARTSON. None whatever.

Senator JONES of New Mexico. Is not that almost conclusive evidence that the old plant was abandoned in——

Mr. HARTSON. It is conclusive evidence to my mind, Senator—and I think the taxpayer conceded it—that their old plant in 1920 could not be economically operated, and conditions were so favorable to them at that time for the purchase of a new power unit, so much so that they got a 10,000-kilowatt power unit for what a 5,000-kilowatt power unit would have cost; and so they, in the exercise of good business judgment, purchased this new plant. They had a boiler capacity at least sufficient to carry them during the periods of substitution, as Mr. Manson pointed out, during periods when the old 1918 plant was not in use.

Senator JONES. Then, is not Mr. Manson's illustration practically admitted by the action of the company itself, that prior to and during the war the old plant was worn out?

Mr. HARTSON. No; I do not conclude that. The plant was in use during the war.

Senator JONES of New Mexico. I understand it was in use during the war.

Mr. HARTSON. And was still subject to being used after the war for some time, but as a matter of economy they could purchase a plant of modern design and substitute it in its place.

Senator JONES of New Mexico. And abandon the old plant?

Mr. HARTSON. That would be the result, Senator.

Senator JONES of New Mexico. Yes; that would be the result.

Mr. HARTSON. Yes; but that just takes the place of the 9,000 and you then have a 20,000-kilowatt capacity, with two 10,000-kilowatt units.

The CHAIRMAN. The committee will adjourn at this time until to-morrow morning at 10 o'clock.

(Whereupon, at 11.55 o'clock a. m., the committee adjourned until to-morrow, Thursday, December 4, 1924, at 10 o'clock a. m.)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

MONDAY, DECEMBER 8, 1924

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE THE
BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The Committee met at 10 o'clock a. m., pursuant to adjournment of Friday.

Present: Senators Couzens (presiding), and Jones of New Mexico. Present also: Earl J. Davis, Esq., and L. C. Manson, Esq., of counsel for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. C. R. Nash, Assistant to the Commissioner of Internal Revenue; Nelson T. Hartson, Solicitor, Internal Revenue Bureau; and S. M. Greenidge, head Engineering Division.

The CHAIRMAN. Mr. Davis, would it be inappropriate to dispose of this witness that we have out here at this time?

Mr. DAVIS. I think that is the thing to do, Mr. Chairman.

The CHAIRMAN. Yes. We have a witness here from Cleveland in connection with the Berwind-White case.

TESTIMONY OF MR. JOHN WILLIAM SWAREN, ENGINEER, CLEVELAND, OHIO

(The witness was duly sworn by the chairman.)

The CHAIRMAN. Give the reporter you full name and address.

Mr. SWAREN. John William Swaren, Cleveland, Ohio.

Mr. MANSON. You are the engineer, Mr. Swaren, who made the field examination of the property in the Berwind-White Coal Co., upon which amortization was claimed in connection with their income tax?

Mr. SWAREN. I am the engineer who made the reexamination.

Mr. MANSON. On October 1, 1922, you made a report based upon that field examination, did you not?

Mr. SWAREN. I presume that is the date. I have not seen the report in two years.

Mr. MANSON. Will you produce Mr. Swaren's report on reexamination for redetermining amortization?

(Mr. Tandrow thereupon handed the report to Mr. Swaren.)

Mr. SWAREN. It is marked here as submitted on October 21, yes, sir.

Mr. MANSON. Now, in that report you recommend that the value in use of the property to be amortized be determined to be 80 per cent, do you not?

Mr. SWAREN. Yes, sir.

Mr. MANSON. Subsequent to the making of that report, you made a supplemental report, dated November 18, 1922?

Mr. SWAREN. There seems to be no date on this.

Mr. MANSON. Is there not a date at the foot of the summary?

Mr. SWAREN. Yes; I see it now—November 18, 1922.

Mr. MANSON. In which you recommend that the value in use be determined to be 56.2 per cent?

Mr. SWAREN. Yes, sir.

Mr. MANSON. Between the time that you made the first report on October 21, and the making of the second report on November 18, 1922, there were various conferences held between the representatives of the taxpayer and the representatives of the bureau, were there not?

Mr. SWAREN. Yes, sir.

Mr. MANSON. Were you present at those conferences?

Mr. SWAREN. Not all of them.

Mr. MANSON. Did any facts develop at any of those conferences attended by you which caused you to change your mind as to the condition and usage to which the old plant was being put by the taxpayer?

Mr. SWAREN. As to the conditions, slightly; as to the usage, no.

Mr. MANSON. What use was being made of the old plant by the taxpayer at the time of this report?

Mr. SWAREN. To the best of my recollection the old plants were not in use at all.

Mr. MANSON. Were any facts developed in these conferences which caused you to change your opinion as to the connected load on the war-time plant?

Mr. SWAREN. No, sir.

Mr. MANSON. Were any facts developed which caused you to change your estimate of the peak load?

Mr. SWAREN. No, sir.

Mr. MANSON. Will you state why you changed your opinion of the value in use of this property from 80 per cent to 52.6 per cent?

Mr. SWAREN. That took place in two steps. Would you like me to explain the two steps?

Mr. MANSON. Yes.

Mr. SWAREN. As I recall, the units installed originally were Allis-Chalmers units of 5,000 k. v. a. each.

Mr. MANSON. You are referring now to the war plant?

Mr. SWAREN. I am referring now to the war plant.

Mr. MANSON. Yes.

Mr. SWAREN. The next smaller sized unit of Allis-Chalmers manufacture would be 4,000 k. v. a. The engineer of the Berwind-White Co. submitted an efficiency curve of 3,500 k. v. a., if my recollection serves me right, General Electric unit, which proved that at the expense of steam economy, these two units would carry

the maximum load, and that caused me to change my opinion on the basis of those data, that the value in use would be approximately 70. I do not recall the exact figures, but the relation between the 4,000 and 3,500 as compared with 5,000.

Mr. MANSON. Right at that point, as I understand your testimony, it is this, that had the Berwind-White Coal Mining Co. installed General Electric equipment instead of Allis-Chambers equipment, they would not have been required to install equipment with as great capacity.

Mr. SWAREN. Yes. If that is not true as to the names of the equipment, it is vice versa.

Mr. MANSON. Yes; but the substance of it is that if they had installed equipment of a different make——

Mr. SWAREN. Yes.

Mr. MANSON. They could have gotten along with less capacity?

Mr. SWAREN. Yes.

Mr. MANSON. Now, what is the next step?

Mr. SWAREN. At all times, in my report, I analyzed the power plant as I found it, interpreting the law to mean the specific facilities, without relation to the other facilities of similar character which the taxpayer might have. At that time, there was no manual of guidance for the engineers. There had been a number of memorandums of policy issued.

Mr. MANSON. Just a minute at that point. Do I understand you, then, to mean that you interpreted the law to mean that in determining the use of a war-time facility upon which amortization was claimed, it was your duty to determine the use to which it was actually being put?

Mr. SWAREN. That was my interpretation of it; yes, sir.

Mr. MANSON. And your original report was based upon that theory?

Mr. SWAREN. Yes, sir.

Mr. MANSON. Proceed now.

Mr. SWAREN. Major De La Mater, who at that time was my chief and superior officer, gave rather careful study, as I understand it, to this report, and subsequently came to the conclusion that I had, to this particular case, misinterpreted the application of how I should consider it in view of other facilities which the taxpayer had; and if that were the case, then, for my value in use formula the denominator would be the total installed capacity of the taxpayer, and not the installed capacity of a particular group of facilities which I was considering. Substituting those figures in my supplemental report would give the value in use as is shown.

Mr. MANSON. As I understand that, the second report is not based upon any change of opinion as to facts?

Mr. SWAREN. No, sir.

Mr. MANSON. But it is based upon instructions received from Major De La Mater that your construction of the law was not right?

Mr. SWAREN. Yes, sir.

Mr. MANSON. That is all.

Mr. HARTSON. Mr. Swaren, do you state that your change in attitude in this case was brought about by Major De La Mater's instructing you to reach a contrary conclusion?

Mr. SWAREN. He was my chief. He was responsible for the policy of the section, and so long as he laid down a definite policy to be followed I do not see that I had anything to do except to accept my chief's policy.

Mr. HARTSON. Did you disagree with it at that time?

Mr. SWAREN. From one point of view, yes; from another point of view, decidedly no.

Mr. HARTSON. Now, that is not very helpful to the committee here, to say that under certain circumstances you would have agreed with it, and under other circumstances you would not. I want to know just what your attitude was at the time you changed your view on the proper interpretation of the law.

Mr. SWAREN. My change of view on the proper interpretation of the law was specifically that Major De La Mater was the proper man to hand down the interpretation policy. Now, if you would like me to go further and explain the reasons from my own personal point of view I would be glad to do that.

Mr. HARTSON. Well, did you change your personal point of view at all?

Mr. SWAREN. In the way that I have said.

Mr. HARTSON. I do not understand it. Describe the way you did it.

Mr. SWAREN. All right. At that time I felt and still feel that a rigid interpretation of amortization would be the actual use of the particular facilities, but there were other features that entered into the Berwind-White case that would lead me to be more lenient. Those were the facts that during the amortization period—that is, during the period of expenditures for amortization—the Berwind-White Co. apparently made a great deal of expenditures for capital assets. I remember observing various pieces of equipment that seemed to be purchased during that period. As I recall, their balance sheets for years showed increased capital assets. I did not investigate those figures on which amortization could have been claimed.

Mr. HARTSON. And was not claimed?

Mr. SWAREN. And was not claimed. In short, it is my belief, although I did not investigate it, because that was outside the purview of my investigation—my personal belief is that had the Berwind-White Co. cared to include everything on which they were entitled to claim amortization, the amortization allowance would have been many times greater than the amortization they have received in this report.

Mr. HARTSON. Is this, then, a fair statement of your attitude, Mr. Swaren, that while you might have technical disagreement with Major De La Mater's view of the interpretation of the law as applied to the particular expenditures on which amortization was claimed, nevertheless, by reason of certain, we will call them, equities, which existed in your mind in favor of the taxpayer, you felt that this was a proper result that might be reached in the case?

Mr. SWAREN. To a certain extent, that is true. Another thing is that I feel that I should be loyal to my chief and do as I was instructed to do, so long as he was the responsible head and the determinator of policy.

The CHAIRMAN. At this point, I would like to ask, for the purpose of getting at the policies of these engineers and auditors,

whether, if you were in violent disagreement with your chief, you would just abjectly follow him or would you appeal your views to some higher authority for a more full determination of the matter?

Mr. SWAREN. If I felt that my chief was entirely outside of his purview, or if I felt that he was trying to drive me into something that was illegal or unjust, I would certainly appeal.

The CHAIRMAN. In view of the fact that you did not appeal, you considered that he was perfectly right and correct in his ruling with respect to the law?

Mr. SWAREN. Yes, I do.

The CHAIRMAN. Then, did you change your mind about the proper interpretation of them yourself or did you accept the change as specified by your chief?

Mr. SWAREN. I have not changed my mind to this day about that interpretation. I believe that it should be the specific use of those specific facilities. That is my own personal belief.

Mr. MANSON. In other words, your own personal belief now is that the value in use of these facilities was 80 per cent?

Mr. SWAREN. No; 70, or whatever it may be. I believe the additional engineering data which were submitted to the conference are entitled to full consideration.

Mr. MANSON. Now, on that point, the additional engineering data that you refer to is upon the hypothesis that they would have installed units of a different nature than those which they did install?

Mr. SWAREN. Quite right; yes, sir.

Senator JONES of New Mexico. Do you think that amortization ought to cover a thing of that sort?

Mr. SWAREN. May I ask you to elucidate your question? It is not quite clear to me.

Senator JONES of New Mexico. Well, the taxpayer purchases one kind of an instrument for manufacturing purposes, and if he had bought another kind it would have been better. He goes ahead using the first kind. Do you think this law contemplates any diminution of the taxpayer's tax liability by reason of that fact?

Mr. SWAREN. Yes, sir; I certainly do, because the question of deliveries enters there. He could get delivery of the Allis-Chalmers unit which would enable him to go ahead and produce coal. He could not have gotten delivery of the General Electric unit, and therefore he would have been hampered in his coal production, and that would have interfered with the military operations.

Senator JONES of New Mexico. That brings into the equation a new element entirely. That had not been mentioned before. Was that a fact, that he tried to get the better facilities, but could not do it?

Mr. SWAREN. Yes, sir. To the best of my recollection, that is a fact.

Mr. MANSON. Is there anything in the record to show that?

Mr. SWAREN. I doubt it. Of course, I did not take stenographic notes at the time of making my investigation.

Mr. MANSON. Is that claim set up in the taxpayer's brief?

The CHAIRMAN. Can anyone answer that question?

Mr. PARKER. I read the brief and I would say no.

Mr. HARTSON. We had better verify that. Mr. Tandrow says it is in the brief. I think that can be verified very quickly.

The CHAIRMAN. We will proceed while he is looking that up in the brief.

Mr. MANSON. I would like to have that brief made an exhibit. I do not want to offer it and swell this record with it.

Mr. GREENIDGE. We can photostat it.

Mr. MANSON. Yes; I wish you would photostat it and let it be made an exhibit. I do not want to encumber the record with it.

Senator JONES of New Mexico. You are quite right about that.

Mr. MANSON. Is that the brief of the conference?

The CHAIRMAN. No; you mean the brief of the taxpayer; not the brief of the conference.

Mr. MANSON. I mean the brief of the taxpayer.

Mr. PARKER. There was a brief submitted by the taxpayer after one of the conferences, of which we have a record.

Mr. MANSON. If the taxpayer has submitted more than one brief, I would like to have photostats of both of them. In other words, I would like to know whether the taxpayer, at any time, predicated any claim upon the theory that if he had bought General Electric equipment, he would not have been put to the expense he was put to by buying Allis-Chalmers equipment.

There is just one more question I would like to ask the witness.

The CHAIRMAN. I think the conference report has been read.

Mr. MANSON. Well, I want to call the witness's attention to it.

Do you remember attending a conference, the minutes of which show that the dispute between the taxpayer and the bureau was a dispute of whether the value in use should be determined to be 70 per cent or 80 per cent?

Mr. SWAREN. Yes.

Mr. MANSON. I will read to you this minute of the conference which appears to be signed by you:

> Taxpayer also contends that the plant as a whole is only 70 per cent in use, as against 80 per cent computed in the engineer's report.

Mr. SWAREN. Yes.

Mr. MANSON. What do you mean by the plant as a whole there?

Mr. SWAREN. I meant the specific plant on which amortization was being claimed, but not the steam electric system. When I use the word "plant" I mean the specific plant. If I had reference to the entire installation of the taxpayer I would have used the term "system."

Mr. MANSON. Did you make this memorandum of the conference?

Mr. SWAREN. I do not remember that. I am inclined to think that I did, but I do not remember it.

Mr. MANSON. Well, that was the taxpayer's contention, then?

Mr. SWAREN. At that time; yes. I should say that that was the taxpayer's engineer's contention, because it was almost entirely a conference between his engineer and myself.

Mr. MANSON. That is all.

Senator JONES of New Mexico. Then it was before that that this question of considering the system was brought up?

Mr. SWAREN. Yes, sir. I was not present at those conferences. I went on vacation—I went on leave shortly after and was not present at those other conferences.

Mr. MANSON. Would you just tell the committee how you happened to make this supplemental report if you were not present at the conference? Just tell what happened when you got back from leave.

Mr. SWAREN. Major De La Mater either called me into his office or came to my desk—I forget which—and outlined what he considered would be the proper policy to follow, namely, considering the system as a whole instead of the plant as an individual item. Immediately that that was laid down as the proper policy the value in use formula would be changed, as it is in my supplemental report, merely changing the denominator.

Senator JONES of New Mexico. Is that "value in use" term applied to the system without regard to the condition of the old plant?

Mr. SWAREN. Yes, sir; in this case. However, that is not altogether, I might say, pertinent, for this reason: That the old plant had not yet reached the limit of its economic life. True, there was a certain feature of obsolescence there, and that feature of obsolescence would have increased the cost per kilowatt hour; but had the taxpayer been willing to accept those costs the old plants would have served its purpose for some years to come.

Mr. MANSON. Now, on that point, you are an electrical engineer, are you not?

Mr. SWAREN. Well, I might call myself that.

Mr. MANSON. Is it not a fact that in the development of electrical generating machinery the cost of operation—that is, the cost of producing electric current per unit—has constantly decreased with the increase in the size of the generators?

Mr. SWAREN. Yes, sir.

Mr. MANSON. And is it not a fact that all over the country, regardless of war or regardless of the demand for additional current, new generating apparatus or new generating equipment consisting of large units has been supplanted by smaller units which were by no means worn out?

Mr. SWAREN. Quite right. There are other economic factors, however, which enter into the Berwind-White case, which would have an effect on that particular phase.

Mr. MANSON. But it is true, is it not, that the saving in cost of operation much more than compensates for the investment?

Mr. SWAREN. Well, that is a matter that can be determined mathematically. It is merely one of the applications of Kelvin's law.

Mr. MANSON. Will you state to the committee just what that law is?

Mr. SWAREN. Well, primarily, it is that the most efficient conductor of electric energy is that where the interest on the investment in copper is equal to the value of the ampere-hours lost. That law, in economics, can be modified and enlarged to solve the economics of almost any project.

Mr. MANSON. Turbo generators in the old plant?

Mr. SWAREN. Some of them were. The principal part of the old generating capacity, as I recall, was old generators. May I look at my report on that?

Mr. MANSON. Yes.

Mr. SWAREN. I think that is stated in the report.

Mr. MANSON. Were there direct connecting generators?

Mr. SWAREN. The turbo generators would be, of course.

Mr. MANSON. Yes, I know, but——

Mr. SWAREN. That I could not say. I did not examine all of the old plant. I state here that a part were engine driven and others were turbine driven.

Mr. MANSON. Those engine-driven generators were belt-driven generators, were they not?

Mr. SWAREN. I could not answer that question. I do not recall ever having seen them. If I did, it has escaped my memory.

Mr. MANSON. What is the size of those engine-driven generators?

Mr. SWAREN. My report says that the oldest units were two 3,500 kilowatt engine-driven units installed in 1906, and still in fair operating condition, and the newest unit, a 3,500 kilowatt generator, installed in 1913, and in excellent operating condition. That, of course, was a turbo generator. So I can not answer fully your question there.

Mr. MANSON. All right.

The CHAIRMAN. Mr. Hartson.

Mr. HARTSON. Mr. Swaren, you were trying to find the basis of useful value in terms of percentages——

Mr. SWAREN. Yes.

Mr. HARTSON. Of the plant, construction of which was started in 1918, were you not?

Mr. SWAREN. Yes, sir.

Mr. HARTSON. What basis would have to be used, according to your interpretation, in order to determine the percentage of value in use of that plant?

Mr. SWAREN. I took for my report the basis of a power plant sufficient for the taxpayer's postwar business, which I worked out to be, as in this report, and then on the basis of subsequent date two 3,500 kilowatt units, which could have been substituted for the two 5,000.

Mr. HARTSON. You did not take into consideration, then, all the available power which the taxpayer had at the close of the war?

Mr. SWAREN. No, sir.

Mr. MANSON. Which I believe includes not only the 1918 plant, but includes the old plant?

Mr. SWAREN. Yes, sir. I did not.

Mr. HARTSON. Figuring the capacity of the old plant which could not be economically operated, but which was available for operation, nevertheless, by the taxpayer, as a part of its productive capacity, together with the plant, construction of which was started in 1918, would give you a different result than the result that you reached?

Mr. SWAREN. Quite different. I would like to qualify your question there. You said the old plant could not be economically operated. There is an economic factor there which possibly would make the old plant come very nearly being a more economical plant than the new plant.

Mr. HARTSON. Well, the plant, if I understand you correctly, was capable of being operated?

Mr. SWAREN. It was capable of being operated.

Mr. HARTSON. And later on was dismantled, and a third plant was substituted for it, but at the time that this inquiry was to be made—

and I do not mean the date of your report, but I mean the post war date, at which time the value in use had to be determined, the old plant was still capable of being used?

Mr. SWAREN. Yes, sir.

Mr. HARTSON. I think the testimony shows that it was held in reserve, as I remember it.

Mr. SWAREN. Yes, sir.

Mr. HARTSON. You told the committee, I think, that you were not present at any conferences following the conference which was reported by you on November 18th?

Mr. SWAREN. I do not recall making that statement. To the best of my recollection, that is true, but if I were present at any of the other conferences, my presence was very very brief.

Mr. HARTSON. The change of the basis for determining this value in use was given you by Major De La Mater and was not concurred in by you?

Mr. SWAREN. Not fully.

Mr. HARTSON. But—and I want to have you be very specific on this—by reason of certain other facts which came to your knowledge during the investigation, you felt that the result which was reached by this adjustment, the technicalities of which you did not agree with, was not unconscionable, and was probably meeting the equities of the Berwind-White case?

Mr. SWAREN. I felt it did not meet the equities of the Berwind-White case, that the Berwind-White company was entitled, if they cared to go to the expense of setting up additional claims, to a great deal more amortization than they claimed. I feel that it was a very favorable compromise for the Government.

Mr. HARTSON. I think that is all.

Mr. MANSON. Did the Berwind-White Coal Mining Co. claim amortization on anything except this power plant?

Mr. SWAREN. No, sir.

Mr. HARTSON. And yet, as I understand you, they had property on which amortization could have been claimed, and on which the Government would no doubt have been compelled to allow amortization?

Mr. SWAREN. That is my belief.

Mr. HARTSON. And which they made no claim for.

Senator JONES of New Mexico. Tell us what that was.

Mr. SWAREN. I did not investigate that carefully, because I did not care to go out of the purview of my investigations, but it consisted, in a general way, of mining machines, locomotives, mine cars, and increased mine development—features of that sort, running into very large expenditures. Now, how much of that had been put into the capital account I did not analyze their balance sheets far enough to determine.

Mr. MANSON. Did you find that property in use when you were examining the property?

Mr. SWAREN. I did not examine them for that purpose.

Mr. MANSON. But you do not know but what it may have been all in use.

Mr. SWAREN. I have no way of knowing. As a matter of fact, I have tried to avoid making any inquiries relative to their business, except as it specifically affected this particular power plant.

The CHAIRMAN. At that point, it seems to me that your conclusions are rather rash. You conclude that the equities of the case justify them in claiming amortization on certain other new equipment, and in view of the fact that you did not know whether that equipment was in use or not, it seems to me that your conclusions are rather rash.

Mr. SWAREN. Well, it very probably was not in use, because the mines were all shut down while I was there.

Mr. MANSON. There was a strike on while you were making this examination?

Mr. SWAREN. Yes, sir.

Senator JONES of New Mexico. I would like to know further whether, in order to satisfy your judgment and conscience in the matter, you did take into consideration any of these other so-called equities of the Berwind-White Co. in arriving at the amount that they were allowed.

Mr. SWAREN. It lessened my tendency to combat Major De La Mater's ruling. Of course, I did look at the balance sheets which were submitted with the returns, but I do not recall how much the capital accounts, particularly the plant and equipment accounts, would increase during 1917 and 1918, but I do recall that there was some increase in those capital accounts.

Senator JONES of New Mexico. Then, are we to understand that the engineers in the bureau go outside of the briefs and outside of the claims and take into consideration the general phase of which they may have a smattering idea and use your own knowledge in a settlement of these claims?

Mr. SWAREN. I believe that that might occur at times; yes.

Senator JONES of New Mexico. Well, do you think it is quite the right thing to do it?

Mr. SWAREN. I believe that under the amortization law the commission has very broad powers of discretion in the matter of the settlement of amortization.

Senator JONES of New Mexico. Well, I know he has, but do you think it is right to do it in a case of this sort? Here you refer to things which, if I understood you correctly, you used in order to ease your conscience in giving the taxpayer some advantage in this settlement, where those matters were not presented to the Government by the taxpayer, and of which you had no specific information. Do you think that is the right thing to have done?

Mr. SWAREN. In many cases I think it would be.

The CHAIRMAN. I wish the witness would answer the question yes or no. We are not talking about other cases. We are talking about this particular case.

Mr. SWAREN. Well, in this case I certainly do, Senator.

Senator JONES of New Mexico. On the face of this statement I certainly disagree with you.

Mr. MANSON. Mr. Hartson asked you something which related to the postwar date as of which useful value was to be determined. What was the postwar date of which useful value was to be determined?

Mr. SWAREN. From March 4, 1921, to March 3, 1924, inclusive, were the dates that I always used in my determinations.

Mr. MANSON. Were those dates laid down by your superiors as the dates which you should use?

Mr. SWAREN. That is my understanding; yes.

The CHAIRMAN. At this point I think it might be enlightening to the committee to have the witness tell just what business he is engaged in at the present time.

Mr. SWAREN. Consulting engineer.

The CHAIRMAN. On your own account?

Mr. SWAREN. Yes, sir.

The CHAIRMAN. For private industry?

Mr. SWAREN. Yes, sir.

The CHAIRMAN. Have your activities brought you into contact with the bureau at all?

Mr. SWAREN. I have never appeared before the bureau in any way. I have prepared reports to be submitted to the bureau.

The CHAIRMAN. For private companies?

Mr. SWAREN. Yes, sir; but I have never appeared before the bureau in any way.

The CHAIRMAN. How long has it been since you left the bureau?

Mr. SWAREN. About a year and two months.

The CHAIRMAN. Can you tell us about how many cases you have presented to the bureau for consideration since that time?

Mr. SWAREN. Possibly five.

The CHAIRMAN. Did they embrace questions dealing with amortization and depreciation?

Mr. SWAREN. Yes, sir.

The CHAIRMAN. Your offices are maintained in Cleveland?

Mr. SWAREN. Yes, sir.

The CHAIRMAN. At what address?

Mr. SWAREN. 1236 Leader-News Building. That is not my individual office. It is an office set out with one of my clients.

The CHAIRMAN. You are not in partnership with anyone?

Mr. SWAREN. No, sir.

The CHAIRMAN. All by yourself?

Mr. SWAREN. Yes, sir.

The CHAIRMAN. Have you anything further, Mr. Hartson?

Mr. HARTSON. I have no further questions of this witness.

Mr. MANSON. That is all.

The CHAIRMAN. That is all, Mr. Swaren.

Mr. DAVIS. I might say, Mr. Chairman, that the next case to be presented is one in connection with which the engineers have not finished their final report in the matter. They will get that out this afternoon, so that we will be prepared to go ahead on it in the morning. That is the case of the Northwest Steel Co.

The CHAIRMAN. You are all through with the Standifer case, as I understand it?

Mr. DAVIS. Yes, sir.

The CHAIRMAN. Are you also through with the Standifer case, Mr. Hartson?

Mr. HARTSON. Yes, sir.

The CHAIRMAN. I will ask Mr. Hartson if he will get such of his reports together as he desires, so that we may proceed with the Northwest Steel case to-morrow.

Mr. HARTSON. Very well, sir.

The CHAIRMAN. And if agreeable to Senator Jones, we will adjourn here until 10 o'clock to-morrow morning.

Mr. HARTSON. Before adjourning, I want to make one statement. Mr. Tandrow tells me that the brief does not contain the statement of this claim concerning which Mr. Swaren testified, as to the different type of machine that might have been installed, but was not installed. He made mention of an Allis-Chalmers machine and a General Electric machine. So far as Mr. Tandrow is able to determine, there was no such claim.

Mr. MANSON. You are referring now to the Berwind-White case?

Mr. HARTSON. Yes; I am referring to the Berwind-White case.

The CHAIRMAN. In other words, that is a statement that, perhaps, was brought out in conference?

Mr. HARTSON. It is quite possible that it was orally presented, but there is nothing, in so far as the brief goes, which indicates that it came up, or that it was contended for by the taxpayer.

The CHAIRMAN. Would it not be wisdom on the part of the bureau if they made a record of these oral claims in the bureau, for future consideration of this kind?

Mr. HARTSON. It would be extremely wise, Senator. The human element, however, enters into it, and due to the tremendous number of conferences that go on there all the time, and by reason of new things which come up and engage the attention of the men who have just been in conference, frequently through negligence there is not a proper record made of a conference.

Mr. DAVIS. Would it not be well to have the testimony of the witnesses in the conference as taken and a record made of it?

Mr. HARTSON. In my judgment, it would almost warrant the expense involved if court reporters were present at every conference of the bureau representatives with the taxpayers. I have always thought so, but there are so many conferences going on down there that the expense would be very large, and the amount of irrelevant testimony that would be taken would be tremendous. It has been a question with those in executive positions in the bureau to determine whether that would be wise.

Senator JONES of New Mexico. Let me inquire at this point: Do you not also believe that it would be a good idea to eliminate these informal conferences altogether and prevent attorneys running in there and asking about this thing and that thing and the other thing? Would it not be a good idea to eliminate that and have nothing but formal conferences?

Mr. HARTSON. It would be an excellent idea—an excellent idea.

Senator JONES of New Mexico. I quite agree with you. I recall very well my experience in regard to that sort of thing, and I undertook to stop it in the legal bureau of the Interior Department. I also stopped clients from coming to me and inquiring when this case would be disposed of and when they might expect a decision, and all that sort of thing. I gave them to understand that as to all such matters they should view the department in the same light that they would a regularly constituted court and that all proceedings should be formal, and should be so treated. I did that, for two reasons; first, I thought it interfered with the efficiency of the

people working in the department, that it was a continual waste of time in discussing with the people who have business before the department these matters. Then, again, I think it lowers the dignity of the bureau and the judicial character that should surround all of this work. I believe that is a procedure there that you should be interested in correcting without delay, and I think perhaps the commissioner might issue a ruling prohibiting anything of that sort, and requiring that these conferences all be formal and at fixed dates, so that the people who are to participate in the conference may regulate their other work so as to be present and have the matter in hand which is to be discussed. But these informal, so-called, conferences, which really amount to the attorneys for claimants, or the claimants themselves, coming in, hoping that their presence may result in quicker action or more favorable action; or that they may create a friendly feeling, or something of that sort, it seems to me ought not to be tolerated.

I am just making this as a suggestion, but it does seem to me that the bureau itself will be glad to bring about some different situation.

Mr. HARTSON. I want the record to show, too, Senator, that in that regard, those have been the instructions of the commissioner. This thing has been up for discussion and decision by the commissioner a great many times. The very thing that the Senator has commented on, the continual interruption of bureau work by men informally coming in and wanting to discuss a case, has been entirely eliminated, so far as men doing original work on the cases are concerned; but one of the prinicpal duties of the chiefs of the sections is to interview people and talk with them, and, in a sense, keep them away from the men who are doing what I have described as original work on the cases.

There are specific instructions that only formal conferences be held, and that only one conference be held, and yet the practical difficulty in the way of putting that 100 per cent into effect is almost insuperable. These taxpayers are tremendously concerned about their cases, of course, and there are so many different elements and small details and items that constantly come up, that the taxpayer does not fairly present at the time of his conference, that he thinks the bureau is acting arbitrarily if the bureau decides it without giving him the opportunity of putting in the additional matters which he should properly have put in originally.

But the bureau, as I stated earlier in the hearing here, has been overly liberal in giving conferences. The attempt to cut down and eliminate the freedom of discussion by the taxpayer of his case in the bureau has resulted in what I have thought to be——

Senator JONES of New Mexico. I realize the difficulties in the way, but at the same time, I am quite convinced that the idea of an attorney or a client running continually to the people who are deciding a case, to discuss it and present it in a new way, or something of that sort, really disorganizes the work in the bureau, and even though taxpayers might not like it, it strikes me that the orderly conduct of the business of the Government requires that there be some system adopted, rather than the miscellaneous coming together and talking with this member of a conference or an engineer or the

employee who might be doing the work on a case. I thought that some law or some system might be inaugurated to cure that. I realize the difficulties in the way of having an absolute rigid system. It seems to me, if you must have some talk with these people about their conferences, or when you suggest a conference, you have one clerk whose duty it would be to look after those conferences alone, to see that the conferences are all orderly and they are set down at a definite time, when there will be a conference in a formal way.

Mr. MANSON. I think that is already true of formal conferences. I think they do that.

Senator JONES of New Mexico. Then, eliminate all of these informal conferences and have nothing but formal conferences.

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

FRIDAY, DECEMBER 19, 1924

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to call of the chairman.

Present: Senators Couzens (presiding), Watson, Jones of New Mexico, and Ernst.

Present also: Earl J. Davis, Esq., and L. C. Manson, Esq., of counsel for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. C. R. Nash, Assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, solicitor, Bureau of Internal Revenue; and Mr. S. M. Greenidge, head engineering division, Bureau of Internal Revenue.

The CHAIRMAN. Proceed, Mr. Davis.

Mr. DAVIS. You were to present some matters in reference to those commitments, Mr. Hartson.

Mr. HARTSON. Yes; I would like to call Mr. Tandrow.

TESTIMONY OF MR. W. S. TANDROW—Resumed

Mr. HARTSON. The Senators will remember that the point arose in the Berwind-White case as to the practice of the Department in permitting commitments to be accrued on books of corporations for the purpose of determining the amortization allowance to those corporations. I made the statement, as I recollect, during that discussion, that the Berwind-White case was not an unusual case, so far as this point is concerned, and the treatment of these commitments, and Mr. Manson then asked for a list of companies where the same practice had been followed with regard to commitments.

A search has been made by Mr. Tandrow and others working with him, and his report is not to be construed as being a complete report on all of the companies wherein commitments were considered in connection with amortization, but it is complete so far as we have been able, up to this time, to secure information on all the companies.

Mr. Tandrow will explain in detail what he has done and what the practice is.

The CHAIRMAN. Before you proceed on that, in order that I may understand it clearly, I would like to ask this question: The bureau allowed for commitments when the taxpayer kept an accrual on his books, that is, when he accrued his liabilities through commitments, but in cases where he did not make journal entries of his commit-

ments, or kept a book record of them, they were not allowed by the bureau; is that correct?

Mr. TANDROW. I would not say so, Senator, for the reason that appropriations are usually made to carry out construction work. Now, where an appropriation was made for war facilities, and the expenditures were not completed in 1918, in those cases that I have investigated, the taxpayer has claimed amortization on the unexpended part of the appropriation for the war facility. Although the expenditure did not, in fact, occur in the year 1918, the appropriation was made out of reserves for construction, and they have claimed amortization on such appropriations in the year 1918.

Mr. HARTSON. Was that done in the Berwind-White case?

Mr. TANDROW. Yes, sir; that is the circumstance in the Berwind-White case.

The CHAIRMAN. I think the testimony will show that you did not look it up to see whether the entire appropriation was spent. Did you?

Mr. HARTSON. We have further information on that, Senator. Since the hearing, Mr. Newton, the revenue agent who made the examination in the field, and who checked the costs of this company, has submitted a report, and Mr. Tandrow is prepared to give you the information contained in that report, so far as the actual expenditures of money by the Berwind-White Co. in the year 1918 went and so far as deliveries of materials in that year went, including also certain priority orders that the company had under the war administration here.

I think, before we get into the list of the other companies, it would be proper to report on the Berwind-White case, as to just what the facts were with regard to their accruals of these commitments.

Mr. TANDROW. In this reply of the revenue agent, it is stated as to why he made a reexamination of the books, and it appears that it was suggested by Mr. Parker, of the engineering staff of the committee. In the revenue agent's report, dated December 12, 1924, which I will read, the following statements are made:

Mr. GEORGE E. FLETCHER,
Internal Revenue Agent in Charge, Philadelphia, Pa.

SIR: Inclosed herewith are working papers showing my verification of 1918 costs with reference to Berwind-White Coal Mining Co.'s claim for amortization of war facilities. This is furnished in connection with question raised by the Senate investigating committee as to whether equipment ordered in 1918 and paid for in 1919 was amortizable as a 1918 addition.

An examination of this memorandum will show that 19 of the orders were paid in part or in full in 1918, and that of the others not paid for in 1918 some had been partly shipped, and that in some others priority sheets were included with order and shipments directed to be made in 1918 when possible. It is thought that this entire amount should be included in 1918 costs as originally recommended on the first audit of the case.

In compliance with Mr. L. H. Parker's request, the depreciation on plants 35–36 and 40 was as follows:

1917	$34,027.47
1918	34,027.47
1919	34,027.47

Mr. Parker's address is 410 Senate Office Building.

In forwarding this letter Mr. Nash suggests that it be marked "Attention of Mr. Nash."

Respectfully,

FREDERIC NEWTON,
Revenue Agent.

To that letter is attached a statement showing the costs of the various facilities on which the Berwind-White Co. claimed amortization. It shows that in the year 1918 $277,323.70 was charged out as actual expenditures for the war facilities. For the year 1919, $737,295.12 was charged.

However, in looking through the orders covering the property which went into the power plant or the war facility, it shows that, without exception, the material was ordered largely under priorities which were granted by the War Industries Board between June, 1918, and the latter part of 1918. In other words, this taxpayer was committed for these facilities entirely during the year 1918. Although the commitments break up, with the larger proportion in 1918, the actual, in fact, postings of expenditures show that the larger expenditure occurred in 1919, and the smaller in 1918.

The CHAIRMAN. In that connection I would like to ask whether the examination verified the actual expenditures, or whether it was just taken from the books of entry?

Mr. TANDROW. This report verifies the actual costs.

Mr. HARTSON. Mr. Tandrow has just read the figures, if I understand it correctly, as to the actual expenditures. Is that correct, Mr. Tandrow?

Mr. TANDROW. That is correct; that is, actual book costs.

Mr. MANSON. Mr. Tandrow, does Mr. Newton's report show how the liability on commitments was carried on the books of the Berwind-White Co., between the time the order was given and the time of shipment?

Mr. TANDROW. It does not directly, but my understanding—not from this report, but from other records in the files—is that when the Berwind-White people committed themselves to the purchase of certain equipment out of their reserve they set aside a fund to pay for the equipment when it was received; so that from one standpoint you might say the expenditures were made when the orders were placed. However, the money probably was not paid until sometime before delivery or on the date of delivery.

Mr. MANSON. Did they treat the contingent liability to pay for the goods, if delivered, as bills payable?

Mr. TANDROW. I am assuming that they did. I would not like to state that to be a fact.

Mr. MANSON. Well, let us take this situation: They ordered these two large generators?

Mr. TANDROW. Yes.

Mr. MANSON. Those generators doubtless had to be manufactured?

Mr. TANDROW. Yes.

Mr. MANSON. If the Berwind-White people, when they gave that order, treated those generators as bills payable, would they set up on their books those generators as an asset, to offset that liability?

Mr. TANDROW. They really would not have any assets; they would have a commitment under contract for the delivery of generators.

They would probably set up in their property account a suspense account covering materials to be delivered, and as the progressive payments were made against those generators, they would charge in this suspense account those payments, until the generators were delivered finally. Then they would transfer that suspense account to a definite property account.

The CHAIRMAN. I would like to ask you right there, Mr. Tandrow, if such a practice of setting up liabilities for purchases is not an unusual practice? In all of my experience I have not seen where they have been set up as a liability on the corporation's books.

Mr. TANDROW. My experience has been just to the contrary, Senator. On all the construction work on which I have been engaged, it is the usual practice of corporations to make an appropriation for construction work, and that appropriation, or the money for that appropriation, is charged against a suspense account.

The CHAIRMAN. That may be true. I am not questioning when the actual payment was made; but assuming that I order a million dollars worth of tires, for instance. Would you think that I should set up a million-dollar liability in the company's books for goods undelivered?

Mr. TANDROW. That material is of a different character from supplies and materials which go into construction work. Here we are dealing with materials that become part of a permanent property account, or become a property asset, while tires are expendable items, in the usual run of industrial organizations that use tires.

The CHAIRMAN. Let us put it another way. Suppose I order a $10,000 garage to be built, at a plant. Do you think the practice would be set up a $10,000 liability immediately I ordered that garage construction?

Mr. TANDROW. You would make an appropriation to cover that construction work, and although I may be wrong, while my experience might not have covered these cases that you have in mind, I have usually found that that appropriation would be credited to a suspense construction account. You see, the money would be actually taken from funds of the company and put into this suspense account. It would be, in fact, an expenditure when the contract was made, but as the construction work was carried on the cost to cover the component parts of your facility would be charges against this suspense account to offset the cash credit or or appropriation. Then, after the job was over, there would be a refund or an overassessment against the account to cover either an overexpenditure or an underexpenditure. That is the usual practice, I think, in accounting in the largest industries we have; that is, railroad work that I have in mind. That is the uniform practice prescribed by the Interstate Commerce Commission.

Mr. MANSON. Mr. Tandrow, these generators were ordered from the Allis-Chalmers Co.

Mr. TANDROW. Correct.

Mr. MANSON. Suppose the Allis-Chalmers Co., after it received this order, had gone into bankruptcy, and the trustee in bankruptcy refused to build the generators. Would you say that the amount which had been set up in the manner you have described, is still a liability?

Mr. TANDROW. Any costs would be changed to profit and loss, with a company going into bankruptcy, necessitating the cancellation of commitment outstanding against it.

Mr. MANSON. If you had not paid anything on these generators, but the company from which you ordered them, however, had gone into bankkruptcy, what becomes of your liability?

Mr. TANDROW. It would be wiped off the books.

Mr. MANSON. It would be wiped off the books?

Mr. TANDROW. Yes.

Mr. MANSON. Suppose they had strikes, and they were unable to build the generators. You would just wipe it off the books, would you not?

Mr. TANDROW. We are dealing, I think, in theorem. Of course, the fact in this case was that the Allis-Chalmers Co. carried through its obligation.

Mr. MANSON. Yes; but we are going back to the time of the order, and we are trying to determine whether at that time there was any expenditure. We are going back of what the bureau did in spreading amortization.

The CHAIRMAN. I do not think that is just relevant. What we are trying to get at here is that money was actually expended in this particular case, and whether that was the policy of the bureau in dealing with all cases, where the taxpayer was given for commitments on war materials.

Mr. MANSON. I would like to say, right at that point, without going further into this examination, that Mr. Tandrow has said that it is the custom of corporations to treat commitments as liabilities. I wish to take issue with that, and point out the absurdity of any such practice. In the first instance where an order is given for any material, if it be raw material or manufactured equipment of any description, the transaction which results is merely a contingent liability. It does not result in a fixed liability.

The CHAIRMAN. I agree with that, from the thousands of financial statements that I have examined for the extension of credit with banks or trust companies. I never saw a single solitary item set up as a contingent liability.

Mr. MANSON. These suspense accounts that Mr. Tandrow talks about are mere memorandum accounts.

The CHAIRMAN. Yes, but if the taxpayer had issued a financial statement at that particular time for the purpose of extending credit, or had filed a statement with the Secretary of State, he never would have had that item; and you can not find now a statement published by the Berwind-White Co. where they set up a contingent liability of that kind, because it is obvious that it would absolutely upset your entire statement, because they would have no property value to represent the liability, and therefore the ratio of debts to assets would be out of all proportion.

Mr. MANSON. I want to point out that at the time this order was given all equipment of this class was going up in price; it was on an ascending market. If the Berwind-White Co. had canceled this order six months after it was given, the Allis-Chalmers Co. would have been compelled to prove that they could not sell those generators to anybody else at the price the Berwind-White Co. had agreed to pay for them before they made them without the Berwind-White

Co. having lost a nickel, and such a condition as that did not exist. As a matter of fact, there was no liability there until the generators had been placed on cars for shipment to the Berwind-White Co.

The CHAIRMAN. Yes; but the developments after that time show that they did actually have a couple of commitments?

Mr. MANSON. Oh, yes.

The CHAIRMAN. I am not questioning that policy, except as I understand it is in contradiction of their own rules, or in contradiction of the statute. I am particularly interested in finding out whether they gave other taxpayers like consideration.

Mr. MANSON. I want to call the committee's attention to the following provision of Article 183, Regulations 62:

> In the case of facilities, the constuction, erection, installation, or acquisition of which was commenced before April 6, 1917, and completed subsequent to that date, amortization will be allowed with respect only to that part of the cost incurred on or after April 6, 1917, and which was (or should have been) properly entered on the books of the taxpayer on or after that date.

Now, do you know, Mr. Tandrow, whether or not it is the practice of the bureau, in cases where facilities were ordered before April 6, 1917—ordered in 1916, and paid for in 1917—to distribute amortization there on the basis of the payment in 1917, or the basis of the commitment in 1916?

Mr. TANDROW. It is on the basis of actual costs incurred after April 6, 1917.

Mr. MANSON. Would you consider in that instance, that if a taxpayer had ordered equipment in 1916 to be erected in 1917 the cost was incurred in 1916 or in 1917?

Mr. TANDROW. You are dealing with an entirely different situation.

Mr. MANSON. Well, I am dealing with this thing.

Mr. TANDROW You are going back to 1916, and the United States did not enter the war until 1917.

Mr. MANSON. That is exactly what I am trying to get at. What I want to know is whether you have carried your policy out consistently by denying amortization to taxpayers who ordered facilities in 1916, which were not paid for until 1917. If the position of the bureau with respect to the spread of amortization on the basis of commitments is correct, then, of course, when an order is given in 1916, in the language of this regulation, the property should be entered on the books in 1916, instead of in 1917.

Have you carried this policy of spreading amortization through consistently by denying the taxpayers who ordered facilities in 1916 amortization, because of the fact that they had ordered them in 1916?

Mr. TANDROW. Well, just consider this, that prior to April 6, 1917, the United States had not entered the war. That is absolute evidence that any commitments prior to April 6, 1917, were not for the prosecution of the war against the German Government, in so far as we were concerned. Therefore, you should not include commitments. But after April 6, 1917, I believe the majority of the industries of the United States devoted their industrial efforts to production for the Government of the United States first. So we have a concern which had in process construction work for the production of any article, and after April 6, 1917, that construction

was carried to its completion. We think in that case he is rightfully entitled to the cost, because there was a conversion of purpose at April 6, 1917, from general production to specific production for the Government of the United States. He is not entitled, when his commitments were incurred prior to April 6, to amortization, but he is entitled to costs after April 6.

Just take it the other way——

The CHAIRMAN. That is certainly giving it to the taxpayer, both coming and going.

Mr. MANSON. Is that the witness' answer to my question?

The CHAIRMAN. He has said so.

Mr. TANDROW. I have not fully covered the point.

On the other hand, between April 6, 1917, and November, 1918, the taxpayers, for economic purposes, or because of a desire to further the prosecution of the war by the Government of the United States, assumed many liabilities for construction work for the purpose of producing articles for this Government. The war terminated on November 11. They had these outstanding commitments at November 11 that they could not cancel without going to great expense.

Senator JONES of New Mexico. Right there, did you inquire into this question as to whether they could cancel them without great expense or not?

Mr. TANDROW. In this particular case, Senator, I have not made a field examination. I do not know the character of the physical facilities, but I would say, just from reading the files and knowing how work was progressing on this construction, it would have been common sense for those people to have completed the facility.

Senator JONES of New Mexico. It may have been common sense if they wanted to use the facility thereafter; but so far as the Government is concerned, would it have been common sense for them to go ahead and purchase generators when the order could have been canceled without any loss whatever?

Mr. TANDROW. Let me answer that in this way: In this particular case, after the close of the war—in 1920, in fact—this company purchased a 10,000-kilowatt generator for the cost of a 5,000-kilowatt generator. The only reason that they were able to purchase the 10,000-kilowatt generator for the cost of the 5,000-kilowatt generator was that the Norfolk & Western Railway had ordered the 10,000-kilowatt generator to carry out plans of enlargement in connection with its participation in war work. After the war terminated the railroad was willing to cancel the contract for that turbo-generator. These people were able to purchase it for approximately one-half of its original contract price.

Senator JONES of New Mexico. When did they make that trade on that particular generator?

Mr. TANDROW. In 1920.

Senator JONES of New Mexico. Did they claim amortization on that?

Mr. TANDROW. No; that is not included in the claim.

Senator JONES of New Mexico. You are using that simply as an illustration?

Mr. TANDROW. Yes.

Senator JONES of New Mexico. It appears that in this case the actual expenditure on those plants that are to be amortized was only about $34,000 in 1918, was it not?

Mr. TANDROW. No.

Senator JONES of New Mexico. $200,000 and some odd?

Mr. TANDROW. Yes; $277,000.

Senator JONES of New Mexico. Yes; $277,000, and the property which was purchased in 1919 was what? What did the $277,000 go into?

Mr. TANDROW. The $277,000 went into the preliminary construction work, I am assuming, such as foundations and steelwork, for the purpose of preparing their power house to receive this equipment.

Senator JONES of New Mexico. When did they actually make the contract for the equipment?

Mr. TANDROW. The contracts were made running from July, 1918, up to the latter part of 1918.

Senator JONES of New Mexico. I know, but——

Mr. TANDROW. This specific generator, the generating equipment, was contracted for in July, 1918, under a priority issued by the War Industries Board. They entered into the contract with the Allis-Chalmers people for the equipment at a stipulated price. When the war terminated, on November 11, the work in the Allis-Chalmers plant had progressed on that equipment to a substantial extent.

Senator JONES of New Mexico. What was the marketable value of the equipment in 1919, when they actually received it?

Mr. TANDROW. Just reasoning from the fact that they purchased a similar turbo-generator later for half its cost in 1920, I would say probably 50 per cent, by discounting their obligations 50 per cent, such as the Norfolk & Western Railroad did.

Senator JONES of New Mexico. The Norfolk & Western Railway took a loss of 50 per cent on that same thing, did they?

Mr. TANDROW. Yes.

Senator JONES of New Mexico. Well, what was the loss to these people who purchased it at a discount of 50 per cent?

Mr. TANDROW. That is it, but this equipment purchased from the Norfolk & Western Railway was not acquired until 1920.

The CHAIRMAN. And was not amortized?

Senator JONES of New Mexico. No.

Mr. TANDROW. I am reasoning from that transaction back to this.

Senator JONES of New Mexico. Why do you have to reason back? What we want to get at are the facts. We want to know what they were.

Mr. TANDROW. Answering the question of the Senator, he asked what this particular company would have lost had it canceled its commissions, rather than to have continued their construction.

Senator JONES of New Mexico. Yes; that is what I am after. Do you know, as a matter of fact, or have you investigated that question to get at the facts, or must you indulge in reasoning, as you call it?

Mr. TANDROW. Yes; we certainly have to, Senator, for——

Senator JONES of New Mexico. Hold on, now. The important thing for us to know is how you did handle those things—by merely reasoninig it out, or did you attempt to find out what the facts were?

Mr. TANDROW. Of course, the engineer that reported in this case went very carefully into the facts.

Senator JONES of New Mexico. What facts did he find out about it? What did he find out about the marketable value of the commitments and the products which he had agreed to purchase? If he had not bought it, what would have been done with it? Could it have been disposed of for the amount that he had agreed to pay for it?

Mr. TANDROW. No.

Senator JONES of New Mexico. Were those facts ascertained?

Mr. TANDROW. Well, I would not speak for the engineer, but I know this, that in every——

Senator JONES of New Mexico. Hold on. I want to know whether those facts were ascertained in this case or not.

Mr. TANDROW. No.

Senator JONES of New Mexico. Well, that answers the question. You did not undertake to make inquiry then, into what could have been obtained for the article, but you just allowed him to go ahead and complete the examination and took his amortization on it, assuming a loss?

Mr. TANDROW. Correct.

Senator JONES of New Mexico. When, on ascertaining the facts, there was no loss at all, or all loss could have been avoided by selling the property to somebody else, but those questions you did not go into?

Mr. TANDROW. I did not, but I will venture to say that the engineer who covered this case in the field gave that very serious consideration.

Senator JONES of New Mexico. But I do not want any assumption from you. I want to know what the record shows as to the facts. Did he make his report on that question?

Mr. TANDROW. Not specifically. It is the usual practice, for that to be considered, though, Senator; that is, as to whether or not it is——

Senator JONES. Then, why did he not consider it in this case, and why did he not report it?

Mr. TANDROW. He doubtless did consider it, but did not embody his reasoning, as I said before, in this report, because he allowed amortization on 1919 expenditures.

Senator JONES. Do you not think, in settling that question of amortization, you should consider what could have been saved in the transaction by canceling the contracts altogether?

Mr. TANDROW. Yes, sir.

Senator JONES. And that was not done in this case?

Mr. TANDROW. Of course, I can not speak for the engineer who made the report. It is usual to consider that feature of every claim.

Senator JONES. The people who deal with amortization are circumscribed by the report. They have nothing before them except the report, and if the engineer fails to make any report on that point, how could the officials of the bureau dealing with this case consider that at all, unless they had something before them?

Mr. TANDROW. I will just answer that, if you would like to have me answer it, from the standpoint of an engineer who has had considerable experience on amortization work.

Senator ERNST. Give as full an explanation as you want to make concerning it.

Mr. TANDROW. If an engineer embodied in the amortization reports all the information secured during an investigation, it would require, I would say, months and months of time to prepare a report on one case. You have opportunities for making a great many studies of these various claims, and after experience, of course, you are able to judge how a case shall be best handled. You consider it from one standpoint and reason that it is not proper to recommend amortization on that basis. You consider it from another standpoint, and you may take into consideration a hundred different factors, but in coming to a conclusion as to how that claim is to be properly handled, you may have to discard many features that should be considered. From the engineers standpoint, that information is absolutely extraneous to the recommendation that you are going to make, so that you do not encumber the files and the report, assuming that your are honestly fulfilling your obligation as an officer of the Government of the United States. You do not embody all of the extraneous information, but you prepare your report on the most logical and most reasonable basis upon which amortization shall be allowed. That is, not including a great many other considerations that have been given to the case, you make your recommendation. It is to your mind a very honest report.

It goes in, and it is read by reviewers. You may be questioned. I have been questioned; I have had reports held up as long as eight months before I could finally convince a reviewer that my conclusions were correct. It is passed on to the chief of section, and he will question certain details in that report, until finally you have your report approved. That report will deal with the allowances upon one basis prescribed in the regulations, although, in reaching that conclusion, you might have considered a dozen, or even a hundred different factors in arriving at your recommendation.

Senator JONES of New Mexico. I am very glad you made that explanation, and I have felt all along that that was quite true, necessarily so.

Now, if that be true, by what sense of justice should reviewing officers overturn an engineer's report when he has taken into consideration in the field all of these extraneous circumstances which you have illustrated, and undertakes to make some sort of adjustment, ironclad, arbitrary, on the basis on which the engineer finally reported amortization should be allowed? In other words, if in this very case the engineer had suspected that a large allowance for amortization on the basis finally adopted should have been had would he not probably have suggested this other theory of amortization which was not reported but which he did take into consideration in making his report? You have intimated that probably the engineer in this case concluded that these materials or these machines could have been disposed of after the war without a loss, but inasmuch as they were not disposed of and were installed, he concluded to allow amortization on the basis of 80 per cent in use. That prob-

ably would have been a fair thing if the engineer's report had been carried out in full, but when you reduce that percentage in use to 35 per cent, or whatever it was, then that would be wholly out of line with the amortization on the theory of what it should have been if the facility had been disposed of or if the contracts had been cancelled. Therefore does not that indicate that the system down there is wrong in overturning these engineers' reports?

Mr. TANDROW. Answering for myself, Senator, I would say no; that the system is very good; that is to say, where we have one reviewer to contend with it might be much better if we had a half a dozen reviewers to contend with, for the reason that the larger number of engineers that you have review the reports the more nearly correct the results are going to be I believe. As it is now, we only have one reviewer who must pass upon our reports.

Mr. HARTSON. These reviewers that you speak of are engineers, are they, Mr. Tandrow?

Mr. TANDROW. Yes; they are engineer reviewers.

In my own experience in many cases I have modified my recommendations at the suggestion of the reviewer, for the reason that I was definitely shown to be in error in my first recommendation. That has not happened in one case, but in a great many cases, and my position is that the greater the consideration the broader the consideration that is given to a report, even though you have to modify your recommendations, the more equitable treatment is the result.

I would not say that simply because a reviewing engineer has not seen the property in the field, and has not considered all of these figures, his suggestions should not be given consideration. He will look at your report from the standpoint of the law and regulations more than from the practical features with which an engineer has to deal in the field; so that you get your reports more nearly to conform with the requirements of the law and the regulations by having those reviews, and I believe you give the taxpayer fairer treatment because an engineer covering a case in the field may have controversies with the taxpayer, just clashes of personality, which will mitigate against the taxpayer's claim. Those things the reviewing engineer will not have knowledge of.

Senator JONES of New Mexico. I am not at war with that idea at all about the utility of consultation with the engineers after you get into the office; but the point I had in mind was this: The engineers in the field, as you say, took into consideration the different plans on which amortization might have been adjusted, and came into the office with only that one plan. That plan might be upset by this reviewing or consulting engineer in the department, and he may lose sight of the very consideration which induced the basis of amortization recommended by the field engineer. I am just wondering whether that is not wrong. In this case it would seem that it would have been favorable to all parties, and especially to the Government, to have amortized this claim on the basis of the value of the property undelivered, and to have allowed amortization, perhaps, on the whole of what had been spent in 1918.

May I ask what would have been the difference in the settlement of the claim to the government had that course been pursued, if the contract had been conceled on November 11, 1918, and the Berwind-

White Co. had stood responsible for any damages to the contractor, and it should have appeared that these machines could have been sold at the price which they had contracted to pay for them? What would have been the difference in the amount of the claim?

Mr. TANDROW. If you would treat this case on the basis of what the company could have canceled their obligations for—you see, they did not cancel their obligations. They carried their work to a state of completion.

Senator JONES of New Mexico. Well, assuming that they had done it.

Mr. TANDROW. Assuming that they had done it, it would have been necessary for the engineer to have proven absolutely by the use of theorem and on the basis of comparitives, how much this company would have lost through the cancellation of their contracts. You see, they did not cancel their contracts.

Senator JONES of New Mexico. That is true.

Mr. TANDROW. And that very point would have been subject to attack by the taxpayer. It would have been a moot question.

Senator JONES of New Mexico. But, hold on. Do not get away from my direct question as to what would be the difference if that had been done, assuming that there was no liability on the deferred contracts?

Mr. TANDROW. I could not answer that question.

Senator JONES. Would it have been a considerable sum?

Mr. TANDROW. Yes; I should say fifty per cent.

Senator JONES. Then, was it not important for the officials to have ascertained that?

Mr. TANDROW. Well, the determination would not have been a matter of facts, because the facts would not be ascertainable. It would have been purely an estimate.

Senator JONES of New Mexico. Why could not the facts have been ascertained?

Mr. TANDROW. For this reason, Senator, that it would have been necessary to determine the cost to the taxpayer of cancelling his obligations on November 11, 1918, when those obligations were not, in fact, canceled, but construction work, under commitments, was continued, and the plant was completed.

Senator JONES. Yes.

Mr. TANDROW. Now, it would have been a question as to how much it would have cost him on November 11, 1918, to have cancelled his obligations.

The CHAIRMAN. In other words, when you came to examine this claim, it was a considerable time after that period, so that it would be difficult to go back and find out what you could have done in your hypothetical case, probably a year or more back of the real figures, when you came to settle the case?

Mr. TANDROW. That is correct, and as the engineer did treat it, my judgment is that he followed a method that treated the facts as nearly as he possibly could, and that his method takes into account a greater number of known facts than any other method.

Senator JONES of New Mexico. But was it not important to know what contracts could have been canceled for and to have used that

as a factor in determining amortization on the claims as it was built up?

Mr. TANDROW. Yes; that is very important, Senator, and practically every engineer that handles a case, where commitments are completed for construction subsequent to the war, determines what it would have cost the taxpayer to have closed down his construction work and retired his commitments.

Senator JONES of New Mexico. What was ascertained in that respect in this case?

Mr. TANDROW. As I said before, Senator, the engineer that handled this case doubtless gave that consideration, but he did not report upon it, because all the factors that he took into consideration would probably have caused his report to cover 200 pages or more. We are simply working against time, and can not, because of the great number of cases that we handle, deal with every detail of the case that we consider in writing our reports.

Senator JONES of New Mexico. How could the consulting engineers, then, or the reviewing engineers, get a correct idea of the situation without such facts as that.

Mr. TANDROW. The reviewers are men of rather broad experience. The review is not so much a mattter of dealing with the particulars in a case, as it is the general principles, to be certain that an engineer, when writing his report, has not violated the prescription of law or regulations. Of course, there are practical features that will be treated in a report, as for example, a reviewing engineer, knowing the balance of costs between 1918 and 1919, will frequently question the allowance of amortization on 1919 costs, when they are out of proportion with the 1918 expenditures.

The CHAIRMAN. Is it not also a fact that many oral discussions go on between the reviewing engineer and the engineer in the field?

Mr. TANDROW. Oh, yes.

The CHAIRMAN. And they are not a matter of record.

Mr. TANDROW. That is true.

The CHAIRMAN. And it may be that some of the very questions that Senator Jones has raised were actually considered in the oral discussion of the case?

Mr. TANDROW. Yes, sir. For example, I have had a report running over a period of seven months, where we were discussing just orally the features in that report from day to day.

Senator JONES of New Mexico. Then, it is impossible for this committee to ascertain in any given case what facts were considered?

Mr. TANDROW. I think it would be impossible, Senator, to ascertain all of the facts that were considered, for the reason that a record is not made of a great deal of the discussion that is had over the different cases.

Senator JONES of New Mexico. Then, if that be so, why should this committee pursue its investigations any further?

Mr. TANDROW. I am not prepared to answer that question.

Senator JONES of New Mexico. If we can not go into a case and find out what the facts were and know how they were applied legally, it seems to me that we are up against a stone wall.

Mr. TANDROW. I think not, for the reason that the recommendations as they are made——

Senator JONES of New Mexico. Well, if we do not know the facts on which they were made, what does it avail us?

Mr. TANDROW. You will find the basis on which a recommendation has been made is covered in the engineer's report.

Mr. DAVIS. How does the reviewing engineer get at those facts? Does he go into conference with the engineer who made the report?

Mr. TANDROW. Of course, in every case there is a very voluminous file, and the practice is that the engineer will complete a report on an individual case. The entire file with his report will be turned over to the chief of section. The chief of section will pass the entire case, including the files and the engineer's report, to a reviewing engineer. The reviewing engineer will read the engineer's report and examine the files, examine the taxpayer's claim, and all material bearing upon the treatment of the case; and if the engineer's report does not appear to be reasonable, he will call the engineer into a conference, and the different features will be discussed. That quite frequently results in the engineer modifying his recommendations.

The CHAIRMAN. I think it is comparable, ofttimes, with the conclusions reached by a committee of the Senate, where they have discussions in committee, and write a report, and recommend a certain law, or approve a bill or disapprove a bill, where the actual records themselves do not show the reasoning that the Senate has used in arriving at their conclusions.

Senator JONES of New Mexico. If that be true, then are we not confronted with this very thing for consideration: Do we want these cases decided in the bureau in the way that the Senator has just outlined that a committee of the Senate would do, that you, without any record facts, have a few people in the bureau get together, discuss matters, and dispose of and fix an important tax liability?

Mr. HARTSON. If I may interrupt the Senator, I think the Senator has unfairly drawn an inference there which is not really the fact. This is the state of the record in this case and in the other cases, with very few exceptions, that the committee will go into: The reasoning and the facts in connection with the adjustment of the case are fairly presented. The reports of all conferences, however, are not completely made. There are a number of facts and a number of points that might have been considered, but which did not form the basis for the final adjustment of the case, that were entirely absent from the files.

Mr. Tandrow has said here that in this case the file is complete in justification of the final settlement on the basis that was used, but the Senator has raised the point that some other element, some other basis for amortization might have been used. The taxpayer might have scrapped his plant; in other words, cancelled his contracts and sold out and saved himself a loss, which would not have permitted him any amortization allowance. The fact is that he did not do that. The report does not contain a statement that the engineer considered that and based his recommendation on what the taxpayer might have done. His report is on a different theory. It

is quite possible that he did consider it. The theory on which the case was closed is fairly reported, and the facts are, I think, reasonably complete.

Senator JONES of New Mexico. I do not care to discuss the matter with counsel, but the witness has stated that in this case it would have been important, and the engineer in the field had taken into consideration the very question as to whether or not the cancellation of the contracts would have been the cheaper way. I think the witness very properly made that statement. I followed that through the record here by means of the witness, to show that there is nothing in the record to bear upon this very important factor, and from this the chairman of the committee drew the deduction that they were acting down there the same as a committee of the Senate would act in recommending legislation. It seems to me that if that is the case, it is a procedure which ought not to be approved.

I do not care to discuss the matter with counsel, but it certainly has been developed here that in these conferences and the engineer's reports matters are taken into consideration which do not appear upon the records. I think that is a very important thing to know.

Mr. MANSON. Mr. Tandrow, would not an engineer examining a plant be much more inclined to go into the question of the basis upon which the orders for plant equipment could be canceled if he were contemplating a 50 per cent in use than if he were contemplating an 80 per cent in use?

Mr. TANDROW. Well, I would not say that.

Mr. MANSON. Well, just a minute. Suppose a plant only has a 50 per cent use to the taxpayer. Would not that taxpayer have a great deal more advantage in paying a larger sum to cancel the contract than he would if the completed contract were going to be of 80 per cent use to him?

Mr. TANDROW. Your question assumes that these actions were taken for the purpose of benefiting by an amortization allowance.

The CHAIRMAN. I think the witness ought to answer the question. The counsel's question was very specific; it was a perfectly plain question and it could be answered yes or no. He asked whether the taxpayer would not be more interested in canceling his contract if he was contemplating that he would only get a 50 per cent use than if he were contemplating an 80 per cent use. I think that question could be answered yes or no, and without dealing with this specific case.

Mr. MANSON. Would he not be much more liable to cancel the contract for material that would be of no use to him after the war?

Mr. TANDROW. Yes, sir.

Mr. MANSON. Than he would be if it were going to be of value to him?

Mr. TANDROW. Yes, sir.

Mr. MANSON. Does not the same thing apply, in different degree, where it might be of 50 per cent use or where it might be of 80 per cent use?

Mr. TANDROW. The difficulty right there is that you can not lay down a standard to work by, but, stating it as a general proposition, what would be material in one case, if you were considering a certain type of equipment, would not be material in another case, be-

cause, with the closing of the war, utility entirely disappeared on many plants, as for example, a shipbuilding plant, whereas, on the other hand, materials that were purchased for war work, after the war, still possessed utility and positive value.

Mr. MANSON. Yes.

Mr. TANDROW. So you can not state, as a general proposition, any rule that would apply?

The CHAIRMAN. But the question of counsel did not deal with that matter at all, as to whether it had a utility value or not. If the concern was a going concern, which was going to continue in the business of using the same class of material, he certainly would think for himself and say, "Well, if I cancel this contract, I am equally as well off as though I continue it," or it might be the reverse, and he would say to himself, "I am going to get 60 per cent value out of that, so there is no use of my losing 50 per cent;" therefore, he decides to proceed with the conviction that he is going to save some money, and that he is going to be able finally to use the facility.

Mr. TANDROW. Of course, if the anticipated use that he has for a facility is law, he would prefer to cancel the commitments.

The CHAIRMAN. That is the point.

Mr. MANSON. That is what I want to get at. Under those conditions, then, do you not think that an engineer examining this property for the purpose of determining amortization would give a great deal more weight to the question of the liability which would arise on cancellation, if they anticipated a 50 per cent allowance for amortization, than he would if he anticipated an 80 per cent allowance for amortization?

Mr. TANDROW. Yes; I should say so.

Senator JONES of New Mexico. In other words, this engineer, when he went down there, made up his mind that the percentage in use was 80 per cent, and the difference did not amount to very much, so that he would naturally not inquire so carefully as to what would have been the result if the contract had been canceled, but if he saw he was up against only 50 per cent in use, then he would have examined the other question, perhaps, more carefully.

The CHAIRMAN. I think we are dealing with a matter which did not receive much consideration by the engineer, as a matter of fact, because I think he went down there a very considerable period after the war, and after the plant was installed and in operation, and did not take into consideration the question of cancellation at all. I think he really took into consideration only the exact conditions that existed.

Mr. TANDROW. I would like to say in respect to that, that where the amount claimed by a taxpayer for amortization is 60 per cent or less, the question of cancellation does not enter into it, because I will venture to say that if we could tabulate the expense or the cost of canceling contracts we would find that it would run to 60 per cent of the commitments, where the work contracted for was substantially in progress.

The CHAIRMAN. I think also, in considering these cases, you have to go further back than in dealing with the immediate case, because I can visualize that the Allis-Chalmers Co. would have a larger amortization claim if the order had been canceled than if it had been

permitted to continue. It is a conclusive fact that there was a larger percentage of the Allis-Chalmers plant in use as a result of not canceling the contract than would have been in use had the contract been canceled.

Mr. TANDROW. Correct.

Mr. MANSON. Provided they did not discard the years 1919 and 1920 for the purpose of determining the Allis-Chalmers amortization.

The CHAIRMAN. In any event, no matter what they considered, as a matter of practice, the plant of the Allis-Chalmers Co. was much more in use as the result of continuing this contract; and you could go back farther to the plant that sold to the Allis-Chalmers Co. their materials. That plant would have been more in use than if the order had been cancelled. In that way, you could go back through the whole succession of industries involved in that particular order, and you have to get to a jumping off place somewhere.

Mr. MANSON. Before I forget it, I would like to give notice to the Bureau, in view of the fact that they have my objections in the Steel company case under consideration, that I will offer a further objection, based upon their present attitude with respect to the spread of amortization; the further objection being that a large part of the amortization cost of the United States Steel Co. goes to that equipment which was ordered and work upon which was started prior to 1916.

The CHAIRMAN. Before we get into a discussion of that, I would like to have this witness put into the record here these other cases they were to have looked up for us.

Mr. HARTSON. I have a question or two, Mr. Chairman, that I would like to ask the witness before he comes to that.

Mr. MANSON. I just said that in order that the representatives of the bureau might have notice.

The CHAIRMAN. Yes.

Mr. HARTSON. I believe you had not completed reading Mr. Newton's report. You had read, as I understand it, into the record, a report from him wherein he said that $277,000 was actually paid on these contracts in 1918. Now, have you any report, with particular reference to deliveries of material that were made in 1918 on these contracts?

Mr. TANDROW. Yes; opposite each item there is a statement showing the date of shipment, or date of receipt of the different items of material.

Mr. HARTSON. Unless the committee disagrees with me, I do not think it is necessary to read those detailed itemized statements, but I think it would be material to determine the aggregate amount of the material which was delivered in the year 1918.

The CHAIRMAN. You are assuming that there was more material delivered in value than was paid for in money?

Mr. HARTSON. Yes.

Mr. TANDROW. Substantially all of the material was delivered in 1918.

The CHAIRMAN. I think that statement is important, but I do not think we need go into the amounts.

Senator JONES of New Mexico. When was that report made up?

Mr. TANDROW. This is the result of an examination made in the office of the taxpayer by a revenue agent on December 12, 1924.

Senator JONES of New Mexico. Do you mean to say that these things were not ascertained until this committee began its investigations?

Mr. TANDROW. As I said before, these features were doubtless inquired into by the engineer who made the field examination, but they were not embodied in his report. He undoubtedly had a knowledge as to when these various materials were delivered.

Senator JONES of New Mexico. You say that they were practically all delivered in 1918?

Mr. TANDROW. According to the report of the revenue agent, yes sir.

The CHAIRMAN. Go ahead, Mr. Hartson. Do you want to ask him any further questions, or do you want him to put in the names of those other concerns, now?

Mr. HARTSON. I have not any more questions. I think he should proceed now and put in the names of those other companies.

Senator JONES of New Mexico. Just a minute. Is not that one of the most important facts which have been presented in this case?

Mr. TANDROW. No doubt it is, Senator.

Senator JONES. Why should it not have appeared in the report?

Mr. TANDROW. In the engineer's report?

Senator JONES of New Mexico. Yes, the fact that material was delivered in 1918?

Mr. TANDROW. In the original claim, as I remember it, there were several thousands of items of property, that is, several thousand cost items. The engineer doubtless had an understanding as to when lumps or groups of property were delivered, but I believe it would have been impracticable for him to have indicated the date of delivery of each individual item.

Senator JONES of New Mexico. Perhaps not each individual item: but the total—should not that have been presented?

The CHAIRMAN. In answer to Senator Jones, I would like to say that, in view of the fact that the policy of the department was to allow commitments, it is not so material whether it was delivered or not. As a matter of fact, they used commitments, whether it was delivered or not. Therefore, the question is not so important.

Mr. MANSON. I wish to say, however (and I am familiar with the engineer's report) that the engineer stated the amount of money expended during each of those years, and took the position that the bureau regulation meant what it said, and called the attention of the auditors who were going to make the spread of the amortization to the fact that the amortization as spread in the claim was not in accordance with the regulation, but he gave him the basis upon which it should be spread.

Mr. TANDROW. I may have misunderstood your statement, but I disagree with you, for the reason that the engineers have substantially agreed upon the cost. The engineers who have reported on this case, Messrs. Woolson and Moore, have reported, as I remember it, a cost of $616,000 in 1918, and the difference between $616,000 and $828,000 as cost in 1919. They recommended in their report that all costs be checked up by the auditor or revenue agent. So far as

the engineers are concerned, there was no substantial disagreement as to the cost distributions.

Mr. MANSON. That report will speak for itself. It is in evidence, and I have stated my recollection of it.

Mr. TANDROW. I do not believe the original report, so far as costs are concerned—at least not to my knowledge—has ever been made a part of the record; but I do know that throughout several reports that were made there was no disagreement as to the distribution of costs between the years.

The CHAIRMAN. You might proceed now and put in those cases.

Mr. TANDROW. The list that I have here is a very incomplete list and is the result of several hours work. I am sure that there are in the files a great many other cases. Engineers are now looking through the various claims to get as nearly as possible a complete list.

Mr. HARTSON. What does such a search entail, Mr. Tandrow? I mean, how would you proceed to hunt for cases wherein this adjustment and basis had been used in determining amortization?

Mr. TANDROW. It will be necessary to go into the original claims filed by the taxpayers to determine how their costs are set up, whether on a priority basis or a direct cost basis. That will necessitate looking through several thousand books or claims; so it will require considerable time.

This is just a statement of cases where amortization has been allowed on commitments entered into prior to the armistice, where actual costs were not incurred until subsequent years.

The first taxpayer is Jones & Laughlin Steel Co., Pittsburgh, Pa.; engineer's report submitted October 24, 1923, by W. M. Nolan; total costs involved, $28,193,771.08.

The second is the Midvale Steel & Ordnance Co., of New York; report submitted February 18, 1924, by Mr. L. E. Luce; total cost, $24,928,520.34.

The third case is that of E. I. du Pont de Nemours Co., Wilmington, Del.; report submitted May 24, 1923, by Engineer A. H. Wellinseik; total cost, $25,601,464.69.

The fourth case is that of the American Steel & Wire Co., Cleveland, Ohio; report submitted by H. A. Whitney and Felder Furlow, with costs of $16,915,995.98.

That represents approximately $100,000,000 of costs.

Mr. DAVIS. What was the date of that last one? Did you give it?

Mr. TANDROW. I do not have the date on the last one.

The CHAIRMAN. I would like counsel for the committee to go into some of those cases to see whether the amount named is involved in commitments alone.

Have you anything further to present to-day, Mr. Hartson?

Mr. HARTSON. No, Mr. Chairman, I have not. This is the only report I had intended to put in to-day, and the only one that I agreed to put in.

The CHAIRMAN. Have you anything further that you want to take up to-day, Mr. Davis?

Mr. DAVIS. In connection with the other matters that our engineers are looking up, Mr. Chairman, they have reported that they are not ready to submit them, particularly with reference to the

individual returns in the Standifer matter, and the question you asked with reference to the profits on that contract.

Senator Jones asked a question about the checking up of amortization allowed by other contracting branches of the Government, with the internal revenue returns thereon. We have taken that up with other contracting branches of the Government. Lists are being prepared on that subject, and they will be submitted.

The CHAIRMAN. Mr. Manson, what is that case that you were to get from the engineers yesterday?

Mr. MANSON. The United States Graphite Case.

The CHAIRMAN. Will that be ready for to-morrow?

Mr. MANSON. I think that will be ready for to-morrow morning.

The CHAIRMAN. The bureau has information as to that?

Mr. HARTSON. Yes; in your letter received to-day, Mr. Senator, there was the statement made that that would probably be the next case taken up.

The CHAIRMAN. Who sent that letter?

Mr. HARTSON. Your committee. It was over your signature.

The CHAIRMAN. Mr. Hartson, I saw a statement in the press to the effect that Commissioner Blair has said that, in response to some criticisms of mine with regard to the workings of the bureau, that these amortization cases were only due to war conditions, and they would not come up again. There was the inference, practically, that Congress could not, therefore, or would not, do anything in connection with those particular cases, or deal with the subject of amortization.

Is it your contention, or the commissioner's contention, or do you know anything about it, as to whether Congress could remove the statute of limitation in these cases and reopen them, to make more plain the intent of Congress when it enacted the statute?

Mr. HARTSON. There is no question, Mr. Senator, in my mind, that the Congress may remove the limitation period and open up these old cases, or permit of such of them being opened up as have been barred in the meantime by the running of the statute of limitations.

The suggestion contained in the statement made by Commissioner Blair, which the Senator refers to, I believe, was not intended as a denial of the right of Congress to reopen these cases; but the point that was made there, if I read his statement correctly, was that the subje t of amortization was a war condition, brought about by peculiar circumstances which would not arise again.

The CHAIRMAN. I think that is correct, but I think the inference went with his statement that the committee was dealing in subjects which were really not relevant and were of no importance, so far as improvement in legislation was concerned, and that therefore the committee was wasting its time on this subject of amortization.

Mr. HARTSON. I did not gain that impression from a reading of the statement, Senator.

The CHAIRMAN. Does that reflect the answer that we are to get in connection with the Steel Corporation Case, which the solicitor is preparing now?

Mr. HARTSON. The statement that was issued by the commissioner had no bearing on the particular inquiries the committee is making of the bureau.

The CHAIRMAN. Did the solicitor see the statement made by the chairman of the Board of directors of the Steel Corporation, Mr. Gary, that the case is closed by the bureau?

Mr. HARTSON. I did.

The CHAIRMAN. Do you agree with that statement?

Mr. HARTSON. I read it in the papers, if that is what you mean.

The CHAIRMAN. Yes.

Mr. HARTSON. Do I agree with it?

The CHAIRMAN. Yes?

Mr. HARTSON. I do not.

The CHAIRMAN. What percentage of amortization cases have been closed?

Mr. HARTSON. I can not answer that, Mr. Manson. It may be that some one else can. The amortization section has been abolished, as you know, and that was done because a large volume of amortization work had been completed.

The CHAIRMAN. To put it in another way, then, can you tell us approximately the number of unsettled cases dealing with amortization?

Mr. GREENIDGE. Less than 800, sir.

Mr. MANSON. When you speak of unsettled cases, you mean cases that are in the status of the Steel Company case, where it has passed out of your division, Mr. Greenidge?

Mr. GREENIDGE. No, sir; they are in my division now.

Mr. MANSON. There are still in your division now 800 cases?

Mr. GREENIDGE. I can give you the exact figure to-morrow.

Mr. MANSON. In addition to that, there are a large number of amortization cases which have passed out of your division, but in which the bureau has not finally closed the cases?

Mr. GREENIDGE. Yes; there are a number. Just how many I would not be able to say.

The CHAIRMAN. Can you get us that information?

Mr. GREENIDGE. We will make every effort to get that.

The CHAIRMAN. And report to us to-morrow?

Mr. GREENIDGE. We will do everything we can to get it and report tomorrow.

Mr. MANSON. Will you also state the amount involved?

Mr. GREENIDGE. We will try to do it. We will get to work on it right away and go as far as we can by tomorrow.

Mr. HARTSON. I do not know how that information can be developed without searching through every corporation case that is still in the bureau, in which the corporation made any expenditures for the production of articles contributing to the prosecution of the war. There are some of them in the solicitor's office, there are some of them on the commissioner's desk; there are some of them on Mr. Bright's desk, and they are scattered all through the Bureau of Internal Revenue.

The CHAIRMAN. I appreciate that difficulty, Mr. Hartson, but I thought you might, for the purpose of giving us a view of the situation, generally reach the conclusion that in all of these corporation cases that are pending for the war years amortization would be involved.

Mr. HARTSON. I think a substantial portion of the corporation cases that are not closed for the war years have amortization claims in them.

The CHAIRMAN. Will you give us that total for the unsettled claims during that period of time? If you do that, I think that will serve the purpose, including the amortization cases.

Mr. MANSON. I am trying to determine whether we are holding a post-mortem here.

The CHAIRMAN. I think the Solicitor has answered that question, that we are not holding a post-mortem, that there might be a change in the statute, and that we might be able to correct what we believe is a wrong interpretation of the law. If I understand correctly counsel and some members of the committee, we do not believe that the bureau has carried out the intent of Congress with respect to the amortization section of the law.

Senator WATSON. Do you know how many amortization cases the bureau has dealt with altogether, or the amount involved? You could not answer that, could you, Mr. Hartson?

Mr. HARTSON. Not even in round numbers.

Senator WATSON. Not even the number?

Mr. HERING. I can give you a rough estimate of the number of cases, I think.

Mr. HARTSON. This is Mr. Hering talking.

Senator WATSON. Yes.

Mr. HERING. If you want me to.

The CHAIRMAN. Can you state it here?

Mr. HERING. Roughly, I think it is 5,000 cases; possibly more.

The CHAIRMAN. If that is all, we will adjourn until ten o'clock to-morrow morning.

Senator WATSON. But you could not give any guess at all, even a wild guess, as to the amounts involved?

Mr. HERING. Oh, no. When you say "the amount involved," do you mean the amount claimed or the amount allowed, or the costs claimed, or the costs allowed, or just what do you mean?

Senator WATSON. Both; the amounts claimed and the amounts allowed.

Mr. HERING. I prefer not to give offhand a figure on that.

Mr. MANSON. Would not that cover all of those 39 sheets that were supplied and summarized in the testimony taken last spring?

Mr. GREENIDGE. Yes, sir.

Mr. HERING. I think it was.

Mr. GREENIDGE. I wish to assure the Chairman that every effort possible will be made this afternoon and to-night to bring that up to date by to-morrow morning.

The CHAIRMAN. I think it is quite important, in a way, because it informs the committee really how much of the taxpayer's money is invested in private plants. It is my view that there has been a great deal of money invested in going plants as a result of the war.

If there is no objection, the committee will adjourn until 10 o'clock to-morrow morning.

(Whereupon, at 11.45 o'clock a. m., the committee adjourned until to-morrow, Saturday, December 20, 1924, at 10 o'clock a. m.)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

THURSDAY, DECEMBER 4, 1924

UNITED STATES SENATE,
SELECT COMMITTEE INVESTIGATING
THE INTERNAL REVENUE BUREAU,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to adjournment of yesterday.

Present: Senators Couzens (presiding), Watson, Jones of New Mexico, and Ernst.

Present also: Earl J. Davis, Esq., and L. C. Manson, Esq., of counsel for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. C. R. Nash, Assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, Solicitor, Internal Revenue Bureau.

The CHAIRMAN. Proceed, Mr. Davis.

Mr. DAVIS. The next matter that we desire to present to the committee is another case involving amortization, and is that of the G. M. Standifer Construction Co., of Portland, Oreg.

Mr. HARTSON. Mr. Davis, may I interrupt for just a moment?

Mr. DAVIS. Yes.

Mr. HARTSON. If I understand you correctly, it is your intention now to proceed with another case?

Mr. DAVIS. Yes.

Mr. HARTSON. Subject to certain corrections which Mr. Davis and I can agree on, so far as the record in the Berwind-White Coal Mining Co. case is concerned, I would like to dismiss these men who are here representing the bureau on the Berwind-White case and send them back to the bureau. Then, these corrections that I have suggested can be made in the record, subject to agreement between Mr. Davis and myself.

Mr. DAVIS. Together with the fact that we may have to put on a little additional testimony in the Berwind-White case the first of the week and conclude it.

The CHAIRMAN. Yes. I would like to say that we have had a telephone message from Mr. Swaren from Cleveland, saying that he would be here on Monday morning.

Mr. DAVIS. Yes; together with some other matter that the Solicitor has talked to me about, I think we can conclude it on Monday.

The CHAIRMAN. Then, I think I can say that all of those connected with the Berwind-White case can be excused until Monday, anyhow, until this man Swaren gets here.

Mr. HARTSON. That is what I wanted to do. We have a number of men here in that case.

The CHAIRMAN. We do not want to disturb the workings of the bureau any more than necessary, Mr. Hartson, and if it should happen that we may want any of these men to come back, we can take that up later, so that you will not have to have any large number of them waiting here.

Mr. HARTSON. Yes. We expected to conclude with the Berwind-White case this morning, and that is why these gentlemen are here, and if they can be released, that will be satisfactory. We will call them if they are needed later.

Mr. DAVIS. It appears from the report of our engineers in this case that amortization was allowed by the Shipping Board, contractual amortization, after the contracts were canceled.

The Standifer Construction Co. was organized in 1917, and it had three plants, the Vancouver, Wash., wood shipyard; the Portland, Oreg., wood shipyard, and the Vancouver, Wash., steel shipyard. In addition to that, there was a housing corporation, which was organized for the purpose of taking care of the employees of the corporation.

The report of our engineers shows that along in 1922 a settlement was had between the Standifer Construction Co., and the United States Shipping Board, and that in this settlement the Shipping Board allowed this company about $862,000 of amortization.

In the next year—I believe it was about June 28, 1923—the tax matter was pending before the bureau and the engineer's report submitted to the bureau by one Griffith, after going over a survey of the matters which we are discussing, recommended an amortization allowance of about $1,500,000. The amount claimed by this company was over $2,500,000, and in that report Engineer Griffith deducted the amount of the amortization allowed by the United States Shipping Board as, under the law, he should have deducted it; and at this point I wish to read the provision of the regulations applying thereto. I am reading in part from article 181 of regulations 62, page 79:

> All allowances made to a taxpayer by a contracting department of the Government, or by any other contractor for amortization specifically as such, shall be treated as a reduction of the cost of the taxpayer's plant investment.

The report of the engineer that I have just referred to also recites that, according to the records of the United States Shipping Board, this amortization is shown to have been allowed to this company, and the report is so filed in the case. Thereafter, the taxpayer put in a claim and claimed that the amortization, as it was set up in the engineer's report, was not allowed specifically, but that the settlement made by the Shipping Board was a lump sum settlement, and that there was not any specific amount allowed for amortization.

On September 24, 1923, the taxpayer filed a brief and demurred to the findings of the engineer with reference to this amortization allowance.

On October 23, 1923, a conference was held and this matter of amortization was discussed. The Engineer's report was up for consideration. The taxpayer was present, with counsel, and claimed, as I have said, that no specific amount with reference to amortization was allowed by the Shipping Board.

The conference resulted in a delay, a postponement of the matter until some time later, and on the first and second of November, 1923, th matter was again up in conference, and in this conference it was finally concluded that the taxpayer did not fully understand, and the records did not fully show that amortization in the sum of $862,000 was allowed by the Shipping Board; that the settlement was more in the nature of a lump sum settlement, and therefore no particular amount could be allocated to amortization.

We will show from the report of the engineer in the case that the taxpayer, with his counsel, appeared before the Shipping Board and discussed the claim with the Shipping Board, and that certain deductions were taken by the Shipping Board from his claim; but that in allowing those deductions, the amount set forth as amortization was not changed, and that that amount went through in the settlement as amortization, and was a specific amount set aside in the settlement as such, that amount being eight hundred and sixty-two thousand and odd dollars.

With reference to the taxpayer's knowledge, we will be able to show that the items were discussed specifically with him, that he was furnished a copy of the set-up of the deductions, that the deductions were discussed with him and his counsel by the Shipping Board, and that he understood he was allowed amortization in the amount that I have stated.

We will show further that this matter was called to the attention of the Bureau of Internal Revenue, and that officers of that bureau were in conference with officers of the United States Shipping Board; that the matter taken up at the conference was this matter of amortization, and it was clearly pointed out by the records and the statements made in the office of the Shipping Board that the amortization claim was allowed in the final settlement in the figures that I have mentioned.

Senator ERNST. What do you mean by that—in what figures?

Mr. DAVIS. Eight hundred sixty-two thousand dollars and some odd, Senator.

Senator ERNST. All right.

Mr. DAVIS. That after being aware of the exact status of affairs with reference to the amortization claim, the Bureau of Internal Revenue finally adjusted the case and did not take into consideration this allowance of amortization by the Shipping Board, and allowed the taxpayer to again deduct an amount for amortization which had already been allowed by the Shipping Board.

The CHAIRMAN. This same amount, or a different amount?

Mr. DAVIS. About that same amount.

The CHAIRMAN. Can you state definitely what difference that made in the taxpayer's tax?

Mr. DAVIS. I do not know. That is computed in your report, is it not [addressing Mr. Parker]?

Mr. PARKER. We did not compute it in this case, because it is a very involved matter, on account of the amount that they have taken up later on as income in later years. We did not do it, but it can be done. I would prefer the auditors of the Department to work it out, rather than to have me do it.

Mr. DAVIS. If you care to have that computation filed, we will make it and put it in the record.

The CHAIRMAN. I think we would like to have it.

Mr. DAVIS. All right; Mr. Parker will do that.

Senator JONES of New Mexico. Well, if you have the precise amount that was allowed to the taxpayer, it would have made that much difference in the taxpayer's income, would it not?

Mr. DAVIS. It would be about that amount, would it not, Mr. Parker?

Mr. PARKER. Well, it depends on the bracket of the engineer.

Senator JONES of New Mexico. You are speaking of the amount under tax now, but that amount would have been added to the taxable income.

Mr. DAVIS. Yes.

Mr. PARKER. In the income received, but not the contractual amortization. If it was put in contractual amortization, they did not take it up as income.

Mr. HARTSON. I think it should be pointed out right here, as throwing some light on this matter, that, as Mr. Davis has read from the regulations, the amount of contractual amortization allowed by another branch of the Government goes to reduce cost.

Senator JONES of New Mexico. Yes.

Mr. HARTSON. Of the facility which is being amortized for income tax purposes.

Senator JONES of New Mexico. Yes.

Mr. HARTSON. So that, conceding the correctness of all the figures and facts here that Mr. Davis has stated, it would be difficult to determine just what the result would be in the tax, but it would be about the same as the $862,000. I mean there would not be that exact sum saved to the company by reason of this allowance.

Senator JONES. Oh, but it would result in that deduction from the taxpayer's income. The rate of tax is another thing.

Mr. HARTSON. No; it would result, Senator, in the lowering of the cost. It would result in a failure to lower the cost of the facilities which were being amortized for income tax purposes.

Senator JONES of New Mexico. Yes; and the effect would be that there would not be that amount to be considered in the reduction of costs any more.

Mr. HARTSON. That is true, but it would not bear a direct relation to this sum which was given the company as contractual amortization.

Mr. MANSON. Let me see if I have this straight. It would result in increasing the net income of the taxpayer for the year for which amortization is allowed. We will say that was in 1918?

Mr. HARTSON. Yes.

Mr. MANSON. By eight hundred and some odd thousand dollars.

Mr. HARTSON. No; it would not do that.

The CHAIRMAN. I am sorry I got into this thing as it has resulted in some confusion. I got it very clearly in my mind that the ratio was not necessarily the same as the tax. It changes the figures, but the percentage would be different, dependent upon the total value of the plant, to that extent, if I understand it correctly. It may be that whatever bracket it falls into at that particular time changes it, but it does not involve the same amount of money in income tax that was allowed as amortization.

Mr. MANSON. If it was 80 per cent it would amount to 80 per cent.

The CHAIRMAN. Yes; that is the idea. They can figure it out and give it to us.

Mr. DAVIS. We will submit that, Mr. Chairman; we will have that submitted.

I will ask Mr. Thomas to take the stand.

TESTIMONY OF MR. RALEIGH C. THOMAS, CIVIL ENGINEER

(The witness was duly sworn by the chairman.)

The CHAIRMAN. Give your name, address, and occupation.

Mr. THOMAS. Raleigh C. Thomas.

Mr. DAVIS. And what is your business?

Mr. THOMAS. Civil engineer.

Mr. DAVIS. What school are you a graduate of?

Mr. THOMAS. Princeton University.

Mr. DAVIS. You are employed now where?

Mr. THOMAS. By the Investigating Committee of the Senate.

Mr. DAVIS. As such, have you rendered a report with reference to the G. M. Standifer Construction Corporation, of Portland, Oreg.?

Mr. THOMAS. I have.

Mr. DAVIS. And have you that report with you?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. With reference to what particular subject is that report made?

Mr. THOMAS. Contractual amortization.

Mr. DAVIS. And what bearing does that have with reference to the income tax matt r that we are taking up?

Mr. THOMAS. Well, it seems either to increase or decrease the amount of taxes paid by a taxpayer, according to whether or not it is allowed.

Mr. DAVIS. Did you find in your report that contractual allowance had been allowed by the Shipping Board in this case?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. To what extent?

Mr. THOMAS. Eight hundred and sixty-two thousand dollars odd.

Mr. DAVIS. When was that allowed; in what year?

Mr. THOMAS. That was in 1922.

Mr. DAVIS. Now, you state in your report that allowance was disregarded by the Bureau of Internal Revenue?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. In the settlement of the income tax matter?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. I wish you would just give us the details of that in your own language.

Mr. THOMAS. This taxpayer had a claim with the income tax unit for amortization.

Mr. DAVIS. What was the amount of the taxpayer's claim for amortization?

Mr. THOMAS. Two million nine hundred and thirty-nine thousand nine hundred and eighteen dollars and seventy-nine cents.

Mr. DAVIS. What was the amount allowed by the unit?

Mr. THOMAS. Two million six hundred and sixty-five thousand two hundred and fifteen dollars and thirteen cents.

Mr. DAVIS. The $862,240 was not deducted therefrom?

Mr. THOMAS. It was not.

Mr. DAVIS. How was that shown?

Mr. THOMAS. I do not quite understand the question, Mr. Davis.

Mr. DAVIS. In the report that you make, how was it shown that that was not deducted?

Mr. THOMAS. As a result of what they call the taxpayer's conference it is shown from the record that it was deducted and that conference resulted in a finding that contractual amortization had not been allowed by the United States Shipping Board.

Mr. DAVIS. I would like to have you turn to page 2 of your report and, beginning at the heading "History of case," read to us the synopsis of that transaction.

Mr. THOMAS. The G. M. Standifer Construction Corporation was incorporated under the laws of Oregon in 1917. In June, 1917, the corporation commenced construction of a shipyard at Vancouver, Wash., for the construction of wooden ships. In May, 1917, the corporation acquired a shipyard at North Portland, Oreg., also for the construction of wooden ships. Early in 1918 the corporation commenced the construction of a shipyard at Vancouver, Wash., for the construction of steel vessels for the United States Shipping Board. It was during the construction period of these steel ships that the corporation found it necessary to provide housing accommodations for its employees. As a result, the Vancouver Home Company was organized in July, 1918. All of the capital stock of this company was owned by the Standifer corporation. The facilities of this new company consisted of a hotel, 20 cottages, and about 37 acres of land.

The combined cost of the above facilities (shipyards and housing project) amounted to $3,396,726.70, and it is on this cost that the taxpayer submitted its claim in the amount of $2,939,918.79. This claim for amortization may be set up as follows:

	Cost	Claimed
Vancouver wood shipyard	$485,970.47	$438,257.80
Portland wood shipyard	197,932.74	59,628.22
Vancouver steel shipyard	2,315,680.55	2,091,680.09
Housing facilities	397,133.94	350,352.68
Total	3,396,726.70	2,939,918.79

This claim was originally investigated and passed upon by the engineering section of the Income Tax Unit with the result that an allowance for amortization in the sum of $1,552,977.56 was recommended, the allowance being reduced by the amount of contractual amortization previously mentioned. The report upon which this recommendation was based was submitted by Mr. William F. R. Griffith, engineer, under date of June 28, 1923, and covered the years 1918–1919–1920. (See Exhibit B.) Subsequently, or on September 4, 1923, the taxpayer filed a brief, demurring from the findings of the engineering section. On October 23, 1923, a conference was held at which the taxpayer was present, together with representatives of the Income Tax Unit. At this conference no

definite conclusions were reached, it being decided to make further investigations. Another conference was held early in November, 1923, resulting in a disapproval of the engineer's original recommendation and a recommendation was adopted by the conference—Messrs. J. C. Hering, W. F. R. Griffith, and E. T. Lewis—to the effect that a settlement made between the taxpayer and the United States Shipping Board on June 22, 1922, should not be considered as including contractual amortization, and further recommending a total allowance for amortization in the sum of $2,665,215.13 as against $1,552,977.50 as recommended in the engineer's original report, or a difference of $1,109,237.57. This recommendation was approved by Mr. Keenan, acting chief of section, and as the case now stands, the allowance has been made.

Senator ERNST. I would like to ask whether the Mr. Hering whose name was read is the witness who appeared heretofore before the committee?

Mr. DAVIS. Yes, sir. Read the next few lines there, Mr. Thomas?

Mr. THOMAS. It is difficult to understand why an addition of $1,109,237.57 over the original recommendation of the engineer should have been recommended by the conferees when, as far as the record is concerned, it does not appear that any new evidence was brought out which would justify such a radical change.

Mr. DAVIS. Now, turn to page 6 of your report, please, where you find the statement, down toward the bottom of the page, "Further, Mr. Adams states," and give us that, please.

Mr. THOMAS. I might say that this is quoted from the report of Mr. Adamson to Mr. James Talbert, who had charge of the claim in the Shipping Board.

Mr. HARTSON. Who is Mr. Adamson?

Mr. DAVIS. A special examiner in the United States Shipping Board.

Mr. HARTSON. And this is his report to his superior, is it?

Mr. THOMAS. Yes.

None of the deductions made from the award of May 26, 1921, affected amortization. The amortization allowances in the original award would naturally remain unchanged as follows——

Senator JONES of New Mexico. What award did he refer to there?

Mr. THOMAS. He refers to the award made by the United States Shipping Board to this taxpayer.

Mr. DAVIS. Pardon me—in which this settlement was made that I referred to, and this is given for the purpose of showing that that amortization was included in that settlement.

Mr. THOMAS (reading):

The amortization allowances in the original award would naturally remain unchanged as follows:

Amortization contract 503	$369,555.19
Amortization contract 508	16,311.01
Amortization contract 509	125,798.66
Depreciation in cost of contract 8 WC	163,059.14
Total	674,724.00

Mr. DAVIS. Proceed with your report, Mr. Thomas.

Mr. THOMAS. To this amount should be added the sum of $187,500 allowed by the Shipping Board as amortization of housing facilities, making a grand total of $862,224.

Mr. DAVIS. Continue right on there.

Mr. THOMAS. Again, in the same report, Mr. Adamson states:

Ample proof is available that no reduction in the award of May 26, 1921, whether made by the auditors, or the Shipping Board, could have affected the allowance for amortization on the cancelled ships or the allowance for depreciation in the costs of 3 WC—

That refers to contract 3 WC—

As already shown, the changes by Mr. Kennedy in addition to the changes by the Stevens audit did not affect amortization or depreciation. That the Stevens audit did not affect amortization or depreciation is shown by the appended analyses of the changes made by the Stevens audit.

Mr. DAVIS. Just a minute, at that point. Will you read the next few lines down to the long paragraph below there?

Mr. THOMAS. Messrs. Kennedy and Stevens were auditors of the United States Shipping Board.

The last paragraph of Mr. Adamson's report reads:

From the foregoing it is clear that all deductions from the May 26, 1921, award are fully identified and not one of these deductions affected the original allowance for amortization or depreciation.

Mr. DAVIS. Do you know what those deductions were, Mr. Thomas?

Mr. THOMAS. Yes, sir. I have a record of them.

Mr. DAVIS. In a general way will you give them to us, please? In that connection, see if they are not set out on page 6 of your report, under "Deductions from award of May, 1921."

Mr. THOMAS. Yes, sir.

Mr. DAVIS. Just give us the items there.

Mr. THOMAS. Award of May, 1921, $2,791,725.07.

Senator JONES. Was that an award made by the Shipping Board?

Mr. THOMAS. That was a tentative award, sir, which was made back in 1921, but it was never put through finally, the reason for it being, as I understand, that at that time there really was not a quorum of the Shipping Board in office, and the President delegated power to Admiral Benson, who was chairman of the board, to make the settlement of claims; but, under some ruling, I think, he never made it, and that held over until the new Shipping Board came into office.

Senator JONES of New Mexico. And when was that?

Mr. THOMAS. That was in 1922. I think they were appointed in July, 1922, as I remember it.

Senator JONES of New Mexico. That claim was finally carried through by the new Shipping Board; was it?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. But certain deductions were taken therefrom, Senator, and as the schedule that covers that is short, I will have him read it in.

Mr. THOMAS. Deductions made by audit, $942,113.25; net award after audit, $1,849,611.82; less payments made, $500,000. I might explain that $500,000.

Mr. DAVIS. I wish you would do that now; yes.

Mr. THOMAS. I might explain that by saying that at one time the Shipping Board, I suppose, realizing that they did owe this taxpayer money, made an advance of $500,000 on account.

Balance due on award of May, 1921, $1,849,611.82. I might state here that, besides the deductions which were made, there were certain additions made to the award.

Mr. DAVIS. Of May, 1921?

Mr. THOMAS. Yes; of May, 1921.

Mr. DAVIS. All right.

Mr. THOMAS. Those additions were as follows: Credits for deductions of debits, one-fourth of wage claims, $148,574.21; interest on note rebated, $325,000; freight differential, $81,678.94; changes and extras, $87,421.69; unexplained allowance, $37,545.80; gross total final award, $2,024,832.46.

Then, we have deductions from award of May, 1921; unlawful gain on Levy sale, $572,276.92; overcharge of 10 per cent per ton material, $350,000; correction of error in audit, $104,139.31; total deductions, $1,026,416.23; net final balance due taxpayer, $998,416.23.

Mr. DAVIS. Now, in those deductions, is there any amount deducted for amortization?

Mr. THOMAS. No, sir.

Mr. DAVIS. That is all with this witness, unless some of the Senators have some questions to ask or Mr. Hartson has some questions. I have Mr. Adamson here from the Shipping Board.

Mr. HARTSON. I would like to ask Mr. Thomas if it is his understanding that this matter has been closed?

Mr. THOMAS. I can not say that all of the tax matters of the Standifer Corporation have been closed, but I understand that, as far as it has gone for 1917, 1918, and 1919, this amortization has been settled, or has been carried on the books as settled; yes, sir.

Mr. HARTSON. I gather from the language of your report that you are a little uncertain about it, because, if I recollect correctly, you said that it appears to have been allowed on this basis.

Mr. THOMAS. Yes.

Mr. HARTSON. That was substantially the language used.

Mr. DAVIS. With reference to that, if I may read from page 3 of your report, Mr. Thomas, you said that this recommendation was approved by Mr. Keenan, acting chief of the section, and as the case now stands, the allowance has been made.

Mr. THOMAS. Yes. I do not say that it can not be reopened, but as the case now stands, as I understand it, the allowance has been made.

Mr. HARTSON. Now, if I understand you correctly, it is your view that the Shipping Board has allowed, on account of contractual amortization, some $862,000 to the Standifer Corporation on account of their ship contracts, that that sum should have been computed by the bureau in reduction of cost of facilities, that were erected or constructed for the production of articles contributing to the prosecution of the war in determining the amortization allowance under the Income Tax Law for income tax purposes?

Mr. THOMAS. Well, I do not believe that I am capable of going into that side of the question. That is more of an auditing question than it is an engineering question, and I presume that would be

adjusted, or the amortization placed where it belongs by the auditing section and not by the engineers.

Mr. HARTSON. My purpose is to get clearly in the record, if I can, and to clear up in my own mind and in the minds of the members of the committee just what the point of your testimony is. As I understand it, it is based on the proposition that the Shipping Board has allowed contractual amortization, and that when the Bureau of Internal Revenue came to audit and close the tax liability, they failed to compute and consider in the computation this allowance that had been made by the Shipping Board.

Mr. THOMAS. Is that a question?

Mr. HARTSON. Yes; I am trying to get the point of your testimony.

Mr. THOMAS. Well, the whole point of my testimony, as I have tried to make it, and as it is in my mind, is that it is a question of whether or not the contractual amortization was allowed by the Shipping Board, and it was. I do not think I am qualified to testify as to what is done with that allowance by your auditors or by the unit's auditors, after it is made.

Mr. HARTSON. Well, I understand your testimony to be that you do say that they did not consider it?

Mr. THOMAS. Yes; I say that they allowed amortization in their way of allowing amortization, after it had already been allowed by the Shipping Board. That is the point in a nutshell.

Mr. HARTSON. But you do not know enough about it to be able to criticise that yourself?

Mr. THOMAS. Oh, yes; I do.

Mr. HARTSON. Then I misunderstood what you said a moment ago.

Mr. THOMAS. I know enough about that part of it. I don't know anything about how they figured or applied the allowable amortization to taxes. That is an auditing proposition, pure and simple.

Mr. HARTSON. Is it your view, Mr. Thomas, that there having been contractual amortization allowed by the Shipping Board, no amortization should be allowed them by the bureau?

Mr. THOMAS. Not at all. No contractual amortization should be allowed by the bureau which has already been allowed by the Shipping Board. That is what I meant to say.

Mr. HARTSON. Then you read the regulation, which says that an allowance which is made by the Shipping Board goes to reduce the amount of the cost to the taxpayer of facilities for income tax purposes. Now, there may be a balance left there, of course, but I am trying to draw out from you whether, in fact, when they closed the tax case, and failed to subtract from cost this $862,000 in computing the amortization for income tax purposes.

Mr. THOMAS. Your auditors can tell you that much better than I can.

Mr. HARTSON. Then, I misunderstood your testimony, because that is my understanding of what you are bringing out, that they failed to take into consideration the $862,000 that had been allowed as contractual amortization by the Shipping Board.

Mr. DAVIS. I think the report of the conference which was submitted to us will answer that question. If you will refer to the conference report of November 1, 1923, Exhibit D, you will find it.

Mr. THOMAS. Yes, sir.

Mr. DAVIS. I will ask you to read that report of the conference, which has a direct bearing on the question of the solicitor.

Mr. THOMAS. This is marked "Copy. Consolidated Returns Audit Division," and is dated November 1, 1923:

TAXPAYER'S CONFERENCE

Taxpayer: G. M. Standifer Construction Corporation.
Address: Portland, Oreg. (formerly Vancouver, Wash.).
Represented by: B. G. Murphy, attorney; G. M. Standifer, president; J. A. Walker, secretary.

Matter presented: Reference is made to conference report of October 23, 1923, for status of the case. Practically all points were agreed to in said conference except the matter of contractual amortization which is the subject of this report.

The engineer in his report on amortization allowance deducted $837,224 as contractual amortization on account of a settlement made with the taxpayer by the Shipping Board in July, 1922. This settlement, it was claimed by taxpayer, was for a lump sum of $968,416.23, and it is contended that no amount can be properly allocated to contractual amortization. Further investigation discloses that the taxpayer's claims against the Shipping Board, which were fairly in dispute, aggregated between $9,000,000 and $10,000,000; that included in these amounts were over $4,000,000 for loss of profits on which no amount was specifically allowed by the Shipping Board. It further appears that of the amounts in dispute, the following items had a fairly equitable basis:

On account of wage increases	$410,471.86
Inventory settlement known as the Levy settlement	372,278.92
Disallowed costs on wooden ships	354,476.82
Additional overhead claimed on said wooden ships	98,000.00
Estimated loss of profits, approximately	4,000,000.00
Total	5,435,225.60

It is claimed by the taxpayer and admitted by the Shipping Board that at the time of the settlement in July, 1922, the details of the settlement or the method of arriving at the figure paid was not furnished to the taxpayer. It is also admitted that prior to that time taxpayers' claims had been considered by the claims board of the Emergency Fleet Corporation, and that in May, 1921, an award had been made aggregating $2,791,725.07. It appears that this award was formally approved by the Shipping Board, but that it was subsequently revoked on the technical grounds that Admiral Benson, who was then acting as chairman, was not in fact authorized to sign the award. It appears also that the $572,276.92 claimed to have been disallowed by the Shipping Board in its final settlement, was allowed by the Philadelphia claims board, of which Mr. Levy was chairman, and that the award was approved by Mr. Ackerson, then vice president of the Shipping Board. These items are cited merely to show that the amount finally accepted by the taxpayer was much less than the amount claimed, and that he had no knowledge of the Shipping Board's method of computing the amount allowed. Under the common law rule the taxpayer would, ordinarily, if the amounts were undisputed, have the right to apply the payment to any item which he pleased. However, it is clear that the amounts were disputed, but it is therefore contended by the taxpayer that the application must be governed by the formal settlement contract in which no specific reference is made to contractual amortization.

Article 181 of regulations 62 provides that "all allowances made to a taxpayer by a contracting department of the Government, or by any other contractor, for amortization, specifically as such, shall be treated as a reduction of the cost of the taxpayers' plan investment." From the evidence submitted in the case, it is not believed that it can be maintained that any amount was specifically allowed as amortization, although it must be admitted that the amount deducted by the engineer was used in the 1921 computation of the Shipping Board. It is to be remembered, however, that that award of $2,791,726.07 was not accepted and was reduced by the application of items never agreed to by the taxpayer.

It is the taxpayer's contention that the final award, as shown in memorandum submitted by the Shipping Board to conferee, E. T. Lewis, was prepared after the settlement and payment had actually been made. It is not the intention of the present conferees to prove or disprove this statement, and it is deemed sufficient to establish the fact that the taxpayer had no knowledge of the method of computing the amount allowed.

For the reason stated it is recommended that no contractual amortization be considered by the engineers, and that the full amount of the settlement, $998,416.23, be taken up as income for the year in which allowed.

Interviewed by:

J. C. HERING, *Conferee.*
W. F. R. GRIFFITH, *Engineer Conferee.*
E. T. LEWIS, *Conferee.*
L. T. LOHMANN, *Head of Division.*

NOVEMBER 1 and 2, 1923.

Mr. DAVIS. Mr. Thomas, there is a reference in the conference report there to estimated loss of profits of approximately $4,000,000.

Mr. THOMAS. Yes, sir.

Mr. DAVIS. Turn to page 4 of your report, in the paragraph next to the top.

Mr. THOMAS. From the above it is evident that the conferees entirely lost sight of the fact that the Supreme Court handed down an opinion in the case of the Russell Motor Car Co., in April, 1923, disallowing anticipated profits. Therefore, of the sum of $5,435,225.60, which the conferees treated as being made up of items having "a fairly equitable basis," $4,000,000, or about 70 per cent, was clearly not allowable.

Mr. DAVIS. Referring, then, to the report of Engineer Griffith, which included the contractual amortization, and stated that that amount should be deducted, that was finally reversed by the conference report that you have just read.

Mr. THOMAS. Yes, sir.

Senator JONES of New Mexico. Was there any lawyer in that conference?

Mr. THOMAS. I do not know, sir.

Senator JONES of New Mexico. That conference report seems to have been signed by several people.

Mr. THOMAS. I do not know, Senator.

Senator JONES of New Mexico. Or it is initialed. I will ask Mr. Hartson what lawyers took part in that case?

Mr. HARTSON. The Senator will recollect that Mr. Hering, who testified here the other day, stated that he was also a lawyer, and he was frequently consulted by members of the unit at the time on legal questions, and I might answer the Senator's question in this way, that there was no lawyer from the bureau, regularly assigned to function at that conference as a lawyer, but Mr. Hering, as I say, was a lawyer, and signed the report.

Senator JONES of New Mexico. What were Mr. Hering's duties?

Mr. HARTSON. He was a conferee.

Senator JONES of New Mexico. I know, but what was his regular job?

Mr. HARTSON. Oh, an auditor. That is what his job was. That is his rating there in the Bureau. He is not rated as a lawyer, but, as he testified, he was an auditor, with the assignment as Assistant Chief of that Amortization Section, working directly under Mr. De La Mater's supervision.

Senator JONES of New Mexico. Did you not consider in that case that that point should be submitted to a lawyer, as such?

Mr. HARTSON. I think there is a nice legal question, Senator, which might occupy the attention of a qualified lawyer to pass on it. I might also say that in these cases, when the adjustments come up in the unit there is very seldom a case that is settled that does not involve some very complicated legal questions. It is rather the exception than the rule when some law point is not raised and not discussed.

The CHAIRMAN. Are you through with this witness, Mr. Hartson?

Mr. HARTSON. Yes. My questions a moment ago to Mr. Thomas were intended to draw out just what the nature of his report was. I have had no opportunity to examine this case, and I am trying to find out from him, for my own information, as well as to find out what the basis of his information was.

Senator ERNST. Are you through with him on that subject?

Mr. HARTSON. Yes; I do not care to ask him any further questions.

Mr. DAVIS. Your investigation then concluded what was finally done in the engineering division?

Mr. THOMAS. Yes, sir.

Mr DAVIS. I will call Mr. Adamson now.

TESTIMONY OF MR. TILDEN ADAMSON, SPECIAL EXAMINER, UNITED STATES SHIPPING BOARD

(The witness was duly sworn by the chairman.)

Mr. DAVIS. Mr. Adamson, are you employed by the Government now?

Mr. ADAMSON. Yes, sir.

Mr. DAVIS. What is your title?

Mr. ADAMSON. My title is special examiner for the United States Shipping Board and Emergency Fleet Corporation. I am attached to the legal department of the Fleet Corporation

Mr. DAVIS. How long have you been so employed?

Mr. ADAMSON. I have been with the Fleet Corporation about eight years, but only about two or two and a half years in the legal department.

Mr. DAVIS. As special examiner, what does your work cover with the Shipping Board?

Mr. ADAMSON. At the present time it has chiefly to do with claims and with litigation.

Mr. DAVIS. And is your work confined to the Washington office; or do you go out through the country?

Mr. ADAMSON. Occasionally I have to go out through the country.

Mr. DAVIS. Do you recall the G. M. Standifer Construction Co. case?

Mr. ADAMSON. Yes, sir.

Mr. DAVIS. What work did you do on that case? What was the nature of it?

Mr. ADAMSON. At that time I made quite a number of reports on claims which were presented by the G. M. Standifer Construction Corporation.

Mr. DAVIS. When did that case come to the Shipping Board?

Mr. ADAMSON. Well, originally, I think the claim was made in 1919, and then it was increased. I think the claims on which the

Shipping Board finally acted were put in in 1920, the latter part of 1920, or possibly early in 1921. The Standifer Construction Corporation continually increased its claims, and I can not say just when they put in the final items.

Senator JONES of New Mexico. Will you state in a brief way when and in what amounts those increases were made in their claims?

Mr. ADAMSON. In 1920, as I recall it, they put in quite a number of claims which were based largely on prospective profits, anticipated profits, which they said they had been deprived of by cancellation. There are so many of the claims that I can not recall them now, Senator; I can give you the exact detail of them from our records, but the larger part of the increases were made up from anticipated or prospective profits.

Mr. DAVIS. There is a tentative agreement spoken of here as of the date of May, 1921. What was that?

Mr. ADAMSON. I suppose that has reference to the resolution of May 6, 1921, adopted by the board of trustees of the Fleet Corporation. That was making an award of $2,791,000 in settlement of all of these claims.

Mr. DAVIS. I see.

Mr. ADAMSON. The award being subject to audit. The $2,791,000 was set up in the resolution as the maximum.

The claimant was not to have in excess of that, in any event, but he was to get an amount less than that if the audit showed that he was entitled to less.

Mr. DAVIS. Now, I wish you would go on and give us a history of what occurred from that tentative settlement of May, 1921, with reference to the additions and deductions thereto and therefrom.

Senator JONES of New Mexico. Have we got that tentative settlement in the record?

Mr. DAVIS. A part of it. I do not know that it is all in there.

Senator JONES. I think we had better have that, hadn't we?

Mr. DAVIS. Yes.

The CHAIRMAN. Let it be inserted in the record.

(The tentative settlement referred to is as follows:)

[Attached to original contract No. 3-156-176-503-508-509]

OCTOBER 4, 1921.

The G. M. STANDIFER CONSTRUCTION CORPORATION.

GENTLEMEN: On May 26, 1921, the board of trustees of the United States Shipping Board Emergency Fleet Corporation adopted resolutions recommending to the United States Shipping Board that settlement of your claim be made upon the basis set out at length in such resolutions, a copy of which is herewith inclosed and marked "A."

2. On the same day Admiral Benson in behalf of the Shipping Board approved the recommendation contained in such resolutions and directed that they be carried into effect.

3. On or about June 8, 1921, a payment of $500,000 was made to you under article 13 of these resolutions.

4. You accepted this payment and in so doing ratified the settlement of your claim on the basis stated in these resolutions.

5. The Shipping Board, upon its reorganization in July, 1921, instructed the general counsel to examine fully into this claim and advise as to whether these resolutions should be carried into effect. In the meanwhile, an audit under these resolutions has been had, and such audit is nearly completed but has not yet been submitted for approval by the general counsel.

6. The Fleet Corporation now has in its possession cheques and drafts from various insurance companies issued in payment of your fire loss on the North

Portland yard. The aggregate amount involved which the insurance companies are prepared to pay is $125,000. These payments can not be made without the Fleet Corporation's approval and consent. The details of the cheques and drafts issued by the insurance companies are stated in a schedule annexed and marked "B."

7. The audit shows that, upon the basis of settlement reached in these resolutions, the balance due upon your claim is largely in excess of $500,000, and that the entire amount of fire loss, $125,000, should be collected by you and the proceeds retained for your own use.

8. In view of the circumstances, I am prepared to bring the matter before the claims commission on the first available day and to recommend that under the resolutions of May 26, 1921, an award of $500,000 be made to you on account, and thereupon to advise the Shipping Board that such award be approved and submitted to Congress for an appropriation.

9. With respect to the balance of your claim (subject to the limitation of $2,791,725.07 fixed by article 13 of said resolutions of May 26, 1921) I am prepared to bring it on for hearing before the claims commission as soon as the auditor's report is completed or brought to a point showing that more than the amount of this balance is due your company and subject in either event to approval by the general counsel with the recommendation that the amount found to be due you be awarded, and thereupon (provided that the award is equal to the difference between $2,791,725.07 and the sum of the payment of $500,000 of June 8, 1921, and the award of $500,000 under paragraph 8 above) your company will approve the award and execute a general release of all claims against the United States and the Fleet Corporation, and thereupon I shall be prepared to advise the Shipping Board that such award be approved and submitted to Congress for further appropriation.

Yours, very truly,

NATHAN A. SMYTH,
Assistant General Counsel.

Approved:

HENRY M. WARD, *S. C.*

O. K.

J. FAIRBANKS.

O. K.

H. S. KIMBALL, *V. P.*

Receipt of letter of which the above is a copy is hereby acknowledged and the terms as stated are hereby confirmed nad approved, October 4, 1921.

G. M. STANDIFER CONSTRUCTION CORPORATION,
By: G. M. STANDIFER, *President.*

In presence of:
HENRY M. WARD, *S. C.*

UNITED STATES SHIPPING BOARD,
Washington.

Be it resolved, Upon recommendation of the construction claims board of the United States Shipping Board Emergency Fleet Corporation that the board of trustees of the United States Shipping Board Emergency Fleet Corporation hereby recommends to the United States Shipping Board that settlement with the G. M. Standifer Construction Corporation be made upon the following terms and conditions:

1. That cancellation allowance of $340,000 be made on contract 508–WH, the United States Shipping Board Emergency Fleet Corporation to take over all raw, finished, and erected materials, and small tools, subject to final audit as at time of lifting.

That item of raw materials, $124,617.54, included in the above allowance and carried in the inventory as cancellation material, be analyzed by the district officials, and only such portion of same as is represented by requirements for the canceled hull shall be allowed in the cancellation allowance, providing the same does not exceed the contract price; the balance, if any, to be credited to the contractor without profit thereon.

2. That on contract No. 509 WC, cancelation allowance of $738,809.65 be made, said Emergency Fleet Corporation to take over all raw and finished material and small tools, subject to final audit as at time of lifting.

3. That on contract 503–SC, cancellation allowance of $756,772.03 be made, subject to the following:

That credit for advancements of $72,162.50 to subcontractors, included in the above allowance, represented by the following canceled commitments:

Pacific Machine Shop & Manufacturing Co	$35,662.50
Pacific Construction & Engineering Co	20,000.00
Williamette Iron & Steel Co	16,500.00
	72,162.50

should only be given providing credits have not been passed at the time settlement with the subcontractors is made.

4. That contract No. 3–WC be settled on the basis of "just compensation," just compensation to consist of the actual cost to the contractor without profits, and as usually defined in Emergency Fleet Corporation costplus contracts, including:

(*a*) Actual audited expenditures incurred by said contractor in constructing ships under said contract, as disclosed in audit report of August 10, 1920, including any delayed billings of materials by said Emergency Fleet Corporation.

(*b*) Audited overhead during the construction period, together with the proper allowance for a period of three months after the close of the physical construction work, October 31, 1919, as recommended by the district officers of said Emergency Fleet Corporation.

(*c*) Amortization of the wooden shipyard plants at Vancouver and North Portland, covering the cost of the plants, less residual value proportionate to this contract on the basis of contract tonnage of all vessels contracted for to be built in these yards since the yards were acquired by the contractor.

5. That the housing project organized by the contractor under the title Vancouver Home Co., for which the Emergency Fleet Corporation advanced the sum of $350,000 to finance said project and for which the final terms of the loan contract the contractor was made surety for the loan to the realty company, be taken over by the G. M. Standifer Construction Corporation, the contractor to pay to the Emergency Fleet Corporation the sum of $162,500 in full and final settlement of said loan, and said Emergency Fleet Corporation to release all right, title, and interest therein on payment of said $162,500.

6. That credit be given said contractor for surplus materials taken over by the Emergency Fleet Corporation as follows:

Excess installation material, Willamette purchase, contract No. 3	$97,458.76
Surplus materials due to machinery not being installed in hulls 18 and 20, contract No. 3	318,451.36
Surplus materials due to changes and extras, contracts 3, 176, and 508	128,556.72
Total	544,466.84

Said credit to be subject to audit and check at time of lifting and to be extended to said contractor only on condition that such credit does not already appear in the audited costs under contract No. 3.

7. That credit be extended said contractor for $201,262.56 for such amounts as paid out of the impressed fund and charged to the contractor's account on Ballin boiler settlements on contracts Nos. 3–WC and 176–WC, such credit to be extended only on condition that such credit does not already appear in the audited coasts on contract No. 3.

8. That payment from the insurance fund of said Emergency Fleet Corporation, for which vouchers have been issued to said contractor, but not paid, amounting to $108,756.99 for insurance on materials stored at the North Portland Yard, destroyed by fire May 13, 1920, be withheld, that said Emergency Fleet Corporation apply same as the salvage value of such materials, and that the contractor be charged with the unpaid premium due on this policy, amounting to $14,027; the costs of said material being included in the cancellation settlement under contract 508–WH.

9. That an allowance for undistributed overhead be made to said contractor from October 1, 1920, to dates on which surplus materials are finally lifted, covering expenses incident to the care and storage of surplus materials in wood shipyards, and estimated at $25,000; such credits to be subject to verification by audit and approval by the district officials of said Emergency Fleet Corporation.

10. That said Emergency Fleet Corporation take over and assume responsibility for all proper commitments for undelivered materials applying to canceled hulls under contracts 508, 509 (including commitment to Fred C. Ballin for royalties), and 503-SC; said contractor to be relieved of all liability thereon, and to be held harmless therefor.

11. That, providing the books of the said Emergency Fleet Corporation do not already include the proper credits and debits for surplus materials taken over on contracts 156-SC and 503-SC and resold to said contractor at 50 per cent, said contractor be credited with the purchase price of said surplus materials amounting to $1,908,113.04 and charged with $954,056.52, said figures being subject to audit.

12. That said contractor's final reimbursement under this resolution shall in no event exceed the amount of $2,791,725.07, said amount to include the reimbursements provided for under the foregoing clauses of this resolution, and all contract reimbursements.

13. That until the amounts set forth in this resolution are definitely determined in accordance with the provisions thereof, the contractor shall not be advanced, on account of this claim, any sum in excess of $1,000,000.

Be it further resolved, That the board of trustees of said Emergency Fleet Corporation further recommends that the resolution adopted by said construction claims board on February 8, 1921, be, and the same is hereby, declared null, void, and of no effect.

I hereby certify this 1st day of June, 1921, that the foregoing is a true and correct copy of a resolution adopted by the board of trustees of the United States Shipping Board Emergency Fleet Corporation on May 26, 1921.

I further certify that the recommendations contained in the foregoing resolution were approved and directed to be carried into effect by Admiral W. S. Benson, under authority of the President of the United States on May 26, 1921.

JOHN J. FLAHERTY, *Secretary*.

Status of insurance on North Portland yards

Policy	Company	Amount	Remarks
A113511	Providence	$1,500	These drafts cashed by Standifer and placed in special account pending settlement.
4431	Lloyd's	7,500	
		9,000	
21395	Norwich Union	5,000	Drafts and canceled policies herewith.
520230	St. Paul Fire & Marine	2,500	
100303	Union Insurance Society	4,500	
912555	New Brunswick	1,250	
79685	Merchants	1,500	
C38101	United States	6,000	
3379371	North British and Merchants	2,500	
		23,250	
4687309	London Assurance	3,000	Drafts herewith. Canceled policies applying are in Emergency Fleet Corporation insurance department, Washington.
1040641	California	2,500	
6507	Hartford	18,000	
014587	Western Assurance	3,500	
4687479	London Assurance	7,000	
		34,000	
27790	Lloyd's	1,500	Draft herewith. Policy in hands of J. & H., New York.
6153	....do	7,500	Policy herewith. No draft issued yet.
61389	....do	36,250	
30042	Caxton		
251848	Western Australia	13,500	Policies indorsed by Standifer but not by Emergency Fleet Corporation are in hands of J. & H., New York. These policies and Lloyds' 6153 above should be indorsed to Standifer by Emergency Fleet Corporation so it will not be necessary for Emergency Fleet Corporation to enforce drafts when received from London.
62131	Traders & General		
		49,750	
		125,000	

WASHINGTON, D. C., *October 4, 1921.*

NATHAN A. SMYTH, Esq.,
General Counsel United States Shipping Board,
Washington, D. C.

DEAR SIR: I acknowledge receipt of your letter of even date inclosing certified copy of resolution of the board of trustees of the Fleet Corporation, May 26, 1921, and schedule of fire insurance policies, etc.

The adjustment of the claims of the Standifer Construction Corporation on the basis stated in your letter above referred to is hereby approved and confirmed.

Very truly yours,

G. M. STANDIFER CONSTRUCTION CORPORATION,
G. M. STANDIFER, *President.*

CLAIM OF G. M. STANDIFER CONSTRUCTION CORPORATION

[Henry M. Ward, special counsel; Mr. Elmer Schlesinger, general counsel]

OCTOBER 4, 1921.

1. In this case contractor, G. M. Standifer Construction Corporation, in the years 1917 and 1918, entered into certain contracts for the construction and delivery of wood and steel ships known by contract Nos. 3-WC, 176-WC, 508-WH, 156-SC, and 503-SC. Certain of these contracts were suspended and canceled in the public interest. The contractor submitted claims for cancellation damages for extra work and for cost of labor and materials resulting from the change of contract No. 3-WC from a lump-sum contract to a cost-plus contract and for progress payments due under contracts, etc. The aggregate amount of all claims presented by the contractor and now on file in this office and the various district offices, was in excess of $10,000,000. These claims were filed in the years 1919, 1920, and 1921. The president of the contractor, Mr. G. M. Standifer, remained in Washington for the greater part of 18 months, from about the end of 1919 to about June, 1921, cooperating with the construction claims board and the General Comptroller's office in making an audit and reaching an adjustment of all these claims. As a result of these efforts, Mr. E. T. Wright, under date of April 16, 1921, submitted to the construction claims board a report embodying findings of fact, recommendations and a summary, and on April 18, 1921, the construction claims board approved the allowance of the claims on substantially the basis stated in Mr. Wright's recommendation and embodied the same in a recommendation to the board of trustees of the Fleet Corporation.

2. On May 26, 1921, the board of trustees of the Fleet Corporation adopted a series of resolutions, a certified copy of which is herewith submitted. The substance of these resolutions is that the contractor's final reimbursement shall in no event exceed the sum of $2,791,725.07, and that until the amounts set forth in the resolutions should be definitely determined, the contractor should not be advanced on account of the claim any sum in excess of $1,000,000. On the same day, May 26, the recommendations contained in these resolutions were approved and directed to be carried into effect by Admiral Benson under authority of the President of the United States. Thereupon an agreement between the contractor and the Fleet Corporation and Shipping Board, embodying the substance of the resolutions, was prepared, approved by the construction claims board and Mr. Tilden Adamson, assistant to the General Comptroller, and submitted to General Counsel Hyzer for approval. Before the agreement was approved by him as to form, the new board was appointed and the agreement has not been executed. In the meantime, however, on June 8, 1921, the contractor was paid the sum of $500,000 as a payment on account in accordance with the resolutions of May 26.

3. Before these resolutions were adopted an audit of the contractor's claims had been undertaken and this audit is not yet completed. The auditor, however, has advised the General Comptroller that the audit shows that more than $500,000 is due the contractor and if funds were available, it would be in order to make a further payment of this amount at the present time.

4. During the year 1920 the contractor sustained a fire loss on its north Portland yard. The property was insured in various insurance companies in the joint name of the Fleet Corporation and the Standifer Corporation, all

premiums, however, were paid by the Standifer Corporation. The Standifer Corporation cashed $9,000 of drafts issued by two companies and placed the proceeds in a special account pending settlement. The fire losses under these policies have all been adjusted and checks and drafts issued in the joint names of the contractor and the Fleet Corporation, to the amount of $58,750, are now held by the Fleet Corporation. The other policies amounting to $57,250 should be indorsed by the Fleet Corporation to the order of the Standifer Corporation.

5. As the insurance was taken out by the contractor for its own benefit and the premiums paid by the contractor, I am of the opinion that the checks and drafts on hand, amounting as above to $58,750, should be indorsed by the Fleet Corporation and turned over to the contractor, that the contractor should be authorized to apply to its own use the $9,000 collected, and that the policies in the aggregate amount of $57,250 should be indorsed by the Fleet Corporation and the contractor authorized to collect the whole amount due thereon and retain it. The detail of the insurance is as stated in schedule herewith submitted and marked "B."

6. After an examination of the report of Mr. Wright, the recommendations of the construction claims board and the resolutions of May 26, 1921, after going through the matter in detail with Mr. Adamson, I have reached the following conclusions with respect to the contractor's claims:

(1) The settlement of the contractor's claims of over $10,000,000 on a basis by which his total reimbursement shall not exceed $2,791,725.07 is for the best interests of the United States. If the settlement is not carried out on this basis, the contractor, in my opinion, will be free to prosecute his claim for the entire amount originally claimed before the Claims Commission and it is likely that a much larger award than the limit stated would finally be made.

(2) The contractor approved the settlement of all claims under the resolutions of May 26, 1921, acted in entire good faith and was prepared to execute an agreement in conformity therewith.

(3) The contractor received the sum of $500,000 on June 8, 1921, in accordance with the resolutions of May 26.

(4) The settlement with the contractor, as evidenced by the resolutions of May 26, is morally in good faith binding upon the United States, the Shipping Board and the Fleet Corporation, and I see no reason why any question should be made as to its legality and binding force, if it is assumed that any such question is open. There is no suggestion of any fraud or bad faith in the entire transaction.

(5) The contractor in good faith accepted and was led to believe that during the month of August, at the latest, a further payment of $500,000 would be made on account. As the conclusion has been reached that no funds were available for such payment, I am of the opinion that every effort should be made to put the contractor in as favorable a position as is permissible under existing law and this can best be done by submitting the matter to the Claims Commission on the first available day with the recommendation of an award of $500,000 on account.

(6) The balance of the contractor's claim, which after deducting the $500,000 paid on account and the $500,000 to be awarded on account, will equal $1,701,725.07 should be submitted to the Claims Commission with the recommendation that an award be made accordingly, as soon as either the auditor's report is completed or has reached a point where it is clearly indicated that at least this amount is properly due.

(7) Upon an award being made equal to the balance, as above stated, the contractor will approve it and will execute a general release of all claims.

(8) I have prepared a letter from the general counsel to the contractor in accordance with the above and am of the opinion that in fairness to the contractor a letter in substantially this form should be signed by the general counsel and handed to the contractor without delay. Such a letter will be of great assistance to the contractor in connection with financing certain new contracts and will evidence the settlement of the matter on the basis above indicated.

HENRY M. WARD,
Special Counsel.

Mr. ADAMSON. Almost immediately after the settlement was made, Mr. Standifer came around to my office and asked me if I would see that the audit was gone into. I wrote to Mr. J. L. Kennedy, the

assistant comptroller, and I think I sent him a copy of the resolution and gave him instructions concerning the audit; so that an audit was started, I believe, at that time, being almost immediately after the resolution was adopted.

Then, Mr. Stevens came into our organization and took charge of this audit. I think his title is general auditor, or some such title, and he completed an audit and made deductions of about $900,000 in the amount of the award.

Then, Mr. Kennedy, the assistant comptroller, finished up certain unfinished parts of the audit. I said Mr. Stevens completed it, but he did not quite complete it, so that the total deduction in the award as made by the auditors, was about $921,000. The audit report, I think, transmitted to us under date of October 25, 1921.

At that time, Mr. Standifer was also anxious to get payments on account. He had, in June, of 1921, obtained one payment of $500,000 on account of this resolution of May 26, 1921, and he came on in September of 1921, and endeavored to get further advances. Before the audit was completed, and while pressing for further advances, he dealt very largely with a Mr. Henry M. Ward, special counsel of the Fleet Corporation, and they went into great detail in connection with the claims and the disallowances which our auditors had made, and were still making, and Mr. Standifer put in quite a number of new claims at that time. But his chief desire then was to get a further advance. At first, his position was that the May 26, 1921 resolution was possibly not binding, and he said he had been pressed by a lot of new claims.

Mr. DAVIS. Did that include amortization?

Mr. ADAMSON. The May 26 resolution?

Mr. DAVIS. Yes.

Mr. ADAMSON. Yes, sir.

Mr. DAVIS. In what amount?

Mr. ADAMSON. $862,500.

Mr. DAVIS. Was that amount ever deducted or ever lessened until the final settlement was made?

Mr. ADAMSON. No, sir.

Mr. DAVIS. That remained intact throughout all the additions and deductions that were made, until the time of final settlement?

Mr. ADAMSON. Yes, sir. On October 4, 1921, Mr. Ward and Mr. Smyth, who was our general counsel, and Mr. Standifer agreed that the May 26, 1921 resolution was binding upon both parties, and Mr. Smyth, on that date, sent a letter, or handed a letter to the G. M. Standifer Construction Corporation, in which he referred to the payment already made under the resolution, and said, "You accepted this payment, and in so doing ratified the settlement of your claim on the basis stated in this resolution." The later part of it referred back to the May 26, 1921 resolution. With the letter, he sent a copy of the resolution of May 26, and Mr. Standifer, who was in Washington at that time, signed on a copy of this letter of Mr. Smyth's as follows:

Receipt of letter, of which above is a copy, is hereby acknowledged, and the terms stated are hereby affirmed and approved October 4, 1921.

In addition to that, Mr. Standifer wrote a letter—I do not know whether I have a copy of it or not—to Mr. Smyth, under date of October 24, 1921, in which he said:

I acknowledge receipt of your letter of even date, inclosing certified copy of resolution of the board of trustees of the Fleet Corporation, May 22, 1921, and schedule of fire insurance policies, etc. The adjustment of the claims of the Standifer Construction Corporation on the basis stated in your letter above referred to is hereby approved and affirmed.

That is all as to that.

Thereafter, in the work that I did on the case, I always considered that the May 21 resolution was binding, notwithstanding the fact that it had never been put into contract form, and I think everybody in the Shipping Board and the Fleet Corporation who worked on the case considered that the deductions were being made in accordance with the May 26 resolution, and that that was a binding resolution.

Mr. DAVIS. Did Mr. Standifer and his counsel consult with you often during this time that you have spoken about?

Mr. ADAMSON. Not so often at this particular time. They had previously consulted a great deal. I saw Mr. Standifer occasionally in connection with this case.

Mr. DAVIS. Was he aware of what the amortization allowance was in that agreement?

Mr. ADAMSON. In the May 26, 1921, resolution?

Mr. DAVIS. Yes, sir.

Mr. ADAMSON. Yes, sir; he knew every item in that resolution.

Mr. DAVIS. While the matter was pending in the Bureau of Internal Revenue, did you see Mr. Standifer and his attorney?

Mr. ADAMSON. Yes, sir.

Mr. DAVIS. Did you have a conference with them?

Mr. ADAMSON. Mr. Standifer and a gentleman whom he introduced as Mr. Murphy, his attorney, came to see Mr. Talbert, who had an office with me at the time. They really came to see Mr. Talbert, because Mr. Standifer, as I recall it, introduced Mr. Murphy to Mr. Talbert and stated that Mr. Talbert was the man who had negotiated the final settlement, the settlement of July, 1922. I did not have anything to do with that conversation in the beginning, but Mr. Talbert called me into it.

It seems that Mr. Standifer wanted to be assured by Mr. Talbert that his, Mr. Talbert's, position would be the same as Standifer's; that is, that this was a lump-sum settlement in 1922, and, consequently, could not have included any amortization. Mr. Talbert's recollection was that the amortization had never been disturbed, and he asked me about it. I told him it had not been, and we discussed that at some length there, and Mr. Standifer argued that because the contract of July 15, 1922, had only a lump-sum figure it could not have included amortization. I explained that none of our contracts included the detailed figures by which the final sum was arrived at, that it was always a lump-sum. The amount arrived at at the conclusion of this visit was in anticipation of the fact that the bureau might take it up with the Shipping Board. I believe Mr. Standifer explained that there would be some representative of the Income Tax Bureau there.

Mr. DAVIS. Now, following that conference, did anybody from the bureau come to see you about it?

Mr. ADAMSON. I think it was the next day, or within two or three days of it, a Mr. Lewis came from the Bureau and talked with Mr. Talbert and me.

Mr. DAVIS. What was that conversation, what was the matter taken up at that time?

Mr. ADAMSON. Well, I had already been advised that a representative was coming, and had been asked to get out the files showing how the award had been built up. I had those there, and showed Mr. Lewis that the award of May 26, 1921, had included amortization, as stated, and I also pointed out that there had been no deductions after that time which affected amortization in any way, and I gave Mr. Lewis a rough analysis of the settlement, which was the best thing I could get up for him on the spur of the moment. He took that away with him, and that is the last I saw of Mr. Lewis.

The CHAIRMAN. Is Mr. Lewis still in the Bureau?

Mr. NASH. He is here.

Mr. DAVIS. Is that the same Mr. Lewis that signed the conference report who is here?

Mr. NASH. Yes, sir.

Mr. DAVIS. Now, instead of this being a lump-sum settlement, in the general use of that term, was it a settlement arrived at by specific additions and deductions to the May, 1921, terms of agreement?

Mr. ADAMSON. I was not in the matter when the settlement was made, but up to a week before the settlement was made we were proceeding upon the line of making deductions from the award and additions to the award.

Senator JONES of New Mexico. Have you got the set-up on that?

Mr. DAVIS. Yes, I have, Senator.

Senator JONES of New Mexico. Don't you want it in the record?

Mr. DAVIS. It is rather long, but I think it should go into the record. It is about six pages.

The CHAIRMAN. I think we had better put it in the record.

Mr. DAVIS. You think it had better go in the record?

The CHAIRMAN. I think so.

Mr. DAVIS. Mr. Adamson, that appears to be Exhibit H of the engineer's report that has been submitted to counsel for this committee, and it seems to be a report from Tilden Adamson, special examiner, to James Talbert, assistant counsel.

Mr. ADAMSON. Yes, sir.

Mr. DAVIS. Will you read that to the committee?

Mr. ADAMSON. The entire report?

Mr. DAVIS. Yes.

The CHAIRMAN. I think we had better put it in without reading it.

Senator WATSON. Give us the general purport of it.

Mr. DAVIS. I wish you would go through it and read your comments with reference to it, or read that part of it which is a rough set-up, as you say, and omit the specific figures.

Mr. ADAMSON. This was written in response to a request from Mr. Talbert, so that he could have before him the facts in any further discussion that may come up:

I find from Mr. Parker's files and the files of the Shipping Board that the final figure was derived by making deductions from and additions to the award of $2,791,725.07 contained in the Shipping Board resolution of May 26, 1921.

The award of May 26, 1921, was not changed in any way that affected the allowance for amortization which it provided.

The CHAIRMAN. I do not understand what report you are reading from now.

Mr. ADAMSON. This is a memorandum report which I made to one of my associates in the Shipping Board, Mr. Talbert, who drew the final contract.

The CHAIRMAN. When did you make this report?

Mr. ADAMSON. This was made under date of October 26, 1923, I think, right after Mr. Standifer's first visit.

The CHAIRMAN. All right.

Senator WATSON. You say his first visit was in October, 1923?

Mr. ADAMSON. Yes sir; his first visit with reference to this amortization.

Senator WATSON. Oh, I see.

Mr. ADAMSON. Yes.

Senator WATSON. Then, you might let that go in the record without reading it.

The CHAIRMAN. The committee wishes to dispense with the reading of it. It may be copied into the record, and the department will have access to the record.

Mr. DAVIS. All right.

(The memorandum referred to is as follows:)

OCTOBER 26, 1923.

From: Tilden Adamson, special examiner.
To: James Talbert, assistant counsel.
Subject: Settlement with G. M. Standifer Construction Corporation.

This is in response to your request for memorandum showing the basis for the settlement with the G. M. Standifer Construction Corporation by the payment of a net amount of $998,416.23.

I find from Mr. Parker's files and the files of the Shipping Board that the final figure was derived by making deductions from and additions to the award of $2,791,725.07 contained in the Shipping Board resolution of May 26, 1921.

The award of May 26, 1921, was not changed in any way that affected the allowance for amortization which it provided.

With the exception of an unexplained allowance of $37,545.80, the final award of $998,416.25 is explained by changes made in the audit and by additions to and deductions from the award as shown in a memorandum of June 30, 1922, from Chauncey G. Parker, chief counsel in charge of litigation, to Elmer Schlesinger, general counsel of the United States Shipipng Board. At the time Mr. Parker wrote his memorandum of June 30, 1922, the General Comptroller's Department in auditing the award of May 26, 1921, had made net deductions in the award amounting to $942,113.25. Also a payment of $500,000 had been made on account of the award. Accordingly, the set-up on June 30, 1922, was as follows:

Original award		$2,791,725.07
Less:		
Deductions by audit	$942,113.25	
Payment made	500,000.00	
Total deductions		1,442,113.25
Balance due contractor		1,349,611.82

This balance of $1,349,611.82 is the same as was used by Mr. Parker in his statement of May 20, 1922, to the Claims Commission of the United States

Shipping Board. The balance is made up by totals of debits and credits by contracts as follows:

Contract	Debits against Standifer	Credits to Standifer	Due from Standifer	Due to Standifer
3 and 176 WC	$13,470,118.37	$12,500,208.83	$969,909.54	
508 WH	1,484,173.68	1,442,196.32	41,977.36	
509 WC	145,910.35	738,809.65		$592,899.30
156 SC	19,022,268.17	20,379,138.98		1,356,850.81
508 SC	1,074,507.42	1,637,940.25		563,432.83
Housing	162,500.00		162,500.00	
Carrying charges		10,815.78		10,815.79
Total	35,359,497.99	36,709,109.81	1,174,386.90	2,523,998.72
		35,359,497.99		1,174,386.90
Balance due Standifer		1,349,611.82		1,349,611.82

Mr. Parker's memorandum to Mr. Schlesinger is attached hereto as Exhibit A. You will note that, while Mr. Parker made a deduction of $1,026,416.23 from the award of May 26, 1921, he added $637,674.84 to the award. The figures shown by Mr. Parker may be summarized as follows:

Gross credits to contractor	$1,987,286.66
Deductions from award	1,026,416.23
Balance due contractor	960,870.43

This balance is $37,545.80 less than the final award. I presume that this is made up of further allowances determined upon by Mr. Schlesinger and included in his total recommendations to the Shipping Board. A rough analysis of the Standifer settlement, beginning with the award of May 26, 1921, is as follows:

Award of May 26, 1921		$2,791,725.07
Deductions made by audit		942,113.25
Net award after audit		1,849,611.82
Less payment made		500,000.00
Balance due on May 26 award		1,349,611.82
Additions to award by now—credits or deduction of debits:		
(a) One-fourth of wage claim No. 156		100,297.16
(b) One-fourth of wage claim No. 176		[1] 43,277.05
(This applies only to ordinary labor on ship construction, and does not include plant or superintendents.)		
(d) Interest on note rebated		325,000.00
(e) Freight differential		61,678.94
(f) Changes and extras, No. 156		10,888.33
(g) Changes and extras, Nos. 3 and 176		11,376.65
(h) Changes and extras (half A. B. S., No. 176)		65,156.71
(i) Unexplained allowance		37,545.80
Gross total final award		2,004,832.46
Deductions from award of May 26:		
Unlawful gain on Levy sale	$572,276.92	
Overcharge $10 per ton, material, No. 3	350,000.00	
Correction of error in audit	104,139.31	
		1,026,416.23
Net final balance due Standifer		978,416.23

[1] Allowance under (b) is actually one-third of the wage claim on 176.

None of the deductions made from the award of May 26, 1921, affected amortizations. The amortization allowances in the original award would naturally remain unchanged as follows:

Amortization contract:	
503	$369,555.19
508	16,311.01
509	125,798.66
Depreciation in cost of contract 3 WC	163,059.14
Total	674,724.00

The first deductions made by audit were reported by L. N. Stevens, chief of the accounting section of the General Comptroller's Department, under date of November 22, 1921. These deductions amounted to a net amount of $921,667.64. Later the process of audit was continued by Mr. J. L. Kennedy, district comptroller, and further deductions were made amounting to $20,435.61 as of May 1, 1922.

I am attaching hereto, as Exhibit B, an unsigned memorandum, dated July 12, 1922. This memorandum appears in Mr. Parker's file and shows not only the deductions made from the award of May 26, but states that the Standifer Corporation agreed to the deductions totaling $1,026,416.23. Also, I am attaching copy of a mimeograph statement issued to the press under date of July 12, 1922, by Elmer Schlesinger, general counsel, showing the three deductions that were made. Exhibit B is a copy of a resolution adopted by the United States Shipping Board on July 12, 1922.

Before I left for The Hague Mr. Schlesinger asked me to write a letter to him stating the highest figure which in my opinion could be justified as an award to the Standifer Corporation. I wrote him under date of July 7, 1922, suggesting a compromise figure of $1,000,000. A copy of that letter is attached as Exhibit E.

In order to make a permanent record of the difference between the award of May 26, 1921, and the Stevens audit report of November 22, 1922, and the difference between Mr. Kennedy's final figures and the audit report of November 22, 1922, I have set up the following analysis showing the differences and the changes made by Mr. Kennedy:

Credits, basis of resolution, May 26, 1921:		
3 WC	$7,972,822.36	
176 WC	4,407,062.56	
508 WH	1,412,600.00	
509 WC	738,809.65	
156 SC	21,429,313.04	
503 SC	756,772.03	
Carry charges	25,000.00	
Total		$36,742,379.64
Debits, basis of resolution, May 26, 1921:		
3 and 176	13,365,228.81	
508 WH	1,487,299.03	
509 WC	164,096.12	
156 SC	17,777,222.37	
503 SC	994,308.24	
Housing project	162,500.00	
Total		33,950,654.57
Balance awarded to Standifer		2,791,725.07

Kennedy's final debits:		
3 and 176 WC	18,470,118.87	
508 WH	1,484,173.68	
509 WC	145,910.85	
156 SC	19,022,288.17	
503 SC	1,074,507.42	
Housing project	162,500.00	
Total		35,359,497.99

Debits, Stevens report:		
8 and 176 WC	$18,418,952.97	
508 WH	1,494,178.68	
509 WC	145,910.85	
156 SC	19,016,642.00	
503 SC	1,074,507.42	
Housing project	162,500.00	
Total		$35,302,686.02
Increase in debits		56,811.97
Kennedy's final credits:		
8 WC	7,969,722.06	
176 WC	4,530,436.77	
508 WH	1,442,196.32	
509 WC	735,909.65	
156 SC	20,379,138.98	
503 SC	1,637,940.25	
Carrying charges	10,815.78	
Total		36,709,059.81
Credits, Stevens report:		
8 WC	4,528,134.52	
176 WC	4,528,134.52	
508 WH	1,455,244.35	
509 WC	765,463.11	
156 SC	20,895,475.69	
503 SC	1,637,940.25	
Carrying charges	24,842.78	
Total		36,672,733.45
Increase in credits		36,326.36

SUMMARY COMPARISON OF DEBITS AND CREDITS

Total debits by Stevens audit	$35,302,686.02	
Total debits May 26 resolution	33,950,654.57	
Increase by Stevens audit	1,352,031.45	
Total credits May 26 resolution	36,742,379.64	
Total credits, Stevens audit	36,672,733.45	
Decrease by Stevens audit	69,646.19	
Total increase in debits by Stevens		$1,352,031.45
Less payment after May 26, 191		500,000.00
Net increase by Stevens		852,031.45
Add increase in credits by Stevens		69,646.19
Total deductions in award by Stevens audit		921,677.64

ANALYSIS OF CHANGES BY KENNEDY

Balance due Standifer as per Stevens report		$1,370,047.43
Balance due Standifer as per Kennedy		1,349,611.82
Difference		20,435.61

This difference is made up by net increases in debits and credits, as shown below:

Increases in credits:		
Restoration of error in cost 3 WC	$104,139.31	
Changes and extras 176	3,604.14	
Wage increase (overtime) 176	545.90	
Charges and extras 156	6,086.03	
Total increases in credits		$114,375.38

Decreases in credits:		
Wage increase (insurance) 176	$1,847.79	
Changes and extras 508	8,251.33	
Wage increases 508	4,446.20	
Wage increases (insurance)	350.50	
Cancellation 509	26,653.46	
Wage increase 156	4,892.30	
Wage increase (insurance) 156	17,620.44	
Carrying charges	14,027.00	
Total		$77,999.02
Net increase in credits		36,376.36
Increases in debits:		
Amounts receivable 3 WC	$48,889.76	
Unclaimed wages 3 WC	10,755.80	
Accounts receivable 176	304.90	
Accounts receivable 156	10,448.47	
Total increase in debits		70,399.02
Decreases in debits:		
Repairs account Nafra contract	$384.14	
Refund charges and extras	5,938.97	
Refund wage increases	2,341.82	
Refund overtime	119.82	
Accounts receivable 156	4,802.30	
Total increase in debits		13,587.05
Net increase in debits		56,811.97
Deduct net increases in credits		36,376.36
Net deduction by Kennedy		20,435.61
Total debits by Kennedy		35,359,497.99
Total debits by Stevens audit		35,302,686.02
Increase in debits by Kennedy		56,811.97
Total credits by Kennedy		36,709,109.81
Total credits by Stevens audit		36,672,733.45
Increase in credits by Kennedy		36,376.36

SUMMARY OF DEDUCTIONS IN AWARD BY STEVENS AND KENNEDY

Deductions by Stevens audit	$921,677.64
Later deductions by Kennedy	20,435.61
Total deductions by Stevens and Kennedy	942,113.25

Ample proof is available that no reductions in the award of May 26, 1921, whether made by the auditors or by the Shipping Board, could have affected the allowance for amortization on the canceled ships or the allowance for depreciation in the costs of 3 WC.

As already shown, the changes by Mr. Kennedy in addition to the changes by the Stevens audit did not affect amortization or depreciation. That the Stevens audit did not affect amortization or depreciation is shown by the appended analyses of the changes made by the Stevens audit.

From the foregoing it is clear that all deductions from May 26, 1921, audit are fully identified and that not one of these deductions affected the original allowance for amortization or depreciation.

TILDEN ADAMSON,
Special Examiner.

Mr. DAVIS. Did anyone else call on you from the bureau after Mr. Lewis was there?

Mr. ADAMSON. Yes, sir; a gentleman who introduced himself as Mr. Hering. I think he came three or four days, or approximately a week, after Mr. Lewis was there.

Mr. DAVIS. I would like to ask if that is the Mr. Hering that signed the conference report?

Mr. HARTSON. He apparently is the same man. I have no personal knowledge of it.

Mr. DAVIS. What was the purpose of his call?

Mr. ADAMSON. Apparently, he wanted to check over the findings, as reported to him by Mr. Lewis. I had all the files and papers before me at the time, and was prepared to show in detail just how the amortization had been arrived at, but he did not care to go into that, and, in fact, rather argued that because the formal contract of July 15, 1922, had stated a lump sum, no amortization could have been allowed. That was his general attitude. He did not stay very long and did not go into the details of it.

Mr. DAVIS. Did he make any further comments about it except what you have stated?

Mr. ADAMSON. Well, there were some general comments, but they have passed out of my mind.

Mr. DAVIS. Do you remember the nature of them?

Mr. ADAMSON. The general trend of what he said was to the effect that he did not think that contractual amortization had been allowed, because this was a lump-sum contract.

Mr. DAVIS. And you showed him the reports and the fact that it was a set-up, just as you said here?

Mr. ADAMSON. I showed him some of the reports, but he did not have time to go into them, apparently.

Mr. DAVIS. Was the taxpayer furnished with copies of these reports and these figures that you have spoken to us about?

Mr. ADAMSON. Which reports are those?

Mr. DAVIS. Showing this amortization and the way it was figured out, the deductions, etc.?

Mr. ADAMSON. The taxpayer worked with the members of the construction claims board, who recommended the settlement of May 26. He knew every item on that, and then he was sent a copy of the resolution of May 26, and when the audit report came in making these deductions, he was given a copy of that report. He and his comptroller, Mr. Soule, and Mr. Brown, one of his auditors, came on, and they, of course, were already familiar with the deductions made, because they had been working with our auditors; but they went over the report and made an extended reply to the audit, protesting the deductions. They knew every item of the deductions made by the auditors.

Mr. DAVIS. I think that is all.

The CHAIRMAN. Do you want to ask the witness any questions, Mr. Hartson?

Senator WATSON. I would like to ask him a few general questions, Mr. Chairman.

As I understand it, the Standifer Construction Corporation built ships for the Government?

Mr. ADAMSON. Yes, sir.

Senator WATSON. To what amount, do you know, as covered by the original contracts?

Mr. ADAMSON. They had six contracts. I suppose the total contract price ran about $40,000,000.

Senator WATSON. How many ships did they finally build for the Government?

Mr. ADAMSON. I can not tell you the number of ships. They built 10 steel ships under contract 156, and 5 steel ships under contract 503, for us.

Senator WATSON. You say "for us." Were you connected with the Shipping Board?

Mr. ADAMSON. Yes; with the Shipping Board. And then 5 cancelled ships under contract 503 were completed for the Naphra Co. (Inc.), under an arrangement by which we financed the completion. So there were 20 steel ships completed. They completed 10 wooden ships under contract No. 3, and I should say there were about 8 or 10 other ships completed under the other wood-ship contracts.

Senator WATSON. By this construction company?

Mr. ADAMSON. Yes, sir.

Senator WATSON. What was the aggregate of their expenditures as related to the aggregate of the contracts, do you know?

Mr. ADAMSON. Well, the total credits allowed to them amounted to about $36,000,000. Of course, that included their profit.

Senator WATSON. Well, was any question raised about the profit; was there any dispute about it?

Mr. ADAMSON. There was a dispute about profit on the wood-ship contract No. 3, which was originally a lump-sum contract. Mr. Standifer contended that that should be changed to cost plus. He wanted us to pay cost and allow him a profit on cost.

Senator WATSON. Was that the policy of the Government generally in the construction of ships?

Mr. ADAMSON. The policy of the board?

Senator WATSON. Yes.

Mr. ADAMSON. No, sir.

Senator WATSON. It was not?

Mr. ADAMSON. The board did in this case, however, agree that they would save him from any possible loss on contract No. 3 by paying all of his costs as audited, and that was part of the resolution of May 26, 1921.

Senator WATSON. Cost plus?

Mr. ADAMSON. No, sir; not cost plus. There was no profit allowed on that.

Senator WATSON. I see.

Mr. ADAMSON. That was done merely to be as generous as possible and save him from any possible loss on that contract.

Senator WATSON. Do you know whether he did lose any money on that contract or not?

Mr. ADAMSON. I do not believe he lost any money, because the costs charged into the ships under contract No. 3WC were so high that it is doubtful if they ever cost that much. In fact, he agreed in this final settlement to a deduction of $350,000 for overcharge on materials; that is, according to a statement in the files of the Shipping Board, he agreed to the deduction.

Senator WATSON. Do you know of your own knowledge, after having gone through all of these transactions, whether this company did lose money on all of these contracts, and if so, how much?

Mr. ADAMSON. My impression was that they had made money, because one of his claims was for, I think, $1,800,000 prospective profits, and that was based on the book profits on five ships completed for the Naphra Co.; that is, apparently he had made $1,800,000 profit on this contract for five ships. My impression was that they made quite a considerable sum of money on the whole transaction.

Senator WATSON. How long were they in getting settlement from the Shipping Board; how long a period did it cover?

Mr. ADAMSON. Their first claim was put in in 1919 and, as I say, that was replaced with a number of other claims in larger amounts, so that final settlement was not made until July 15, 1922. That was the date of the contract. The settlement was approved by the Shipping Board.

Senator WATSON. Well, when did he get his money?

Mr. ADAMSON. On July 16 or 17, I think.

Senator WATSON. 1922?

Mr. ADAMSON. Yes, sir.

Senator WATSON. He received payment in full for the whole adjustment of the claim?

Mr. ADAMSON. The final amount of $998,000 and odd was paid him, I think, on the 17th of July, or thereabouts.

Senator WATSON. Then, about two years elapsed from the time the first claim was filed until final settlement. Was any interest allowed him on the deferred payments during that time?

Mr. ADAMSON. Apparently there was interest of about $325,000 allowed him.

Senator WATSON. You worked in collaboration with certain gentlemen from the Bureau of Internal Revenue in the adjusting of the tax problem, did you?

Mr. ADAMSON. No, sir; not in collaboration at all, simply in explanation of the award made by the Shipping Board.

Senator WATSON. Yes; that was your department?

Mr. ADAMSON. Yes.

Mr. HARTSON. Mr. Adamson, if I understand you correctly, the board of directors of the Emergency Fleet Corporation on May 26, 1921, made an award to the Standifer Co. of $2,791,000?

Mr. ADAMSON. $2,791,725.07; yes, sir.

Mr. HARTSON. Subject, however, to audit?

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. Have you a copy of that resolution?

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. I would like to have that resolution go into the record.

The CHAIRMAN. There is no objection.

(The resolution referred to has already been inserted in this record in connection with the discussion of the tentative settlement.)

Mr. HARTSON. Does that resolution, Mr. Adamson, set forth in detail the elements of the items going to make up that grand total?

Mr. ADAMSON. Not the elements. It sets up the major items. The subtotal, in some cases, would include possibly 100 or 200 or 1000 items.

Mr. HARTSON. I see. Is there any other specific item there which is characterized as contractual amortization?

Mr. ADAMSON. No, sir.

Mr. HARTSON. So that on the face of that resolution adopted by the board of directors on May 26, 1921, there is nothing to indicate that an allowance has been made for contractual amortization?

Mr. ADAMSON. That is true of everything except the contractual amortization on the housing project, the Vancouver homes. There it is clearly to be seen from the resolution that there is amortization of $187,500 allowed him.

Mr. HARTSON. In what way is it clearly to be seen? Just indicate in what manner it is shown.

Mr. ADAMSON. Shall I read it?

Mr. HARTSON. Yes; I would like to have you read it.

Mr. ADAMSON (reading):

That the housing project organized by the contractor under the title "Vancouver Home Co." for which the Emergency Fleet Corporation advanced the sum of $350,000 to finance said project and for which the final terms of the loan contract the contractor was made surety for the loan to the realty company, be taken over by the G. M. Standifer Construction Corporation, the contractor to pay to the Emergency Fleet Corporation the sum of $162,500 in full and final settlement of said loan, and said Emergency Fleet Corporation to release all right, title, and interest therein on payment of said $162,500.

The amortization, of course, was the difference between the $350,000 loan and the $162,500 which was received in payment for the loan.

Mr. HARTSON. Yes; I can agree with you that that difference probably is amortization. There was no specific identification even under that item of contractual amortization as such?

Mr. ADAMSON. In the other case, the amortization is shown in the details leading up to the figures used here, and Mr. Standifer was fully informed of every item making up those total costs. He worked with Mr. Wright, and the others, who prepared the report.

Mr. HARTSON. Do I understand that an analysis of the figures which were used to make up the report which was embodied in this resolution does show that certain amounts were allowed by this company for contractual amortization?

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. But in the resolution itself, there is nothing to specifically identify that item.

Mr. ADAMSON. That is true, except on the housing.

Mr. HARTSON. The sum that you said was, however, included in this report, but not specifically so identified as contractual amortization, was allowed in the amount of $862,000.

Mr. ADAMSON. $862,500.

Mr. HARTSON. After that resolution was passed, there were many conferences held, no doubt; is that true?

Mr. ADAMSON. There were, months after the resolution was passed, beginning in September, I think.

Mr. HARTSON. Amended claims were filed by Mr. Standifer, were there not?

Mr. ADAMSON. Well, he filed claims in a more or less informal manner with Mr. Ward, one of our special counsel.

Mr. HARTSON. And in the meantime, subsequent to this resolution, there was an audit made?

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. So that following the resolution and the adoption therein of some maximum sum which might be allowed the company, there were certain subtractions from that maximum sum which resulted because of an audit, and as opposed to that Mr. Standifer was coming in and making some additional claims.

Mr. ADAMSON. Yes, sir; and Mr. Schlesinger, I think, made certain allowances on those claims.

Mr. HARTSON. And that extended over a period of time up until there was a final agreement between the contracting parties.

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. And when was that agreement consummated?

Mr. ADAMSON. By the Shipping Board's action of July 12, 1922, approving the resolution.

Mr. HARTSON. Now, in that connection, approving this resolution, or a resolution, was there any specific identification of an item of $862,500 as contractual amortization to this company?

Mr. ADAMSON. There was not.

Mr. HARTSON. After that action was taken, there was a formal contract entered into, was there not?

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. And that bears date of July 15, I think you said?

Mr. ADAMSON. Yes, sir; that is correct.

Mr. HARTSON. 1922?

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. I would like to have that contract go into the record, too, because I think it is going to be material here, as to just what the legal effect of that contract was, from the standpoint of allowance of contractual amortization.

Mr. ADAMSON. Gentlemen, I have a mimeographed copy of the contract. It is uncertified.

Mr. HARTSON. I have not any criticism of its not being certified.

Mr. DAVIS. That is all right, so far as I am concerned.

Mr. HARTSON. I do not care to have you read it now, but I would like to have it go into the record.

The CHAIRMAN. There is no objection.

(The copy of the contract referred to is as follows:)

SETTLEMENT AGREEMENT AND RELEASE AFFECTING CONTRACTS W. C. 3, S. C. 156, W. C. 176, S. C. 503, W. H. 508, W. C. 509, WITH THE G. M. STANDIFER CONSTRUCTION CORPORATION

Agreement entered into this 15th day of July, 1922, between G. M. Standifer Construction Corporation, a corporation organized and existing under the laws of the State of Oregon, party of the first part, and United States Shipping Board, acting as such and also in behalf of Government of the United States of America, by United States Shipping Board Emergency Fleet Corporation, a corporation organized and existing under the laws of the District of Columbia, and hereinafter referred to as the Fleet Corporation, party of the second part, witnesseth:

Whereas the party of the first part and the United States Shipping Board Emergency Fleet Corporation, representing the United States of America, have heretofore entered into various contracts, agreements and mortgages, to wit:

Contract W. C. 3, dated May 14, 1917, for the construction of 10 wooden steamships.

Contract S. C. 156, dated January 8, 1918, for 10 steel steamships.

Supplemental agreement to contract 156, dated July 18, 1918, providing for payment of interest.

Contract W. C. 176, dated February 1, 1918, for six wooden steamships.
Contract S. C. 503, dated September 20, 1918, for five steel ships.
Contract W. H. 508, dated October 2, 1918, for four wooden hulls.
Contract W. C. 509, dated October 2, 1918, for six wooden steamships.
Mortgage on three plants of the G. M. Standifer Construction Corporation, dated October 18, 1918, in the sum of $1,300,000.

Bond in sum of $350,000 and mortgage to secure same, both dated July 1, 1918, given by Vancouver Home Co., a corporation organized and existing under the laws of the State of Oregon, to the G. M. Standifer Construction Corporation, the bond being indorsed, guaranteed, and delivered to the Fleet Corporation, and the mortgage assigned by the G. M. Standifer Construction Corporation to the Fleet Corporation.

Whereas the following contracts have been heretofore cancelled by the United States Shipping Board Emergency Fleet Corporation, namely; Contract S. C. 503, contract W. C. 509; one vessel cancelled under contract W. H. 508; and

Whereas all other vessels mentioned in the various contracts have been completed and accepted; and

Whereas during the execution of the work and performance of said contracts, various controversies, disputes, and disagreements arose and have not heretofore been fully settled and agreed upon; and

Whereas the contractor has presented various claims for the cancellation of the said three contracts above mentioned as well as claims in connection with certain instructions and letters given regarding contract W. C. 3; and

Whereas the contractor has various other claims regarding wage reimbursement, changes and extras, eliminations, charge backs, freight differential, interest, and damages arising from various causes to date; and

Whereas it is the desire and intention of both parties to fully and completely settle, compromise, and adjust all of said claims, as well as any other claims of any character, kind, or nature whatsoever that the party of the first part may have on account of the matters above mentioned, or any other claims arising from any cause whatsoever; and

Whereas it is also the intention of the parties that the party of the second part shall, in view of the settlement made by this contract, fully settle, adjust, liquidate, and release all claims of whatsoever nature that it may have against the party of the first part and the Vancouver Home Co.;

Now, therefore, in consideration of the premises and the mutual covenants herein contained, and upon other good and valuable considerations, it is agreed by the parties hereto as follows:

First. The said party of the second part shall forthwith pay to the party of the first part the sum of $998,416.23.

Second. The party of the second part shall take over and assume responsibility for the settlement of all proper commitments for undelivered materials applying to canceled hulls under contracts 508, 509, and 503 S. C., including commitment to Fred C. Ballin for royalties, and to release the party of the first part of all liabilities thereon providing the party of the first part shall promptly notify the party of the second part of any claims made against the party of the first part by reason of said commitments or of any suits filed against the party of the first part on account of said commitments, and providing further that the party of the first part shall at all times render such assistance and furnish such records as are necessary to properly investigate or defend any claims or action that may be brought in connection with said commitments. It is understood and agreed that any property or benefits accruing from the settlement of these commitments are to be and belong to the party of the second part and the first party hereby agrees that the second party shall have and receive credit for whatever sums have been advanced to any subcontractors by the party of the first part. It is further agreed and understood that all materials of whatsoever kind, character, or description now in the yards of the party of the first part shall be and remain the property of the party of the first part.

Third. The party of the first part agrees to indemnify and hold the party of the second part harmless against a certain action brought by the Pacific Marine Iron Works in the circuit court of the State of Oregon for Multnomah County for the sum of $48,156.50, or any other action brought by the Pacific Marine Iron Works with reference to the subject matter of said suit.

Fourth. The greater part of the work under the various contracts above mentioned was carried out under a financial agreement commonly known as an

imprest fund, the Fleet Corporation advancing money to take care of the pay rolls, etc. A number of workmen and other employees have not called for the checks due them for work, or have lost the checks, or for various other reasons the checks issued in payment for certain wages have not been cashed. The approximate amount of these uncalled-for wages is $30,000. The Fleet Corporation has heretofore required the party of the first part to retransfer or pay back to the Fleet Corporation the full amount of said unclaimed wages. In order to settle and determine this question as between the party of the first part and the Fleet Corporation it is agreed that the Fleet Corporation shall retain said funds that have been repaid on account of said unclaimed wages and shall hold the party of the first part harmless against claims of employees for unpaid wages which have been returned to the Fleet Corporation as aforesaid.

Fifth. The party of the second part shall execute and deliver to the party of the first part such instruments, releases, or other documents as are necessary to effectually release the mortgages amounting to $1,300,000 given by the G. M. Standifer Construction Corporation, dated October 18, 1918, to the United States Shipping Board Emergency Fleet Corporation.

Sixth. The party of the second part hereby agrees to indorse without recourse and deliver to the G. M. Standifer Construction Corporation the bond amounting to $350,000, dated July 1, 1918, given by the Vancouver Home Co., to the G. M. Standifer Construction Corporation, and later assigned to the Fleet Corporation, and the Fleet Corporation further agrees to reassign to the G. M. Standifer Construction Corporation the mortgage amounting to $350,000 given July 1, 1918 by the Vancouver Home Co., to the G. M. Standifer Construction Corporation, which mortgage was heretofore assigned to the Fleet Corporation by the party of the first part, and the party of the second part further agrees upon the execution of this contract to reassign and deliver to the party of the first part the stock of the Vancouver Home Co., now being held by the Emergency Fleet Corporation as security for the loan secured by the mortgage of the Vancouver Home Co. dated July 1, 1918.

Seventh. The party of the second part further agrees to reassign and deliver to the party of the first part the leases on the yards of the party of the first part which have heretofore been assigned and delivered to the Fleet Corporation.

Eighth. The party of the first part hereby agrees to idemnify and protect the United States of America, the United States Shipping Board, and the United States Shipping Board Emergency Fleet Corporation in its individual capacity and in its capacity as representative and agent of the United States against any and all claims, actions, or suits of any character whatsoever of the Vancouver Home Co.

Ninth. The party of the first part, for itself and its successors and assigns, does hereby remise, release, and forever discharge the United States of America, the United States Shipping Board, and the United States Shipping Board Emergency Fleet Corporation and their respective successors and assigns, jointly and severally, of and from all action and actions, cause and causes of action, suits, debts, dues, sums of money, bonds, covenants, contracts, agreements, damages, claims and demands in law, and in equity, and in admiralty, of every sort, kind and description whatsoever, arising or growing out of, or in any way connected with, the previous dealings and relations of the parties hereto, which against the said party it ever had, now has, or which its successors or assigns, or any of them, hereafter can, shall or may have, from the beginning of time up to the date of these presents, except as hereinbefore in this contract specifically provided.

Tenth. The party of the second part, for itself and its successors, does hereby remise, release and forever discharge the party of the first part, its successors and assigns of and from all action and actions, cause and causes of action, suits, debts, dues, sums of money, bonds, covenants, contracts, agreements, damages, claims and demands, in law, and in equity, and in admiralty, of every sort, kind and description whatsoever, arising or growing out of, or in any way connected with, the previous dealings and relations of the parties hereto, which against the said party it ever had, now has, or which its successors or assigns, or any of them hereafter can, shall or may have, from the beginning of time up to the date of these presents, except as herein before in this contract specifically provided, and for taxes.

In witness whereof the parties hereunto have executed this agreement by causing the same to be signed respectively by an officer of the said party

of the first part and by an officer of the said Fleet Corporation, acting for the said party of the second part as aforesaid, and by causing the corporate seals of the said party of the first part and of the said Fleet Corporation to be hereunto affixed, duly attested, on the day and year first above written.

G. M. STANDIFER CONSTRUCTION CORPORATION,
By G. M. STANDIFER, *President.*
UNITED STATES SHIPPING BOARD,
By UNITED STATES SHIPPING BOARD
[SEAL.] EMERGENCY FLEET CORPORATION,
By ELMER SCHLESINGER, *Vice President.*

Attest: WILLIAM H. DONOVAN,
Assistant Secretary.

As to form:
S. H. E. FREUND.
J. F.
J. T.
[SEAL.]

J. PIERSON JAMES.
Assistant Secretary.

G. M. STANDIFER CONSTRUCTION CORPORATION,
Vancouver, Wash.

This is to certify that the following is a copy of a resolution adopted at a meeting of the board of directors of the G. M. Standifer Construction Corporation, held at its offices at Vancouver, Wash., on July 10, 1923, at which were present R. V. Jones, L. B. Menefee, and N. C. Soule, constituting a majority of the board of directors of said corporation.

"*Resolved*, That full authority is hereby given to G. M. Standifer, president of this corporation, to make settlement with the United States Shipping Board Emergency Fleet Corporation in connection with all matters unsettled and now pending between this corporation and the said Emergency Fleet Corporation, and the said G. M. Standifer is hereby authorized to sign and execute such settlement agreement as may be necessary in the premises.

"*Further resolved*, That William H. Donovan be and he is hereby appointed assistant secretary of this corporation, with authority to sign with the president and attest said settlement agreements, and to do such other things in connection therewith as may be necessary."

[SEAL.] G. M. STANDIFER, *President.*

WASHINGTON, D. C., *July 17, 1923.*

Mr. HARTSON. I have no further questions of this witness.

Mr. DAVIS. I think a copy of the letter ought to go with the resolution.

Mr. HARTSON. Oh, yes; I think we ought to put in just what the record shows covering the transaction in the Shipping Board.

Senator JONES of New Mexico. That letter is from whom and to whom?

Mr. ADAMSON. From the general counsel of the Fleet Corporation, Shipping Board, to G. M. Standifer Construction Corporation, transmitting a copy of the resolution of May 26.

Mr. DAVIS. Is that explanatory of the resolution and has it reference to it?

Mr. ADAMSON. Yes, sir.

(A copy of the letter referred to has already been inserted in this record in connection with the tentative settlement.)

Senator WATSON. When did the dispute about the amount of taxes to be paid begin?

Mr. ADAMSON. I can not tell when it began. I think it was in October of 1923 that it was first called to my attention.

Senator WATSON. October, 1923?

Mr. ADAMSON. Yes, sir.

Senator WATSON. Do you know how long it arose prior to that?

Mr. DAVIS. I think, in answer to that question, on September 4, 1923, the taxpayer filed a brief demurring to the findings of the engineer on this contractual amortization matter.

Mr. HARTSON. I have another question or two.

During the time that the negotiations were progressing between Mr. Standifer and your organization there was no change made, as I understand it, by the Shipping Board or Emergency Fleet Corporation in any way altering this allowance of $862,000?

Mr. ADAMSON. If there was a change I have not been able to find any evidence of it.

Mr. HARTSON. Would you testify to the committee that there was no change made in that, and that that stood right through the negotiations, and was finally carried into effect by the contract entered into on July 15, 1922?

Mr. ADAMSON. I testify that I believe that there was no change made affecting amortization.

Mr. HARTSON. Now, the Bureau of Internal Revenue, in considering whether contractual amortization had been allowed by the Shipping Board, would have to go to something other than the contract which was entered into, settling the dispute between Mr. Standifer and the Shipping Board?

Mr. ADAMSON. They did go back of that.

Mr. HARTSON. My question is that it would have to, would it not?

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. Because the contract itself did not indicate that it was on the basis of a contract which was or has been turned into a lump-sum settlement, was it not?

Mr. ADAMSON. That is true. Well, it was not what we call a lump-sum settlement, but the amount to be paid to the contractor was stated as a lump sum.

Mr. HARTSON. There being nothing on the face of the contract to indicate whether contractual amortization had been allowed the company by the Shipping Board, the bureau, through its representatives, came over to find out what the elements were that went to make up this final settlement?

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. And the bureau called on you in the person of Mr. Lewis, in the first instance, and later on in the person of Mr. Hering?

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. And in both instances, if I understand you correctly, you pointed out clearly to these men and gave them a full interpretation of the legal effect of what had been done by the Shipping Board in the settling of the case by contract.

Mr. ADAMSON. In the case of Mr. Lewis, I pointed it out rather clearly. In the case of Mr. Hering, I attempted to point it out clearly, but Mr. Hering seemed just a little bit impatient, and did not go into it in the same detail as Mr. Lewis had gone into it.

Mr. HARTSON. You said to the committee that Mr. Hering seemed to leave the impression with you that it was a lump-sum contract, and there was not much doubt about it, and therefore the amortization allowed by the Shipping Board could not be considered by

the bureau. Did Mr. Lewis leave any impression with you as to what his views were, following your conference?

Mr. ADAMSON. The impression I got from Mr. Lewis was that he was convinced that contractual amortization had been allowed.

Mr. HARTSON. I think that is all.

Mr. DAVIS. That is all.

Attached to the engineer's report to the committee, I find Exhibit B, which appears to be a copy of the engineer's report, submitted by Mr. Griffith, the engineer, and it contains the following statement:

It was found from the Emergency Fleet Corporation's records that contractual amortization amounting to $305,168.91 had been allowed.

That refers to only one contract, but I offer it for the purpose of showing that the engineer who made the first report had access to the Emergency Fleet Corporation books, and knew about what the allowance was in reference to contractual amortization.

The CHAIRMAN. And, of course, the conferees had this report before them?

Mr. DAVIS. The conferees had this report before them, and the conference was held after this report was rendered.

I now show Witness Thomas a copy of a statement purporting to be signed by E. T. Lewis, addressed to Mr. Keenan, chief of appraisal section, and I will ask him to read it.

Mr. THOMAS. It is undated, and reads:

Reference is made to the attached conference report on the case of the G. M. Standifer Construction Co.

The question of contractual amortization has been carefully investigated and recommendation is made that the amount arrived at by the engineer be allowed to stand.

Taxpayer claims that a lump-sum settlement was effected with the Fleet Corporation for $998,416.23 and that this amount did not include any amortization. A review of the records of the Fleet Corporation disclosed the tentative settlement of October 25, 1921, to be the basis for the final settlement. The amount of $998,416.23 was arrived at by taking the amount of the 1921 settlement and making additions and deductions as set forth on the attached schedule. Since none of these adjustments refer to the original amortization allowed in the 1921 settlement, it is considered that the final award allows contractual amortization of $837,224. The writer conferred with Mr. Talbert and Mr. Adamson of the Fleet Corporation, who confirmed the above.

Mr. Murphy requested that another conference be arranged to discuss this matter and I suggested that he take the question up with you and if necessary, have Mr. Hering present at the conference to pass on the points at issue.

That is signed by Mr. E. T. Lewis.

Mr. DAVIS. Does the record show that this is the Mr. Murphy, the attorney for the taxpayer?

Mr. PARKER. One of the conference reports will show it.

Mr. DAVIS. I think that is all.

Mr. HARTSON. Mr. Chairman, I would like to request an adjournment until to-morrow. It is nearly the adjournment hour. I have had no opportunity to examine this case at all, and I would like to talk with some of the people from the bureau that we have here, who passed on it and who considered it. Therefore, I would request an adjournment until to-morrow, so that I may have an opportunity to discuss it with our people.

Senator WATSON. Was this case ever brought to your attention, Mr. Hartson?

Mr. HARTSON. Never to my personal attention, and, so far as I know, never to the attention of my office.

The CHAIRMAN. Does anyone know what brought it to the attention of our engineers?

Mr. PARKER. I guess I can answer that. When I first went into the bureau, into the amortization section, I naturally studied the methods there, and it appeared to me that there was considerable danger of a mistake arising through the matter of contractual amortization granted by other Government departments being overlooked. Therefore, when Mr. Thomas came, he was more or less familiar with the subject, and he was put on that work. This happened to be one of the cases that he took. There was no special reason for picking this one any more than others, and we have some others on this same subject.

The CHAIRMAN. This was not an Ernst & Ernst case?

Mr. PARKER. No, sir.

Mr. MANSON. I might say that Mr. Thomas, the engineer here, is a former employee of the Shipping Board. He was attached to the legal department as consulting engineer.

The CHAIRMAN. If there is no objection, we will adjourn here until 10 o'clock to-morrow morning, when we will resume with the hearing of this case.

(Whereupon, at 11.55 o'clock p. m., the committee adjourned until to-morrow, Friday, December 5, 1924, at 10 o'clock a. m.)

INVESTIGATION OF THE BUREAU OF INTERNAL REVENUE

FRIDAY, DECEMBER 5, 1924

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE
THE BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to adjournment of yesterday:

Present: Senators Couzens (presiding), Watson, and Jones of New Mexico.

Present also: Earl J. Davis, Esq., and L. C. Manson, Esq., of counsel for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. R. C. Nash, Assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, Solicitor, Bureau of Internal Revenue; Mr. S. M. Greenidge, Head Engineering Division, Income Tax Unit, Bureau of Internal Revenue.

The CHAIRMAN. If you are ready, gentlemen, you may proceed. I think you want to go ahead now, Mr. Hartson?

Mr. HARTSON. Yes, sir; I will ask Mr. Lewis to take the stand.

TESTIMONY OF MR. EARLE T. LEWIS, AUDITOR, BUREAU OF INTERNAL REVENUE

(The witness was duly sworn by the chairman.)

Mr. HARTSON. Give your full name, Mr. Lewis, to the reporter.

Mr. LEWIS. Earle T. Lewis.

Mr. HARTSON. Are you employed by the Bureau of Internal Revenue?

Mr. LEWIS. Yes, sir.

Mr. HARTSON. What position do you hold with the bureau?

Mr. LEWIS. Auditor.

Mr. HARTSON. Have you had any connection with the settlement of the Standifier case in the bureau?

Mr. LEWIS. Yes, sir; in regard to getting information as to contractual amortization.

Mr. HARTSON. Will you tell the committee how the matter first came to your attention?

Mr. LEWIS. As I remember it, the matter was first brought up by Mr. Keenan, who, at that time, had just taken over the appraisal section. A conference had been held at which this question of contractual amortization was brought up, and the conferees were not

fully decided on the question and left it open for further investigation. Mr. Keenan asked me, as at that time I was subsection chief of the old amortization section, and being thoroughly familiar with where to find this information, to go to the Shipping Board and get him the full facts and make a report to him, so that he would decide what to do further on the case. I went to the Shipping Board.

Mr. HARTSON. You then went to the Shipping Board, did you?

Mr. LEWIS. I went to the Shipping Board and, through Mr. Adamson, I got information on the case, just as Mr. Adamson gave it to me. In fact, he gave me a detailed statement, which he said was the settlement, and I accepted Mr. Adamson's statements and facts and figures.

Mr. HARTSON. Did you then report to Mr. Keenan after your conference with Mr. Adamson?

Mr. LEWIS. I then made a memorandum report to Mr. Keenan, stating my findings and that, based upon the information received, I considered that this was contractual amortization.

Mr. HARTSON. Is that the report which was read into the record yesterday by Mr. Thomas?

Mr. LEWIS. Yes, sir.

Mr. HARTSON. That report is undated, is it not?

Mr. LEWIS. It is undated, but it was just prior to the second conference. It was made between the first and second conferences.

Mr. HARTSON. In that report, you stated that that contractual amortization had been allowed by the Shipping Board?

Mr. LEWIS. Yes, sir.

Mr. HARTSON. Will you tell the committee the basis used by you in making that report?

Mr. LEWIS. Well, the basis used by me in making that report was Mr. Adamson's figures and statements. Mr. Adamson made the statement to me that a final settlement had been made with the Standifer Corporation, and that contractual amortization had been allowed. Mr. Adamson brought out a statement, a supposed set-up of figures coming to the total, I believe, of $996,000 and some odd cents.

Mr. HARTSON. Up to that time, if I understand you correctly, you had had no conferences with representatives of the Standifer Corporation?

Mr. LEWIS. No, sir.

Mr. HARTSON. And knew nothing about the case, except what Mr. Keenan had told you in asking you to go over to see Mr. Adamson and the knowledge that you gained through your conversation with Mr. Adamson?

Mr. LEWIS. That is correct.

Mr. HARTSON. That, as I understand it, was all the information you had at the time you prepared this memorandum which Mr. Thomas read into the record yesterday?

Mr. LEWIS. Yes, sir.

Mr. HARTSON. Now, what happened after you prepared this memorandum to Mr. Keenan?

Mr. LEWIS. Well, if you will notice, I suggested in that memorandum that another conference should be held.

Mr. HARTSON. Let me read that exact language.

Mr. LEWIS. Yes; you might read that.

Mr. HARTSON (reading):

Mr. Murphy requested that another conference be arranged to discuss this matter, and I suggested that he take the question up with you and, if necessary, have Mr. Hering, present at the conference to pass on the points at issue.

Mr. LEWIS. Now, Mr. Hartson, you will understand that that report of mine was not a final report for the closing of the case. It was simply the information that Mr. Keenan had requested me to get in order that they might settle the case. Now, the first conference which was arranged suggested, I think, that this information be gotten and a further conference arranged and the case settled.

Mr. HARTSON. Was there a conference held after you reported to Mr. Keenan?

Mr. LEWIS. There was another conference held, yes sir.

Mr. HARTSON. Did you participate in that conference?

Mr. LEWIS. I sat in that conference.

Mr. HARTSON. Will you tell the committee now what happened in that conference?

Mr. LEWIS. Prior to sitting in the second conference, I was enabled to go over the brief, which the Standifer Co. had presented after the first conference, protesting this item of contractual amortization. Before I went to the Shipping Board I had never seen this brief, and I had seen none of the Standifer statements, but on examining the brief before going into the second conference, the statements in there, under oath, by the Standifer Construction Corporation, that no contractual amortization, as such, had ever been allowed by the Shipping Board, but that they had simply received a lump sum of $996,000, or $998,000, and they went on to elaborate that there was a set-up of the figures on the Shipping Board books, of which they had no knowledge at the time of making the settlement. This was further elaborated on by Mr. Standifer, president of the company, who sat in the conference. Mr. Standifer stated that the settlement was made as a lump-sum settlement; that the settlement——

Mr. HARTSON. Just let me interrupt you there. With whom did he make the final settlement, if you know?

Mr. LEWIS. Yes; if I remember correctly he stated it was with Mr. Schlesinger, who at that time——

Mr. HARTSON. And Mr. Schlesinger was——

Mr. LEWIS. Chief counsel, I believe, of the Shipping Board.

Mr. HARTSON. Will you tell the committee what was represented to the bureau by Mr. Standifer concerning the terms of the settlement and the method by which it was finally arrived at?

Mr. LEWIS. Mr. Standifer stated that he had been, I believe—I don't know, but for some months or some years—trying to effect a settlement with the Shipping Board. In fact, he made his permanent home here, I believe, while he was trying to effect a settlement, and they were in one day and he stated to Mr. Schlesinger, "If you will give me a million dollars, I will call off our claim by accepting it in settlement." At that time, I believe, he had claims based on this $2,700,000, which they were juggling back and forth. They were adding figures to it and taking them off all the time. Mr. Schlesinger agreed and said, "Come back at 11 o'clock and you will have your check." So Mr. Standifer came back and Mr. Schlesinger

at that time told him, "We can not settle for $1,000,000, but will settle for $998,000," or whatever the amount was. "We do not care to make a settlement on the full sum of a million dollars."

Mr. Standifer stated at that time that he saw—that the only figures he saw was a contract drawn up, stating that he would be paid the sum of nine hundred and ninety thousand and some odd dollars in full settlement of all claims, and releasing the Shipping Board from all claims. He accepted that settlement. His statement was that these figures which Mr. Adamson produced before the committee yesterday, and which I saw when I was over there, were made up afterwards at Mr. Schlesinger's suggestion, so that they would have a paper in the files to show how they had arrived at this settlement of $990,000. Mr. Standifer's statement was that "these additions and deductions from that original award of $2,700,000 are all arbitrary," and that he never agreed to one of them. In other words, that "we might as well have pulled out the old item of contractual amortization which showed in the original claim and used that as deductions, as to have used this $500,000 for the Levy award, and one or two other items that he has in there."

It was his statements and his brief, under oath, testifying to these conditions that made me change my report and agree with the conferee and the engineer who sat in that conference, that no contractual amortization, as such, had ever been paid to Standifer.

Mr. HARTSON. Then it appears that after an extended period of negotiations over the actual terms and details of the settlement with the Shipping Board, Mr. Standifer went to the general counsel of the Shipping Board and said, "I will accept a million dollars in settlement of my claim."

Mr. LEWIS. Yes, sir.

Mr. HARTSON. Which was of course, in round numbers and in round figures?

Mr. LEWIS. Yes, sir.

Mr. HARTSON. And that he came back again to get his answer a little later and was told that they would let him have nine hundred and ninety-eight thousand and odd dollars?

Mr. LEWIS. Yes, sir.

Mr. HARTSON. At that time, and during these negotiations with Mr. Schlesinger, the set-up or the analysis of that settlement was never mentioned, was never gone into, nor agreed upon?

Mr. LEWIS. No, sir.

Mr. HARTSON. But a sum was finally settled upon between Mr. Standifer and Mr. Schlesinger.

Senator JONES of New Mexico. Mr. Witness, did you not know, as a matter of fact, that this question of amortization was a very important factor in the settlement; that is, the question of contractual amortization?

Mr. LEWIS. I did not so consider it, Senator, after looking at all of the other features of the case. The contractual amortization, as has been testified before, was not in any of the original contracts with the Shipping Board, although it was mentioned in this tentative settlement in 1921.

Senator JONES of New Mexico. Was it not a very important factor in that tentative settlement? Was not it one of the very large amounts which were being considered?

Mr. LEWIS. No; I believe it was only around $800,000 out of $2,700,000.

Senator JONES of New Mexico. Well, is not $800,000 out of $2,700,000 a good part of it?

Mr. LEWIS. Well, it was an important factor at that time—in the settlement of 1921.

Senator JONES of New Mexico. Yes. Now, when you came to the settlement, you chose to ignore that and to let all of the deductions go against the contractual amortization and apply the whole thing to the other and absolutely ignore——

Mr. LEWIS. No, sir.

Senator JONES of New Mexico. The fact that amortization had entered into the original settlement, at all. Is not that what you did?

Mr. LEWIS. No, sir; we did not totally ignore it.

Senator JONES of New Mexico. What did you do with it, then? Did you make any allowance for it in your settlement?

Mr. LEWIS. In our analysis of the final contract there was no allowance made in Mr. Standifer's final settlement. The law under which we operate in allowing amortization states that any amount allowed, specifically as such, for contractual amortization, shall be deducted.

Mr. HARTSON. Was there ever any allowance to Mr. Standifer's corporation, specifically as such, for contractual amortization?

Mr. LEWIS. No, sir; not in the final settlement, and it was only tentatively allowed in the settlement of 1921, because that settlement was never approved and paid.

Mr. HARTSON. It really was not settled, was it?

Mr. LEWIS. No, sir; it was not settled.

Mr. HARTSON. That is what is known as the so-called Benson award?

Mr. LEWIS. It is what is known as the so-called Benson award, which was ruled to be invalid, and it was never paid.

Mr. HARTSON. After Mr. Schlesinger and Mr. Standifer agreed on this amount, which, if I understand you correctly, was not analyzed, and based on certain elements going to make up that total, but was a compromise made without reference to any analysis——

Mr. MANSON. Might I inquire whether this is testimony of Mr. Hartson or of this witness?

Mr. HARTSON. Well——

Senator JONES of New Mexico. I just want to ask Mr. Hartson, do you approve of this transaction?

Mr. HARTSON. I do, sir. I do, sir; and I never knew of this case until yesterday, and I do approve of it.

The CHAIRMAN. In other words, Mr. Hartson, you choose to take the taxpayer's word entirely, rather than that of the officials of the Shipping Board?

Mr. HARTSON. Now, Senator, I think that everything that has been said here has been borne out by what Mr. Adamson said. Mr. Adamson, if I understood him correctly, was given the award agreed upon by the general counsel of his organization to Mr. Standifer, as a lump sum and then told to work backwards and analyze it. That is my understanding of Mr. Adamson's testimony.

Mr. DAVIS. Mr. Adamson came before us and in detail very specifically set up just exactly what that settlement was, in dollars and cents. He has told us what the amortization was, to a penny. This engineer, in conference with Mr. Adamson over at the United States Shipping Board, went over the figures with Mr. Adamson and made up his engineer's report, in which he recognized that the amortization was deducted, as allowed by the Shipping Board, and he now tells us that the statements that he makes here as a witness are practically based on what the taxpayer told him and not what he gathered from the case as handled by the Shipping Board.

Mr. LEWIS. No, sir.

Mr. HARTSON. Now, if there is any dispute about the question as to what the taxpayer told the representatives of the bureau, I think there might be some basis or ground for criticism that you could make; but I understand there is no dispute.

Now, Mr. Davis, we have to go to the contract of settlement, and if we can show you that that contract of settlement was for a lump sum, which after the amount was agreed upon the auditor or the subordinates in the Shipping Board tried to justify by some proper analysis, then I say that the settlement with Mr. Standifer was a lump-sum settlement, but the record shows——

Senator JONES of New Mexico. Let me ask you this, Mr. Hartson. Do you think that there was no element of contractual amortization entering into the Shipping Board settlement? You reach that conclusion from this evidence?

Mr. HARTSON. Senator, I would like to answer that in this way, that here was a claim, and a very large claim, against the Shipping Board, which had been made by the taxpayer, and in a tentative award made by Admiral Benson, contractual amortization had been allowed. Following that time, covering a period of a year or more, there were negotiations, additions, and subtractions, and the Senator will know from his experience that finally a taxpayer is, in a sense, worn out, and the Government representatives are also sick and tired of talking about a claim and adjusting the amount, and finally the claimant says, "Without trying to analyze each item that goes to make up this settlement, I will take a certain sum," and in this case, Mr. Standifer said that he would take a million dollars, which was just a round sum.

Senator JONES. But, notwithstanding that fact, do you not think that this contractual amortization item was an important factor in this settlement by the Shipping Board?

Mr. HARTSON. I do.

Senator JONES of New Mexico. Yes.

Mr. HARTSON. I do.

Senator JONES of New Mexico. Then, why was there not some allowance made for it in the settlement by your bureau?

Mr. HARTSON. Because, in our bureau we were controlled by our regulations, which state that contractual amortization had to be allowed specifically, as such, before we could recognize it.

Senator JONES of New Mexico. Oh, no.

Mr. HARTSON. Well, I should be glad to point that out.

Mr. LEWIS. Article 181, I think.

Senator JONES of New Mexico. I can see how you might put your interpretation upon it.

Mr. HARTSON. The exact language, Senator——

Mr. MANSON. That is the regulation.

Mr. HARTSON. Yes; but it is just as binding and effective upon the representatives of the bureau in adjusting this case as the law itself.

Mr. MANSON. That was not your position with reference to the spread of amortization the other day.

Mr. HARTSON. I do not so understand it at all. That was exactly my position with reference to the spread of amortization.

Senator JONES of New Mexico. And you would let a simple word deprive the Government of just revenue on a mere technicality that it was a lump sum?

Mr. HARTSON. No, Senator.

Senator JONES of New Mexico. When you knew that contractual amortization had been figured in the transaction over in the Shipping Board?

Mr. HARTSON. I think, Senator, contractual amortization was one of the important claims made by the taxpayer, and I think finally, when the settlement occurred, it was a lump-sum settlement. There may have been a compromise in the sense of the claim for contractual amortization along with a reduction or compromise in all of the other claims, but nowhere in the written contract, although other specific items are mentioned as being claimed by the taxpayer, is any reference made to contractual amortization. My point is this: I think, when the bureau came to settle this case, it had before it the compromise settlement entered into in writing, and the written terms of that contract, together with the surrounding circumstances which occurred at the time the amount was arrived at, and which was the basis for the settlement, were such that the bureau believed contractual amortization was not specifically identified.

Senator JONES of New Mexico. I will take your own point of view now, if I understand it, that because it is not specifically mentioned, although you knew it was an important factor in it, you would ignore it absolutely in your settlement.

Mr. HARTSON. I would not ignore it, simply because it was not specifically mentioned, but I would ignore it if it was not specifically allowed.

Senator JONES of New Mexico. But don't you know that it did specifically enter into the whole claim over in the Shipping Board?

Mr. HARTSON. I understand it was one of the specific claims made by the taxpayer against the Shipping Board, but I do not take the position, which I think is erroneous, that it was specifically allowed, or that it was allowed at all, in any amount.

Now, let us analyze it, Senator. The $2,700,000 tentative allowance provided for a contractual amortization allowance of $862,000, roughly speaking. That was finally settled for $998,000 plus, and the $500,000 advance that was made.

Senator JONES of New Mexico. $1,500,000?

Mr. HARTSON. Yes. The $2,700,000 was the allowance that was tentatively given by Admiral Benson. According to the circumstances of this settlement with the Shipping Board, I believe you can not show that the contractual amortization was specifically allowed, any more than you can say that any other single element was specifically allowed, and this so-called analysis of the $998,000 which

Mr. Adamson testified to yesterday was worked backwards, in other words, to justify the figures that were used when Mr. Schlesinger gave him the final terms of settlement.

Senator JONES of New Mexico. Let me ask you again: Is it not the rule of construction of contracts that you have to take all of the facts and circumstances leading up to it in order to interpret it, and when you go behind that contract and look into the records of the Shipping Board, do you not specifically find there that the only controversy was about other items, and not about contractual amortization?

Mr. HARTSON. Senator, if you go behind a written contract——

Senator JONES of New Mexico. Well, don't you have to go behind a written contract in order to interpret just such things as we have before us now? Is not that the rule of law?

Mr. HARTSON. Under certain circumstances it is the rule of law, but I do not concede that, necessarily, it is the rule in connection with these contracts. Here we have a contract as to which there is no ambiguity or dispute, and you do not go behind the contract, unless there are things about which the contract itself is ambiguous or vague.

Senator JONES of New Mexico. Right there, in order to ascertain whether or not contractual amortization was provided for in this contract, would you not have to go behind it? Could you interpret this contract otherwise when you are considering contractual amortization as being involved here at all. Don't you have to go behind it?

Mr. HARTSON. I think you would have to go behind it to find contractual amortization; yes. But I am looking at the terms of the contract, and I think it is unfair, and a court would not permit you to drag something into a written contract about which, on its face, it was clear and distinct, in order to vary the terms of the contract.

The CHAIRMAN. Well, as a matter of fact, you did go behind the contract, because two of your representatives went over to investigate the records in the Shipping Board.

Mr. HARTSON. I know, but both of them, as we will explain, were unfamiliar with the surrounding circumstances.

Mr. DAVIS. Right there, I would like to say that, accompanying the memorandum from E. T. Lewis, the witness on the stand, to Mr. Keenan, there appears in the files a statement showing the amount claimed and showing the deductions, the specific amount of those deductions, and just exactly what the deductions were; so that the witness, Lewis, was familiar with every item concerning the transaction, as far as the United States Shipping Board was concerned.

Senator JONES of New Mexico. That report of Mr. Lewis was put in the record yesterday, was it not?

Mr. DAVIS. Yes.

Mr. LEWIS. May I interrupt to say that attached to that was the statement handed to me by Mr. Adamson at the Shipping Board, which is what I based my report upon?

Mr HARTSON. And which, as stated by Mr. Adamson, was prepared after he had been given the figures by Mr. Schlesinger?

Mr. LEWIS. Yes; that is Mr. Adamson's statement. I think you will see that I say I received those figures from Mr. Adamson. I would rather have the whole report in.

Mr. DAVIS. I read it into the record on yesterday.

Mr. LEWIS. I do not remember that.

Mr. DAVIS. In your report, you make the statement, which was found from the records of the Emergency Fleet Corporation, that contractual amortization amount to $305,168.81 had been allowed with reference to that particular contract, and then you go on with reference to the others.

Mr. LEWIS. Are you referring to my report, or the report of Engineer Griffith? I am afraid you have the two reports mixed.

Mr. DAVIS. Well, I find that in the engineer's report.

Mr. LEWIS. Yes.

Mr. DAVIS. Were you familiar with that?

Mr. LEWIS. No, sir; I never saw it. As I stated, the first I saw of this case was when Mr. Keenan, after the first conference—the first conference was held after that report was written——

Mr. DAVIS. Did you not familiarize yourself with the details of the engineer's report on record, before you went over to the Shipping Board?

Mr. LEWIS. No, sir.

Mr. DAVIS. To find out what was there?

Mr. LEWIS. No, sir.

Mr. DAVIS. You did not know, when you went over to the Shipping Board, that there was an engineer's report on file?

Mr. LEWIS. Yes, sir; I knew that there was an engineer's report on file, and that the subject of contractual amortization had been approved of.

Mr. DAVIS. Did you know that the engineer stated in that report, and possibly it was found from the Emergency Fleet Corporation records, that contractual amortization had been allowed?

Mr. LEWIS. I knew that the engineer had allowed contractual amortization.

Mr. HARTSON. We have the engineer here to explain the circumstances under which that statement was made.

Mr. LEWIS. I was simply asked to go and verify the information in the Shipping Board by Mr. Keenan, so that all of the facts would be before him, in order to hold another conference, and all the facts that I received were from Mr. Adamson's papers, a copy of which I have with my report.

Mr. DAVIS. Did you know that the taxpayer and his attorney went over to see Mr. Adamson while the matter was pending in your unit?

Mr. LEWIS. No, sir.

Mr. DAVIS. And your statements with reference to contractual amortization are based mainly now upon what Standifer claimed, are they not?

Mr. LEWIS. No, sir.

Mr. DAVIS. What are they based upon?

Mr. LEWIS. They are based partly on what Standifer claimed, and partly on information which was brought out later in the conference, and which Mr. Adamson did not bring out.

Mr. DAVIS. What information?

Mr. LEWIS. Information that the Standifer Construction Co. was not familiar with the settlement, did not agree to this award of $996,000 as itemizing it, and all of Mr. Adamson's testimony will bear that out, that this information was worked up later, because I believe it is in the record that Mr. Adamson was out of the country at the time the settlement was made.

Mr. DAVIS. Did you hear Mr. Adamson testify that he laid before Standifer the entire situation with reference to deductions, etc., and that Standifer was familiar with those?

Mr. LEWIS. Well, we have Mr. Standifer's statement under oath. Now, remember, Mr. Adamson made that statement yesterday, but Mr. Adamson had not previously made that statement, except to tell me at the time I got the figures that this was the final settlement. Now, understand, this detailed amount of $996,000——

Mr. DAVIS. Mr. Adamson's statement to you, or his claims, have never at any time varied from the testimony that he gave yesterday, or from the figures that he presented to us.

Mr. LEWIS. May I read one figure from this statement?

Mr. HARTSON. I would like to ask, if I may interrupt there, whether, in that analysis, contractual amortization is specifically identified and allowed?

Mr. LEWIS. No, sir.

Mr. HARTSON. And that is the analysis which is the final figure——

Mr. MANSON. Does not that carry down a balance though?

Mr. LEWIS. Yes; that is the award of May 26, 1921, of $2,791,725.07.

Mr. MANSON. Did not Mr. Adamson show you the figures that made up that balance?

Mr. LEWIS. No, sir. Mr. Adamson showed me this statement only, but he explained that in the original claim there was a contractual amortization, which had not been changed, and which Mr. Standifer had agreed to.

Mr. DAVIS. Then he explained the deductions and additions made to that, did he not?

Mr. LEWIS. No; he showed me the additions and deductions, but Mr. Standifer had since stated that none of these items could be identified in his books. For instance, they have one item here, which they have taken as the deduction from this award, "Unlawful gain on Levy sale, $572,276.92." Mr. Standifer made the statement in conference that that amount was not in controversy; that it was originally in controversy, and had been allowed. Now, if we took that one item alone of $572,000, and deducted it from the $842,000 amortization, it would only leave $270,000 still to be accounted for.

We have another item here taken as a deduction from this award of $350,000 overcharge, $10 per ton materials No. 3. Mr. Standifer stated that that deduction had never been agreed to by him, and had never been settled by the Shipping Board.

There is another item here, in order to bring this total up to $998,000, which is given as unexplained allowances of $37,545.80, which Mr. Standifer states must have been put in to make up the total figure of $998,000. Mr. Adamson could not explain that figure.

So that, in reality, starting at the starting point here of $2,791,000, the Shipping Board figures do not tie up to the $998,000, that is, in items which they would be able to explain.

Mr. DAVIS. These statements are based mainly on what Standifer told you?

Mr. LEWIS. Not only that, but here is the statement in the record of unexplained allowances of $37,000.

Mr. DAVIS. Outside of that $37,000, then?

Mr. LEWIS. Outside of the $37,000, the other items are based on Mr. Standifer's statement, and sworn brief, that these items were never agreed to.

Mr. HARTSON. If there is any dispute about the correctness of the representations made by Mr. Standifer to the bureau, I would like to go into that.

Senator JONES of New Mexico. I am not so much concerned about that as I am concerned about the people in your bureau taking the word or the statement of a taxpayer in the face of records to the contrary.

Mr. HARTSON. Now, Senator, I must respectfully disagree with you when you say that the representatives of our bureau, in the face of the records to the contrary, took the word of the taxpayer. I think the whole testimony of Mr. Adamson shows that, after negotiations, they finally agreed on a sum roughly, and then Mr. Schlesinger called on his auditor or special examiner.

The CHAIRMAN. I do not follow you on that at all, because your own engineer's report, the report of Mr. Lewis, after conference with the Shipping Board, all of which information was before the conferees, was, in fact, absolutely ignored, and the statement of the taxpayer taken in its place. Now, that is a fact, no matter what else you may say about the contract. In substance, you knew that contractual amortization had been allowed, not only by the statement of your engineer but the statement of your auditor, after conference with the Shipping Board. Is not that the fact?

Mr. HARTSON. No, Senator.

The CHAIRMAN. Do you deny that this information was before the conferees?

Mr. HARTSON. I have explained how Mr. Lewis came to report as he did. He did not know anything about the case until he went over and heard Mr. Adamson's story, and then he came back and reported. After he had reported, and after the engineer, Mr. Griffith, whom I would like to call after Mr. Lewis has left the stand, reported, they both changed their minds about it, in the face of information furnished by the taxpayer and uncontroverted by any record in the Shipping Board. Now, both men who reported adversely on this subject were in possession of insufficient information when they made their adverse reports, and when both were confronted with more complete information they changed their minds and were in agreement on the disallowance of contractual amortization.

Mr. MANSON. I would like to ask whether you ever went back to the Shipping Board, after Standifer had made these representations, to find out what the view of the officers of the Shipping Board was as to the representations made by Standifer to you?

Mr. LEWIS. No, sir; I did not go back. I do not know whether any representative of the bureau did, but I can state that I did not, for the reason that, after rendering this original memorandum report to Mr. Keenan, I left the question open to a future conference, at which Mr. Hering sat in. Mr. Hering did sit in and was in charge of that second conference, and I simply signed the report as conferee, with Mr. Griffith. Now, whether anybody afterwards went over, I can not say; but I know that I did not. I was only over there once.

The CHAIRMAN. I think, as a matter of fact, the representatives of the bureau will remember that Mr. Adamson testified yesterday that Mr. Standifer went over to the Shipping Board or Emergency Fleet Corporation and asked them to tell the bureau not to say that any contractual amortization had been allowed.

Mr. HARTSON. Well, it is clear in the record that they did not comply with Mr. Standifer's request, and that they did tell the representatives of the bureau that contractual amortization had been allowed.

The CHAIRMAN. That is true.

Mr. HARTSON. That is the record, and there is not any dispute about that.

The CHAIRMAN. I am mentioning that to indicate that Standifer was framing the bureau at all times, because he did take the trouble to go over to the Shipping Board and ask them not to say that contractual amortization had been allowed.

Mr. HARTSON. Well, what were Mr. Standifer's motives in going to the Shipping Board I do not know. He did not succeed in his purpose so far as the Shipping Board was concerned, apparently.

The CHAIRMAN. But he did succeed in his purpose with the Bureau of Internal Revenue.

Mr. HARTSON. Yes; and I see no reason why he should not. He compromised a big claim, which was not itemized until afterwards, and when itemized afterwards there was no specific recognition of the allowance of contractual amortization.

Senator JONES of New Mexico. Is not that the basis of your last statement, the original claim that was made—I forget the date of it?

Mr. HARTSON. It was the original Benson award.

Senator JONES of New Mexico. The original Benson award?

Mr. HARTSON. So-called.

Senator JONES of New Mexico. Is not that the basis of that statement made, and when you go to the Benson award, do you not find the whole thing?

Mr. HARTSON. When you go to the Benson award and see some of the accompanying schedules, you do find that $862,000 allowance for contractual amortization. The deductions from that original claim in these subsequent negotiations do not, according to Mr. Adamson's testimony, appear to change that original tentative allowance of that sum. On the other hand, as Mr. Lewis has pointed out here, there are other items, as to which there was dispute, and which Mr. Standifer apparently made no agreement on. This was an adjustment made afterwards in an attempt to harmonize, or, in other words, in an attempt to justify the terms and the amount finally agreed upon to close that claim.

Senator WATSON. Was the Benson award supposed to be the final adjustment of the whole controversy at that time?

Mr. HARTSON. I can not answer that, Senator. It at least was an award, and on the basis of that award, $500,000 was paid to the taxpayer.

Senator WATSON. If it was, whatever became of it?

Mr. HARTSON. Well, immediately, the taxpayer protested that the award was incorrect, and filed additional claims, and the Shipping Board then——

Senator WATSON. That was confirmed in writing thereafter?

Senator JONES of New Mexico. Yes; I want to call attention to the fact that there was something approved specifically in writing by the taxpayer. What was that?

Senator WATSON. Was the Benson award approved in writing by Mr. Standifer?

Mr. LEWIS. Yes, sir; it was.

Senator WATSON. It was?

Mr. LEWIS. Yes, sir.

Senator WATSON. And then there was a final acceptance and closing up of the whole transaction, was there?

Mr. LEWIS. Yes, sir; but the Benson award was afterwards ruled illegal, that Benson had not authority to sign the award; so it threw the whole question open again.

Mr. MANSON. Let us correct that in the testimony.

Mr. LEWIS. All right.

Mr. MANSON. The Benson award was not carried into effect, at the time it was made, because of a question as to Admiral Benson's authority; but after the new Shipping Board was appointed, and there was no longer question of authority involved, the Benson award was approved in writing. In other words, it laid down the principles upon which the settlement was to be made, but left the definite amounts open to be thereafter audited. Thereafter the audit was carried out in accordance with the Bosson award, and there was this subsequent ratification in writing, and certain items were disallowed. The claimant presented certain additional claims, some of which were allowed.

Senator WATSON. Then, right there, Mr. Manson, it is a fact that the Benson award was not the basis of the final settlement?

Mr. MANSON. Oh, no.

Senator WATSON. It was broken up both ways?

Mr. MANSON. No; it was not broken up at that time.

Senator WATSON. There ware other claims allowed, you say, so the Benson award was not the final settlement?

Mr. MANSON. There were some additions to the Benson award at all times. The Benson award was the basis of the settlement right down to the date of the last settlement, and I wish to challenge on the record here the statement by Mr. Hartson that there was anything in Mr. Adamson's testimony to indicate that this was a lump sum settlement which was thereafter justified by computations. Mr. Adamson's testimony was directly to the contrary, inasmuch as they took the balance of the Benson award and the amount finally agreed upon was the result of the audit of the Benson award, plus the allowance of certain additional claims presented after the Benson award was made.

The CHAIRMAN. In other words, there is nothing in the testimony of yesterday—and I have been trying to refresh my mind on it—which justifies the solicitor in saying that these figures were built up backward after the settlement?

Mr. HARTSON. I would like to explain that to the committee. Mr. Adamson was not in this country when Mr. Schlesinger finally agreed on the amount which would be satisfactory in settlement of these claims, and my understanding is that, upon his return, he having handled this case, worked out the analysis from the figures that were given to him as having been the amount agreed upon in settlement.

The CHAIRMAN. He did not testify that he had been requested to work backward to justify these figures.

Mr. DAVIS. He said those figures were the figures finally used all the way through and decided upon in the final settlement.

Mr. HARTSON. I was disappointed in not seeing Mr. Adamson here this morning.

Mr. MANSON. We will have him back here.

Mr. HARTSON. I think on that point we might inquire further as to just how those figures were arrived at, and when they were prepared by him.

Mr. DAVIS. Mr. Lewis, in this memorandum that we have been talking about to Mr. Keenan, you said:

A review of the records of the Fleet Corporation disclosed the tentative settlement of October 25, 1921, to be the basis for the final settlement. The amount of $908,416.23 was arrived at by taking the amount of the 1921 settlement and making additions and deductions as set forth on the attached schedule.

Mr. LEWIS. Yes, sir.

Mr. DAVIS. You examined the records of the Shipping Board, did you?

Mr. LEWIS. No, sir; only the few papers which Mr. Adamson showed me, which I considered an examination of the Shipping Board. That was the only examination we were ever permitted to make.

The CHAIRMAN. Wait a minute—"ever permitted to make." Did you ever ask for any examination that you were not permitted to make?

Mr. LEWIS. Well, Senator, I will qualify that by saying that when we were after a settlement of this kind, whoever was handling the case usually got out the papers pertinent to the case and gave us all the information we wanted from them. For instance, they would give us a copy of the final settlement, and we would make a copy of it.

The CHAIRMAN. But you said "ever permitted to make."

Mr. LEWIS. I want to qualify that. I did not mean that anything was held back.

Mr. DAVIS. Now, after examining those papers you conferred with Mr. Adamson, did you?

Mr. LEWIS. At the time I was examining them?

Mr. DAVIS. Yes.

Mr. LEWIS. Yes, sir.

Mr. DAVIS. Besides your conference with Mr. Adamson and what he told you about this matter, you also talked to Mr. Talbert, the counsel, did you not?

Mr. LEWIS. Yes, sir; Mr. Talbert, as I understand it, told me it was a lump-sum settlement.

Mr. DAVIS. You state in here that they both apparently confirmed the matters set forth here.

Mr. LEWIS. I might state how the case first came up. I went to Mr. Talbert originally, and I believe Mr. Talbert was the attorney who drew up the final settlement of $998,000. He stated that he knew nothing about the details of the settlement, that he was simply told to prepare a contract for a certain amount, and I took his statement to be a lump-sum settlement, and that afterwards Mr. Adamson drew up the details of the settlement, bringing the total up to that amount, and if I wanted any information as to the details, I would have to get them from Mr. Adamson. That is as far as Mr. Talbert went in the conference, and he turned me over to Mr. Adamson, with the statement that Mr. Adamson would give me any information necessary, as he knew the whole case. So that is probably what my statement meant, that Mr. Talbert confirmed this, that he turned the entire case over to Mr. Adamson, and any information that Mr. Adamson gave was confirmed by him on the case.

The CHAIRMAN. I would like to ask at this point, Mr. Lewis, if your interpretation of the lump-sum settlement would not take into consideration all of the disputed items in arriving at a lump sum? In other words, if, after all of these conferences that Mr. Hartson has spoken about, and all of the disputed items had been considered, and all of the conferees and Government officials and the taxpayer were tired out, and they settled on a lump sum; that that being so, then, as a matter of fact, all of these items in controversy had been considered, had they not?

Mr. LEWIS. Yes, sir.

The CHAIRMAN. So that, no matter if it was a lump sum, you can not ignore the fact that these claims, and large claims, had been considered?

Mr. LEWIS. Senator, I do not believe the final contract has been read into the record.

The CHAIRMAN. I think it has.

Mr. LEWIS. But there is one paragraph in the final contract which sets forth in detail the items that were being considered. It mentions wage awards, and maybe a dozen other items, and at no place in this final settlement contract is contractual amortization mentioned as one of the items beng allowed on this final contract.

The CHAIRMAN. Then, it can not be considered a lump-sum settlement, if these items were being considered?

Mr. LEWIS. It was a lump-sum settlement in all claims which were then before the Shipping Board.

The CHAIRMAN. Yes; in all claims, including the contractual amortization.

Do you want to put your engineer on now, Mr. Hartson?

Mr. HARTSON. Yes; I would like to have the engineer take the stand.

TESTIMONY OF MR. WILLIAM S. R. GRIFFITH, APPRAISAL ENGINEER, BUREAU OF INTERNAL REVENUE

(The witness was duly sworn by the chairman.)

Mr. HARTSON. State your full name, Mr. Griffith.

Mr. GRIFFITH. William F. R. Griffith.

Mr. HARTSON. You are employed by the Bureau of Internal Revenue?

Mr. GRIFFITH. I am.

Mr. HARTSON. In what capacity?

Mr. GRIFFITH. Appraisal engineer.

Mr. HARTSON. Were you appraisal engineer at the time that this Standifer case was up for settlement in the Bureau?

Mr. GRIFFITH. I was.

Mr. HARTSON. The record of the investigation shows that you made a report in this case, in which you stated that contractual amortization had been allowed by the Shipping Board. Did you make such a report?

Mr. GRIFFITH. I did.

Mr. HARTSON. Will you tell the committee the circumstances under which that report was made by you?

Mr. GRIFFITH. I was assigned to the case while I was on the coast by a telegram. I made an examination on the coast, and on my return to Washington I prepared my report. During that time we were in the old amortization section, which was under the special audit division.

Senator WATSON. Now, let me ask you right there: You say you were on the coast and received a telegram and made an examination in the case. What did you examine out there? Were all the papers sent to you out there?

Mr. GRIFFITH. Oh, no.

Senator WATSON. What did you examine? The physical property?

Mr. GRIFFITH. Yes, sir; the physical properties, to get the residual value of the physical properties, the salvage value.

The audit section at that time had an auditor who was assigned to get the contractual amortization for the engineers. The engineers did not have access to any of the records of contractual departments of the Government. I asked Mr. Maddock, who had charge of getting the records, to get me the contractual amortization on the G. M. Standifer Construction Co. A week or so later he handed me a breakdown, showing that the contractual amortization had been received on the wooden ship yards, and on the steel yards some depreciation, a large amount of depreciation, that we considered was contractual amortization.

From that I prepared my report. A copy of it was sent to the taxpayer, and later, in September, a protest was sent in against the findings, stating that the amount deducted as contractual amortization was not contractual amortization, as such.

Senator WATSON. Do you make a distinction between depreciation and contractual amortization?

Mr. GRIFFITH. Yes, Senator. Contractual amortization, as such, should be stated as amortization, but very often there are large

amounts given as depreciation, and we do consider at time amortization.

Mr. HARTSON. Now, what settlement, Mr. Griffith, was used by Mr. Maddock in basing his report to you that contractual amortization had been allowed by the Shipping Board?

Mr. GRIFFITH. Mr. Maddock's original report stated that it was on settlement contracts of July 15, 1922. Subsequent to that, I had another examination made, and Mr. Henry F. Morgan reported on May 24, 1923.

Senator WATSON. Who is he?

Mr. GRIFFITH. He was another auditor that was assigned to assist Mr. Maddock. That was on July 15, 1922, practically substantiating the claim.

The CHAIRMAN. You mean practically substantiating the claim of Mr. Maddock?

Mr. GRIFFITH. Yes; although the breakdown here says it was compiled as of October 25, 1921.

Senator WATSON. What do you mean by the "breakdown"?

Mr. GRIFFITH. That is an analysis of the claim.

Senator WATSON. The final summing up?

Mr. GRIFFITH. The final summing up.

Senator WATSON. Yes.

Mr. GRIFFITH. That would be, as I understand it, on that $2,700,000 award, because I did not go into the records at all, but I presume it was on that $2,700,000, which was never paid.

Senator WATSON. Were you called into the case before the award was made or afterwards?

Mr. GRIFFITH. It was in December, 1923, that I made my investigation on the coast. At that time, I asked Mr. Jones, who was representing the taxpayer, if they had received any contractual amortization, and he said they had not. But we always have it looked up afterwards.

Mr. HARTSON. After having Mr. Maddock and Mr. Morgan make that search, the analysis of their report shows that they had based the statement that contractual amortization had been allowed by the Shipping Board on the records in existence in the fall of 1921, which, if true, was on the basis of the Benson award, which did tentatively make an allowance.

Mr. GRIFFITH. As I understand it, yes; that is right.

Mr. HARTSON. That is all.

The CHAIRMAN. I would like to ask Mr. Hartson if this case is closed at this point?

Mr. HARTSON. The case, I think, is closed for one of the years. I can not answer that.

Mr. LEWIS. I can answer that.

Mr. HARTSON. I wish you would.

Mr. LEWIS. It is tentatively closed, Senator. There has been a revenue agent's report, and an examination in the field made, which is based on the evidence at hand showing no additional taxes for 1917, 1918, and 1919. The case has been tentatively closed in the bureau through 1919. In other words, no action would be necessary if the revenue agent's report is approved, which it has been through the year, showing no additional tax.

The CHAIRMAN. Is the Government foreclosed from opening up this case again?

Mr. LEWIS. No, sir.

The CHAIRMAN. It is not?

Mr. LEWIS. The only question is whether there is a waiver on file, which would permit the assessing of any additional tax for 1918.

The CHAIRMAN. Is there an additional waiver on file?

Mr. LEWIS. I could not answer that.

The CHAIRMAN. Will you look that up?

Mr. LEWIS. Yes. It is right here.

The CHAIRMAN. It seems to me, in view of the testimony, there is at least evidence of fraud, or attempted fraud in the settlement of this case, and I think, in the interest of the Government, if this final settlement has not been made it should not be made until this is threshed out.

Mr. HARTSON. I have no further questions of Mr. Griffith.

Mr. DAVIS. Mr. Griffith, in your first report, you found that amortization had been allowed on the records of the Emergency Fleet Corporation, so you state here?

Mr. GRIFFITH. That was given to me by our auditor; yes.

Mr. DAVIS. Yes.

Mr. GRIFFITH. We put that in always as the auditor finds it.

Mr. DAVIS. Was that the sole basis of your recommendation in that report?

Mr. GRIFFITH. The auditor's recommendation?

Mr. DAVIS. It sufficiently satisfied you so that you would make that report to the unit, and they would base their tax findings upon that?

Mr. GRIFFITH. We take the auditor's figures for our contractual amortization.

Mr. DAVIS. Then, why did you change this report and recommend in your later report that no amount should be deducted as contractual amortization?

Mr. GRIFFITH. That was after the conference.

Mr. DAVIS. Well, what did you do?

Mr. GRIFFITH. Mr. Hering and Mr. Lewis looked it up, and they decided it was not contractual amortization, so I changed my report, the same as I would put it in when the auditor gives it to me. They said it was not.

Mr. DAVIS. So that was merely a formal matter in your report?

Mr. GRIFFITH. Yes, sir.

Mr. DAVIS. Without any findings of yours?

Mr. GRIFFITH. None whatever.

Mr. DAVIS. That was simply an office report?

Mr. GRIFFITH. That was smiply an office report; yes, sir.

Mr. DAVIS. You made no further investigation; you have not looked into this any further?

Mr. GRIFFITH. No.

Mr. DAVIS. That is all.

Senator WATSON. You always accept the auditor's report, do you?

Mr. DAVIS. Yes, sir; we did until we came under the engineering division, and now we have access to the records ourselves at the present time. We look up our own now.

Senator WATSON. How long has it been since that policy has been adopted?

Mr. GRIFFITH. That policy was adopted since we went into the engineering division. I think it was December that we began looking up our own.

The CHAIRMAN. December, 1923?

Mr. GRIFFITH. November or December, 1923; yes, sir.

The CHAIRMAN. In view of the report that you got from the auditors on the coast and in view of Mr. Lewis's report after conference with the Shipping Board, then you decided in the conference that contractual amortization had not been allowed solely on the statement of the taxpayer?

Mr. GRIFFITH. I did not decide it. It was not an engineer that would decide about contractual capitalization at that time, Senator.

The CHAIRMAN. You were a conferee, though?

Mr. GRIFFITH. I was a conferee.

The CHAIRMAN. And you signed the conferee's report, which eliminated that factor?

Mr. GRIFFITH. Their findings; yes, sir.

The CHAIRMAN. And you did it solely because the conferees agreed that that was so, and not because of any findings of your own?

Mr. GRIFFITH. Well, from what Mr. Standifer said at the time and the sworn statements, I considered that probably it was not contractual amortization there myself.

Senator JONES. What is your opinion about it now, in view of all this testimony that has been taken here? Do you think the amortization was properly ignored?

Mr. GRIFFITH. I do not consider that it is contractual amortization, as such, as I see it now in the records.

The CHAIRMAN. Great emphasis seems to be laid on the expression "as such."

Mr. GRIFFITH. That is all we have to go by, Senator, our regulations.

The CHAIRMAN. You would not now say, though, Mr. Engineer, that contractual amortization was not considered by the Shipping Board, in view of the testimony, would you?

Mr. GRIFFITH. Well, Mr. Adamson, as I understood him yesterday, showed additions that they made that would amount to some $600,000 that would be taken out of the $998,000 and additions that were put in. Now, those additions must have been legitimate claims or legitimate additions. That would only leave $838,000 for the other claims.

The CHAIRMAN. But you did not answer my question. Do you now consider at this late date that contractual amortization was not considered by the Shipping Board?

Mr. GRIFFITH. Was not considered by the Shipping Board?

The CHAIRMAN. Yes.

Mr. GRIFFITH. It was considered in the original award, yes sir.

The CHAIRMAN. Do you still think that contractual amortization was not considered in the final settlement?

Mr. GRIFFITH. I have not gone through the records sufficiently.

Senator JONES of New Mexico. But you have listened to all of this testimony, have you not?

Mr. GRIFFIN. Yes, I have, Senator, for income-tax purposes I consider that there was no contractual amortization received as such.

Senator JONES. I think it is at least subject to comment, which I will not indulge in at the present time.

The CHAIRMAN. Have you anything further?

Mr. DAVIS. Nothing.

Mr. HARTSON. Mr. Hering is here, and Mr. Hering also signed this.

Mr. LEWIS. Senator, I might answer your question about the waiver. There is a waiver on file permitting us to assess any taxes for 1918, limited to April 1, 1925, and for the other years we do not need a waiver; 1919 is still within the period when we can assess.

The CHAIRMAN. So that this matter can be reopened?

Mr. LEWIS. It can be reopened. The case is not closed.

The CHAIRMAN. I would like to see it reopened and further discussed.

Mr. HARTSON. I would like to make this suggestion, that if the Senators are going to decide this case that we have here, it may be well to call in the taxpayer who is interested. The bureau has to decide these cases by hearing both interests, and if this committee——

Senator JONES. I think the taxpayer is pretty well represented here.

Mr. HARTSON. I do not know whether the Senator's remark is directed to me or not.

Senator JONES of New Mexico. It is.

Mr. HARTSON. I think it is most unfair, Senator, and without justification, and I protest against such a remark being made to me in connection with this case. I think there is every justification for the action that the bureau took here, and if I must disagree with the Senator, I do it honestly and with the deepest respect for the Senator.

Senator JONES of New Mexico. My remark simply referred to the ability with which the taxpayer was represented.

The CHAIRMAN. I might say in this connection that I do not think the committee wants to decide this case, but I think the committee might develop some information, and there are enough differences in point of view, so that the case ought to be further considered by some one, whether by the bureau or a court or whatnot. Certainly the evidence given here, the testimony of the Shipping Board officials, indicates that there was, if not a dishonest settlement, a settlement which was unjustifiably in favor of the taxpayer.

Mr. HARTSON. If the committee will permit me to say so, I believe I can speak for the commissioner and assure the committee that this case will be gone into by the bureau again, by people who have never considered it in any instance. I myself, of course, am now disqualified from having anything to do with the case, because of the remarks of the Senator, but I think the commissioner would be fully justified in referring this to competent, able men in the bureau now as a new proposition, and let them decide it over again. If the Government's interests have been prejudiced in this case, it will be the commissioner's desire to see the matter corrected immediately, and it will be my desire to see it corrected, if a mistake has been made.

The CHAIRMAN. Of course, it is quite natural that the bureau would stand by its original decision, and if that is so, would it not be a good case to settle in the courts, for the benefit of the committee, in any event.

Mr. HARTSON. Then, if that is done, the decision is made against the taxpayer.

The CHAIRMAN. Then, you will, of course, have to reverse your decision, so as to get it before a court.

Mr. HARTSON. Yes. If the committee wants to formally advise the bureau that its decision is wrong in this case, and suggest that the amount be assessed now to make up for this difference, then the taxpayer would have to pay and sue for its recovery.

Senator JONES of New Mexico. Has it been figured out yet what difference this will make in the taxpayer's payment or assessment?

The CHAIRMAN. That was asked for yesterday, and it was promised. I wish counsel would see that this information is gotten for us promptly at the next meeting when it is called for by the committee.

Do you want to put Mr. Hering on the stand now?

Mr. HARTSON. Yes.

The CHAIRMAN. You have already been sworn, have you not, Mr. Hering?

Mr. HERING. Not in this case, Senator.

TESTIMONY OF MR. JAMES C. HERING, AUDITOR, INCOME TAX UNIT, BUREAU OF INTERNAL REVENUE

(The witness was duly sworn by the chairman.)

Mr. HARTSON. Mr. Hering, you are connected with the bureau, and I believe you testified in another matter that was before this committee?

Mr. HERING. Yes, sir.

Mr. HARTSON. You have knowledge of the settlement that was made by the Bureau of Internal Revenue of the tax liability of the Standifer Corporation, one element of which was the amortization that should be allowed that company for the costs of war facilities?

Mr. HERING. Yes; with reference to the amortization, I did. I did not audit the case with reference to the tax liability.

Mr. HARTSON. I should like to have you, in your own way, tell the committee what connection you had with the case, and what you based your view of the case on?

Mr. HERING. My particular duty was to sit in conference with the engineer and the auditor, Mr. Lewis, to determine whether or not contractual amortization had been allowed in this case by the Shipping Board, or by anybody else, for that matter, and if so, in what amount. You have heard the testimony of the other witnesses, and have the facts very largely in mind.

The only thing that I should like to say is that after Mr. Lewis's investigation, and after the first conference, and possibly after the second—I do not remember exactly the date—I went to the Shipping Board and had a personal conference with all the men up there who handled the case, so far as I could find. Mr. Schlesinger, who made the direct settlement with the company, was not then connected with the Shipping Board, and I did not see him. Mr. Talbert, who drew the final contract, was there, and I saw him and

talked with him. I also saw Mr. Adamson and talked with him. Mr. Talbert very strongly led me to believe that Mr. Standifer's statements in conference and in his brief were correct.

Mr. MANSON. What statements do you refer to?

Mr. HERING. To the effect that he did not know of how the sum allowed him was computed in detail, and that he did not have any detailed analysis of it at the time he agreed to accept it. As I say, I made as patient an investigation as I could to determine whether the statements made in the taxpayer's brief were correct or not?

Mr. MANSON. Were there any other statements made by Mr. Standifer that you discussed with Mr. Talbert?

Mr. HERING. I do not recall any particularly. This was the main point at issue.

The CHAIRMAN. I think we ought to let the witness continue with his statement.

Mr. HERING. I was saying that, so far as my investigations went. I believe that the testimony of the Shipping Board officials confirms the taxpayer's statement and his brief. Mr. Adamson admitted that he was not present when the final agreement was made. He, of course, could not have had any direct part in it. Mr. Talbert was present, in the Shipping Board. I do not know whether he was in the same room with Mr. Standifer and Mr. Schlesinger when they discussed the matter or not, but his testimony, in connection with the other testimony, led me to believe that the statements of the taxpayer were correct. I feel that, as Mr. Hartson has pointed out, the primary evidence as to the terms of the settlement was the written contract that was executed at that time, and I relied largely on that.

Taking the testimony as a whole, with the written contract before me, making no special reference specifically to contractual amortization, I came to the conclusion that none had been specifically allowed, as such.

Now, there is just one other point that I want to explain. I want the committee to understand that the effect of the ruling in this matter does not ignore this matter of contractual amortization. That is, if we suppose that the Shipping Board did have in mind some allowance, not definitely known, as to how much it was, as contractual amortization, the proposed treatment of the item does not entirely disallow that item. It merely switches it from one year to another. In other words, whatever amount we allow as contractual amortization we must disallow as income from some other year.

This transaction, this final settlement, took place in 1922. July 15, 1922, as I recall, was the date of the contract. There has been quite a strong protest on the part of taxpayers throughout the country against some of the bureau's regulations, which would have the effect of throwing income received at these later dates from Government settlements back into a prior year when the tax rate was different and higher. Of course, we all know that the rate in 1918 was the highest that has ever been assessed at any time in the history of this country, and was an extremely high rate at that. So, if we had made a ruling that would have had the effect of throwing this income received by this company in 1922 back into 1918, as

would have been the effect if we had considered any amount of contractual amortization, it would work a hardship upon the taxpayer.

Senator JONES. Why, Mr. Hering?

Mr. HERING. Because——

Senator JONES. Was not the year 1918 the year in which they did the work?

Mr. HERING. Only very little of it—relatively little of it.

Mr. HARTSON. It was not the year in which he made his profits.

Mr. HERING. No; he did not; according to method of reporting income, he made no taxable profit in 1918.

The CHAIRMAN. Was not the rate the same then as in 1919?

Mr. LEWIS. No, sir; it was just a little lower.

Mr. HERING. It was very much lower, unless the income was from Government contracts. Of course, then, the rate was the same as in 1918, but there would be a difference on account of invested capital; but in 1922, when the payment was actually made, the excess-profits tax had been abolished entirely.

The CHAIRMAN. Have you computed, or can you do so, if you have not already done so, and show this committee just the difference to the taxpayer, in dollars and cents, by the ruling of the bureau in allowing him contractual amortization, in preference to taking the word of the Shipping Board officials that they allowed contractual amortization?

Mr. HERING. I have not made any such computation.

The CHAIRMAN. But you can?

Mr. HERING. I can make the computation, but it would be difficult to make it final, for this reason, Senator, that the taxpayer requested a special assessment in 1918. If that were allowed, I would not know at what rate it would be allowed.

The CHAIRMAN. But this whole controversy develops around this one particular item, does it not?

Mr. HERING. Yes.

The CHAIRMAN. Assuming, for instance, that you had insisted upon the engineer's report, and had insisted upon the contention of the Shipping Board, what would have been the difference in taxes to the taxpayer?

Mr. HERING. Well, as I say, I have not made a computation, but I am willing to admit that it would be materially favorable to the taxpayer.

The CHAIRMAN. You can compile the amounts, can you?

Mr. HERING. Well, as I say, I can only make a tentative calculation on that, because I could not determine what the special assessment might be.

Senator JONES of New Mexico. What do you have in mind when you speak of a special assessment?

Mr. HERING. You will recall that the 1918 law provided that in cases where the ordinary method of computing taxes would work a special hardship upon the taxpayer, the commissioner was authorized to grant special relief under sections 327 and 328 of the act. The effect of those sections is what is commonly referred to as a "special assessment" in the unit.

Senator JONES of New Mexico. How did you interpret those sections of the law in this case?

Mr. HERING. I personally had nothing to do with the administration of this case. I can only speak in a general way. I do not quite understand your question, Senator.

Senator JONES of New Mexico. Well, I want to find if you have information upon it as to the effect of those sections. How did they operate, and in what way were they administered? What was considered a special hardship to the taxpayer, and how was he given relief under those sections?

Mr. HERING. I am not a very good authority as to what was a special hardship, but I can say, in a general way, that abnormalities of invested capital were considered as such, where the taxpayer had an extremely low invested capital and a large amount of borrowed money, or where it was impractical to accurately compute his invested capital. That is one ground which is specially named in the statute, I think, as a basis for special assessment.

Now, after this determination that a taxpayer is entitled to special assessment, the general method of computing that, as I understand it, is to compare that taxpayer with other taxpayers in the same general line of business, whose tax has been regularly computed under the invested capital method of computing it, to determine the percentage of income which has been taken as tax, and then an average or net figure which is thus found by comparison with other companies in the same line of business, and under similar conditions is applied as the tax rate applicable to the particular taxpayer which is being specially assessed.

Senator JONES of New Mexico. And you think there was a special assessment in this case for 1918?

Mr. HERING. There was none actually made, but it was requested. None was made by reason of the fact that no taxable income was developed.

Senator JONES of New Mexico. Then why should a special assessment have been requested? What was the reason for it?

Mr. HERING. Well, the reason was at that time the threatened income; if this amount had been disallowed as contractual amortization, I think it would have produced an income in 1918.

Senator WATSON. I did not understand that.

Mr. HERING. I did not state that correctly. I think if it had been allowed as contractual amortization——

Senator WATSON. I do not know just what you mean by that.

The CHAIRMAN. Will the witness restate it, so that the Senator can get it?

Senator WATSON. Yes; I wish you would.

Mr. HERING. I say, if this $884,000 which is in controversy bebetween the unit and the Shipping Board as to whether it is contractual amortization or not had been treated as contractual amortization, it would have produced a taxable income in 1918.

Senator WATSON. Oh, yes; I understand.

The CHAIRMAN. I think, as long as Mr. Adamson is here now, we might as well hear him.

Mr. DAVIS. Just a question or two, Senator, of Mr. Hering.

Mr. Hering, you went over to the Shipping Board after Mr. Lewis had gone over, in reference to this matter?

Mr. HERING. I did; yes, sir.

Mr. DAVIS. How did you come to go over there?

Mr. HERING. I had been assigned to conference on the case and I wanted to find the further facts in the case.

Mr. DAVIS. Whom did you talk to when you got over there?

Mr. HERING. I talked to Mr. Talbert and also to Mr. Adamson, and I may have talked to others. I do not remember as to others, but they were the particular men involved.

Mr. DAVIS. Did you go into the matter fully with Mr. Adamson?

Mr. HERING. As fully as I thought was necessary to go. I did not deem it necessary to go back over the ground that Mr. Lewis had been over, and that is the explanation of what Mr. Adamson says was my impatience in the matter. I had Mr. Lewis's report before me, and I did not feel it necessary to take his time or mine either to go all over the same ground again.

Mr. DAVIS. Well, Mr. Adamson offered to explain the entire situation, did he not?

Mr. HERING. He made his explanation, as far as I deemed it material.

Mr. DAVIS. But did he not offer to do that at the time you went over?

Mr. HERING. I do not recall just what he offered, but I do not recall, on the other hand, that he refused anything that I requested.

Mr. DAVIS. Were the taxpayer and his attorney in town at the time you made your visit over to the Shipping Board?

Mr. HERING. I expect they were. I do not know, though.

Mr. DAVIS. Did you receive a telephone call from Mr. Murphy, attorney for Mr. Standifer, while you were in Mr. Adamson's office?

Mr. HERING. I do not recall.

Mr. DAVIS. Were you in touch with him at that time?

Mr. HERING. Mr. Murphy came in whenever there was a conference, and he came in informally to look after the case.

Mr. DAVIS. Was it at the taxpayer's suggestion that you went over to the Shipping Board to find out about the matters that you then had in mind?

Mr. HERING. The taxpayer said, as I recall it, that they were perfectly willing that I should go over there, but I should have gone regardless of the taxpayer's statements, one way or the other.

Mr. DAVIS. You had Lewis's report before you and he told you the details of the entire transaction. Then why did you go over again and go over these matters?

Mr. HERING. Because of the taxpayer's contentions in his brief that he had not received any specific amount as contractual amortization.

Mr. DAVIS. Well, Mr. Lewis gave you that information, did he not, from his conference?

Mr. HERING. Mr. Lewis's evidence was to the contrary. I wanted to find out what the facts were.

Mr. DAVIS. Then, with that in mind, why did you not go over the entire matter with Mr. Adamson, as he offered to do when you came here?

Mr. HERING. I did, in so far as I considered his testimony was pertinent to the decision of the case.

Mr. DAVIS. I understood him to say that you did not go into the details of the matter?

Mr. HERING. Not into minor details; no, I did not.

Mr. DAVIS. What did you go into?

Mr. HERING. I went as far as was necessary to find whether there was any contractual amortization specifically allowed as such.

Mr. DAVIS. Was the taxpayer at that office the day that you went to the Shipping Board?

Mr. HERING. I do not think he was.

Mr. DAVIS. Was he in town?

Mr. HERING. I did not follow his movements. I do not know where he was.

The CHAIRMAN. Is Mr. Murphy a local attorney, or is he an attorney from the coast?

Mr. HERING. He is a local attorney here. He lives here.

The CHAIRMAN. How long have you known Mr. Murphy, Mr. Hering?

Mr. HERING. About four years.

The CHAIRMAN. Is that all, Mr. Davis?

Mr. DAVIS. That is all, Senator.

The CHAIRMAN. Do you want Mr. Adamson now, Mr. Hartson?

Mr. HARTSON. Yes, sir.

TESTIMONY OF MR. TILDEN ADAMSON, SPECIAL EXAMINER, UNITED STATES SHIPPING BOARD, EMERGENCY FLEET CORPORATION—Resumed

Mr. HARTSON. Mr. Adamson, I understand you were out of this country when this final settlement was made by the Shipping Board with the Standifer Co.?

Mr. ADAMSON. I was.

Mr. HARTSON. How long a period elapsed before the settlement was made between your departure from the office and the settlement?

Mr. ADAMSON. The settlement was made on the 12th of July, and my recollection is that I left the office on the 6th or 7th of July; but I might explain, Mr. Hartson, that for two months or more prior to that time, I had not been working with the Fleet Corporation or the Shipping Board, but had been assigned to the State Department, and the only work I had done, in fact, for the Shipping Board was when Mr. Schlesinger would call on me for some information about this particular case.

Mr. HARTSON. But up until your departure you did have knowledge of what was going on in this case?

Mr. ADAMSON. I knew that they were attempting to reach a settlement.

Mr. HARTSON. Were you called into that conference?

Mr. ADAMSON. Well, I was called in by Mr. Schlesinger and asked about various items in connection with the claims.

Mr. HARTSON. But, others were doing the actual work in the case in your stead during the time that you were attached to the State Department?

Mr. ADAMSON. Mr. Schlesinger personally was handling those cases.

Mr. HARTSON. You were relieved, then, from handling the negotiations, about two months before the settlement was made?

Mr. ADAMSON. Well, I can not recall anything except casually, or rather incidentally, in connection with the case from May on until the time the settlement was made.

Mr. HARTSON. You testified yesterday, and I am reading from the transcript of your testimony, page 684:

I was not in the matter when the settlement was made, but up to a week before the settlement was made we were proceeding upon the line of making deductions from the award and additions to the award.

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. Now, when you refer to "we" whom do you have in mind?

Mr. ADAMSON. The Shipping Board, the representatives of the Shipping Board, Mr. Schlesinger in particular.

Mr. HARTSON. It has been testified too, that when Mr. Lewis came to call upon you to investigate the question of contractual amortization, you showed Mr. Lewis what is termed a rough analysis of the Standifer settlement.

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. Who prepared that rough analysis?

Mr. ADAMSON. I prepared it for the purpose of showing Mr. Lewis, to the best of our information, what the settlement was based upon.

Mr. HARTSON. Was that statement prepared after or before the settlement?

Mr. ADAMSON. Oh, that statement was prepared either the day or the day before Mr. Lewis came down, I think it was prepared at Mr. Talbert's suggestion, after Mr. Standifer and Mr. Murphy came in. Mr. Talbert asked me to get the details of the settlement.

Mr. HARTSON. I will repeat my question.

Mr. ADAMSON. Yes, sir.

Mr. HARTSON. Was the rough analysis prepared by you made after or before the settlement with the Shipping Board on this Standifer controversy.

Mr. ADAMSON. Oh, long after.

Mr. HARTSON. Long after?

Mr. ADAMSON. Yes.

Mr. HARTSON. That is all.

Senator JONES of New Mexico. Go ahead and state the circumstances under which it was made, as you were proceeding to do.

Mr. ADAMSON. As I recall it, Senator, when Mr. Murphy and Mr. Standifer came in, Mr. Talbert called me into the conference. He asked me to ascertain just how the settlement figure was reached I went to the file, and went to Mr. Parker, now general counsel, who was then the chief counsel in charge of litigation. I knew that he had worked with Mr. Schlesinger in this settlement, and Mr. Parker told me that his recollection was he had a memorandum in the files which showed the basis of the settlement. I looked in the files and found a memorandum of Mr. Parker. That memorandum is a part of my report, which Mr. Thomas attached to his report to your committee. It is headed "The Standifer Set-up," addressed by Mr. Parker to Schlesinger.

It shows at the start the Kennedy audit figure of $1,349,000 and odd due to Mr. Standifer. It makes certain additions to that amount,

and then it makes three deductions from the amount, those three deductions amounting to $1,026,000. I found, in addition to that, an unsigned memorandum in the files of the Shipping Board which was dated, I think, the 12th of July, and it was stated on that memorandum that on that morning the Shipping Board had acted on this settlement and had made these three deductions. They were discussed in the memorandum, and it was stated in this memorandum that the contractor, the claimant, had agreed to the three deductions.

The CHAIRMAN. What were those three deductions?

Mr. ADAMSON. $572,000 on account of the Levy sale, $104,000 on account of duplicated overhead in the audit, and $350,000 on account of excess charges for materials in the ships on contract 3 W. C. which had been changed to cost, and we found that the costs were excessive, and they agreed that they would cut out a $10 deadweight-ton on account of the excess charge for materials.

Then, in addition to that, I found that Mr. Schlesinger had issued a statement to the press, in which he discussed these three deductions. All the evidence that I could find indicated that they had proceeded as they had been proceeding, when I left this country, upon the line of restoring certain disputed items, which the audit had eliminated, and allow claims which had not been allowed by the audit. Then, making these three deductions and taking all the evidence that I could get in the case, and the best recollection of Mr. Parker, I set up this rough analysis, and I headed it, "Rough Analysis," deliberately, because I could not be absolutely sure that those were the figures, because there were $37,000 there of additions to the award which could not be explained from the files.

The CHAIRMAN. Just what point did you find the allowance of $862,000 for contractual amortization?

Mr. ADAMSON. Where did I find that?

The CHAIRMAN. Yes.

Mr. ADAMSON. Oh, that was in that original award.

The CHAIRMAN. That is where you found that, in making this set-up for Mr. Lewis?

Mr. ADAMSON. There is nothing shown in this set-up here. This simply shows that the final settlement was based upon the original award, and we knew from all the facts in the case that the original award included the $862,000 in amortization.

Mr. DAVIS. And there were no changes in that item thereafter up until the settlement?

Mr. ADAMSON. There had been no deductions affecting amortization.

The CHAIRMAN. Are you through, Mr. Hartson?

Mr. HARTSON. I am through.

Mr. GREENIDGE. May I interrupt just a moment, Mr. Chairman? You asked a moment ago if we could figure the tax, and if we do figure that tax, it will be necessary for us to know how much contractual amortization was allowed by the Shipping Board in its final settlement. I think, inasmuch as the Shipping Board members are here, if they will supply that information, it would probably simplify our work. Do you agree with the necessity for that information, Mr. Lewis?

Senator JONES of New Mexico. What we would like is an adjustment, or, rather, a calculation made on the assumption that $862,500 amortization was allowed.

Mr. GREENIDGE. All right, sir. Then, that answers my question.

Senator JONES of New Mexico. Yes.

Mr. ADAMSON. Senator, I might say, having listened to the testimony of Mr. Hering and one or two others, that I think they have the wrong figures for amortization. They are assuming that it is $837,500. It is $862,500. I think that discrepancy comes from the fact that they have taken the housing amortization as only $162,500 instead of $187,500. As a matter of fact, the Standifer Corporation was to pay the Fleet Corporation back $162,500, instead of getting that as amortization. That left $187,500 as amortization on housing.

Mr. DAVIS. Do you remember the conference with Mr. Hering with reference to this matter?

Mr. ADAMSON. Yes, sir.

Mr. DAVIS. I think you stated yesterday that he did not go into the details very much with you in reference to it.

Mr. ADAMSON. No; he did not.

Mr. DAVIS. Did he state the reason for not wanting to go into the details?

Mr. ADAMSON. He did not state any reason. He just dismissed it.

Mr. DAVIS. Did he receive a call from anyone while in your office?

Mr. ADAMSON. No, sir; he did not receive a call.

Mr. DAVIS. Did some one call him?

Mr. ADAMSON. No; he called up.

Mr. DAVIS. Whom did he call?

Mr. ADAMSON. I don't remember the number he called. He talked to a Mr. Murphy, a man whom he addressed as Mr. Murphy.

Mr. DAVIS. Do you know who Mr. Murphy was?

Mr. ADAMSON. No, sir.

Mr. DAVIS. Did you ever meet a Mr. Murphy, attorney for Standifer?

Mr. ADAMSON. I met a gentleman who was introduced to me as Mr. Murphy by Mr. Standifer. He was Mr. Standifer's attorney, according to Mr. Standifer.

Mr. DAVIS. Was there something in reference to a tax matter pending when he talked with Mr. Murphy?

Mr. ADAMSON. As I recall it, he called up this gentleman whom he addressed as Mr. Murphy and made an engagement to meet him in a very short time thereafter. I do not recall listening to what he said further than that. I sat there. This is at my desk that he was calling from.

The CHAIRMAN. I would like to refresh my mind about this, and I am not sure whether you brought this out at the hearings on yesterday. I have two points in mind, one is that you made up this rough adjustment or settlement——

Mr. ADAMSON. Yes, sir.

The CHAIRMAN. For the benefit of Mr. Lewis?

Mr. ADAMSON. Yes, sir.

The CHAIRMAN. What suggested that you do that?

Mr. ADAMSON. Mr. Talbert. The claimant or taxpayer had come in to see Mr. Talbert, and had brought his counsel with him, and

Mr. Talbert had had some discussion as to whether there had been amortization allowed, and he thoughht that I was familiar with the case and worked on it so much that he asked me if I would get up the figures on the final settlement and show how the $998,000 had been arrived.

The CHAIRMAN. Now, if I remember correctly, you said the taxpayer and his attorney appeared and suggested, if they did not ask, that the Shipping Board assure the Bureau of Internal Revenue that the contractual amortization had not been allowed.

Mr. ADAMSON. Well, Mr. Standifer indicated that a representative of the Internal Revenue Bureau would be down to see us. I do not recall that he made any request, but he just argued that this was a lump-sum settlement, and, of course, there was no amortization allowed. The only impression that could be gained from his conversation was that he came there to make sure that Mr. Talbert, or whom ever was seen by the Bureau of Internal Revenue people, would agree with him that there was no amortization allowed in this settlement.

The CHAIRMAN. Of course, the Shipping Board did not agree with him?

Mr. ADAMSON. We did not.

The CHAIRMAN. Is Mr. Talbert here?

Mr. MANSON. Yes.

Mr. HARTSON. One other question of Mr. Adamson: How much amortization, according to your view, was allowed by the Shipping Board in this settlement; that is, contractual amortization?

Mr. ADAMSON. $862,500. That includes the depreciation on contract 3–WC.

Mr. HARTSON. In other words, the full amount that was identified as contractual amortization under the Benson award?

Mr. ADAMSON. Yes.

Mr. HARTSON. It was carried through and allowed in this settlement of July 15, 1922?

Mr. ADAMSON. That is my belief.

Mr. HARTSON. Yes.

Mr. ADAMSON. I have been unable to find any evidence showing that any deduction was made at all.

Mr. HARTSON. If Mr. Standifer compromised this matter, in a sense, after frequent negotiations with the Shipping Board, it is possible that although the Shipping Board considered contractual amortization as one of the elements that that was also one of the elements which was compromised, or some lesser sum was received in satisfaction thereof.

Mr. ADAMSON. Our files do not indicate that there was such a compromise. In fact, the statement issued to the press on the day of the settlement indicated that there were specific deductions made, and their effect was discussed in that statement.

Senator JONES of New Mexico. I wonder if we could get a copy of that statement which was given to the press?

Mr. ADAMSON. I am under the impression that it is in Mr. Thomas's report.

Mr. HARTSON. On the other hand, it may have been a compromise settlement from the standpoint of Mr. Standifer.

Mr. ADAMSON. Well, the unsigned memorandum in the files with the Shipping Board states that Mr. Standifer agreed to those three specific deductions.

Mr. MANSON. Is that memorandum in the record?

Mr. ADAMSON. That is also a part of Mr. Thomas's report.

Mr. HARTSON. That is all.

Mr. DAVIS. Is that the press statement that you referred to [handing paper to the witness]?

Mr. ADAMSON. This is the statement that was issued to the press.

The CHAIRMAN. Will you read it, please?

Mr. ADAMSON. Yes, sir. This is dated July 12, 1922, and is headed "Immediate release":

Elmer Schlesinger, general counsel United States Shipping Board, stated to the press to-day that the board had settled the claims of the G. W. Standifer Construction Co. for $998,416.23. This is in addition to the $500,000 paid June 7, 1921, on account of previous award.

In arriving at the final amount to be paid the claimants, the board made a deduction of $350,000, which represented 35,000 tons of wooden ships at $10 per ton. The board claimed that this amount was the excess over the average cost for this amount of tonnage. It also disallowed the sum of $572,276. This sum represented 50 per cent of the cost of material purchased by the Standifer Corporation for use in five steel ships, which they were to build under contract with the board. The board canceled this contract and the contractors were permitted under what is known as the Levy agreement to purchase this material from the Emergency Fleet Corporation at 50 cents on the dollar. The board also found a mistake in audit of $104,000.

The CHAIRMAN. Is Mr. Talbert here now?

Mr. MANSON. Yes.

TESTIMONY OF MR. JAMES TALBERT, ASSISTANT COUNSEL IN CHARGE OF CLAIMS, UNITED STATES SHIPPING BOARD

(The witness was duly sworn by the chairman.)

The CHAIRMAN. Will you give the reporter your full name and occupation, please, Mr. Talbert?

Mr. TALBERT. James Talbert, attorney at law; at the present time working for the Shipping Board as assistant counsel in charge of claims.

Mr. DAVIS. Do you recall the matter of the Standifer Construction Co.?

Mr. TALBERT. Yes, sir.

Mr. DAVIS. Did you do work on that case?

Mr. TALBERT. Yes, sir; I did.

Mr. DAVIS. What, in particular?

Mr. TALBERT. The case first came up for attention before me in the latter part of 1919, when I was at Philadelphia, and I was at that time a member of the general cancellation claims and contracts board. Later, I came to Washington, and was made a member of the construction claims board, and still later chairman of that board. In all of those capacities I had to do with this claim.

Mr. DAVIS. When did you come to Washington?

Mr. TALBERT. February 1, 1920.

Mr. DAVIS. What feature of the case was first called to your attention?

Mr. TALBERT. The question of surplus materials; that is, materials made surplus by reason of the cancellation of contract No. 503.

Mr. DAVIS. Was the amortization question ever before you?

Mr. TALBERT. Yes, sir.

Mr. DAVIS. I wish you would go ahead and state just what that was and how it was disposed of, if you know.

Mr. TALBERT. Amortization was one of the biggest claims that the Standifer Construction Co. had, and a claim that was always asserted in principle. There was no question about some amount being allowed, and as a member of the construction claims board, and later as chairman, we held several conferences, some at day and some at night, in my office, to determine what the various amounts should be.

Mr. DAVIS. Was the taxpayer present?

Mr. TALBERT. Yes, sir.

Mr. DAVIS. And his counsel?

Mr. TALBERT. He did not have counsel at all times. He was represented by several different attorneys in different stages of the game, but he represented by an accountant, his comptroller or auditor, a man named Soule, who was in on all of the conferences.

Mr. DAVIS. Was there an attorney named Murphy before you?

Mr. TALBERT. No, sir; he was not in the case at that time.

Mr. DAVIS. Now, coming down to the settlement or tentative settlement of May, 1921, do you know about that?

Mr. TALBERT. No, sir; I had nothing to do with it. In May, 1921, you say?

Mr. DAVIS. Yes.

Mr. HARTSON. That is the so-called Benson award.

Mr. TALBERT. I was not present when that settlement was made. I was still chairman of the construction claims board. We had gone over the details a great deal, and had tentatively arrived at amounts, and those amounts were agreeable to the Standifer Construction Co. I remember particularly on the housing that I made an agreement with Mr. Standifer that he would pay back, that he would take the housing and pay to the Fleet Corporation or the shipping board the sum of $162,500, I believe.

Mr. DAVIS. Do you know the amount of amortization finally allowed?

Mr. TALBERT. In the Benson award, as I remember it, it was something like $800,000 altogether, but I have not looked at those papers for years. It was a considerable sum, and the amortization allowed by the construction claims board was agreeable to Mr. Standifer and his accountant.

Mr. DAVIS. That is what I am trying to get at. He understood the details of the entire transaction?

Mr. TALBERT. Well, he was there practically every day. Mr. E. T. Wright, a member of the construction claims board, was designated by me to cover the details. He did that in conjunction with Standifer's auditor and with Standifer on any question of difference which came before the board for determination, and the amortization was agreed on between Standifer and our board.

Mr. DAVIS. At about the time you mentioned?

Mr. TALBERT. Yes; and he spoke of it many times afterwards, especially on the housing, that while I had been taken out of the case, was in it no longer, they still insisted on holding him to that

agreement he made, that agreement on the housing proposition, claiming that he had gotten the worst of that part of the deal.

Mr. DAVIS. After the matter came up in the Bureau of Internal Revenue, did you have a conference with anyone from the bureau concerning this matter?

Mr. TALBERT. Yes; I had a conference with two gentlemen at different times.

Mr. DAVIS. Who were those gentlemen?

Mr. TALBERT. If I had not heard their names here this morning, I would not have remembered them, but I think their names were Lewis and Hering.

Mr. DAVIS. Which one did you see first?

Mr. TALBERT. Mr. Lewis.

Mr. DAVIS. What was the substance of that conference, if you can give it to us?

Mr. TALBERT. Mr. Lewis came in and asked me if I drew the contract of settlement in the Standifer case, and I told him that I did draw that. He asked me about the circumstances of drawing it, how I came to draw the settlement, and I told him. I explained to him that I had had nothing whatever to do with the negotiations or with any feature of the settlement after May, 1921; in fact, the settlement had been reached between Mr. Standifer and Mr. Schlesinger, and that on one Saturday morning in July, 1922, I guess that was, Mr. Standifer came into my office about 10 o'clock. On Saturdays we have half holidays in the summer time. He told me that he had reached a settlement with Mr. Schlesinger, and Schlesinger had directed Mr. Freund——

Mr. DAVIS. Who was Mr. Freund?

Mr. TALBERT. Mr. Freund was either coming in as general counsel to succeed Mr. Schlesinger, who was going out at that time, or he was assistant general counsel. Anyhow, he was occupying the general counsel's office.

Mr. Schlesinger had always had an office down on the first floor, quite a ways from the offices occupied by the legal department.

Mr. Stadifer came in and he had a piece of paper in his hand, with a figure on it of $998,000, or something like that—an exact figure, and told me that he had at last come to an agreement with Schlesinger, and that Schlesinger had notified Freund to see that the contract was drawn. Finally he went to Freund, and Mr. Freund sent him to me. He stated that he had requested Mr. Freund to assign the job to me because he thought I could get it out, so that he could get his money that very day. We had to get this through and sign the vouchers and have them out by 1 o'clock in order for him to get his cash. That was the most important thing in Mr. Standifer's mind, the getting of the cash that day.

So I went to work on the case at 10 or 10.30, or something like that. There were a number of contracts involved, and they had to be mentioned and recited in the contract of settlement in some way. I called in two or three assistants, a man who had once been on the West Coast, Mr. Scheer, and one or two others, and I began dictating this contract. He told me that that was the figure, and I think I called up Mr. Freund to verify that that was the figure.

I dictated the settlement. A stenographer went to writing on it, and there were two or three items on commitments, and there was a lawsuit or two pending against Standifer in connection with canceled commitments or canceled contracts.

That apparently had not been covered in the negotiations. I wanted to make this settlement complete and to cover everything; so I took Mr. Standifer with me, and we went down to see Schlesinger about the lawsuit that was pending and some of the commitments.

We arranged those details satisfactorily to both of them, the Shipping Board assuming some responsibilities regarding some of the commitments, and, as I remember it, Mr. Standifer waived some minor items, and corrected the contract to conform to the oral agreement regarding those commitments and the lawsuit that we were to take over. I got the contract out, and it was signed. It was signed by Schlesinger and he was also vice president of the Fleet Corporation.

The CHAIRMAN. Who was vice president?

Mr. TALBERT. Mr. Schlesinger was also a vice president of the Fleet Corporation. That is a part of the Shipping Board.

The CHAIRMAN. Yes.

Mr. TALBERT. He had authority to sign the contract, and we got Standifer his check that day before quitting time.

Mr. DAVIS. When was it that you saw a representative of the Bureau of Internal Revenue?

Mr. TALBERT. That was about a year ago, or over a year, possibly.

Mr. DAVIS. That was whom, did you say?

Mr. TALBERT. Mr. Lewis first.

Mr. DAVIS. What was that conference about?

Mr. TALBERT. Well, I related all of this story to Mr. Lewis that I have told you, and he asked me if I knew how the settlement was arrived at. I told him I did not, that at the time I drew the contract I had no knowledge of what constituted the various figures because it was not necessary for me to write the contract. There is not 1 per cent of our settlement contracts in which we pay amortization that has a list of the items named in the settlement.

Mr. DAVIS. You just take the amount of the settlement and put that in the contract?

Mr. TALBERT. We just take the amount of the settlement and put that in the contract, and take a general release.

Mr. DAVIS. Did you call anyone into the conference with you at the time that this gentleman called on you?

Mr. TALBERT. Yes. I think Mr. Lewis called me on the telephone to make an appointment and stated what he was coming for, and Mr. Standifer had been there before with his attorney.

Mr. DAVIS. What attorney?

Mr. TALBERT. I can not remember the name, but I presume it was this man, Mr. Murphy, the same man that Mr. Adamson speaks about. I never met him since, and that is the first time I had ever met him.

Mr. Standifer told me that he had the question of taxation up before the Internal Revenue Bureau, and they were waiting to have a conference with some people in the Shipping Board to determine what their charges should be over there. I do not think

he discussed the case in very much detail, except to state that it had reference to the amount of amortization he got in this settlement, and he asked me, before his attorney there, if I knew anything about amortization being allowed at the time the settlement was made, and I told him that I was given nothing but a lump-sum figure, and told to draw the contract, and I had nothing to do with the negotiations. I told Mr. Lewis that.

But in the meantime, either while Mr. Lewis was there or after he telephoned me that he was coming over, I asked Mr. Adamson to find out from the files, if he could, what elements did enter into the settlement. I knew he was very familiar with the case, more so than anybody else in the Shipping Board, because he continued to work on the case long after I had nothing to do with it. I went out of the case in May, 1921, while Mr. Adamson worked with Mr. Schlesinger during the time that Mr. Schlesinger was making all of his investigations. Mr. Adamson did prepare a little statement on one sheet, about the size of a letterhead, and I showed that to Mr. Lewis. Mr. Lewis then went into a very extended discussion of the case with Mr. Adamson, in which I did not take very much interest, but was there, and listened to a part of it, and discussed various issues with Mr. Lewis. Mr. Lewis was quite positive that it was one of the elements that entered into the figure, as was Mr. Adamson.

Mr. DAVIS. That amortization was?

Mr. TALBERT. That amortization was one of the elements that entered into the figure.

Mr DAVIS. Was the amount of that amortization allowance discussed in detail, there, that you know of?

Mr. TALBERT. Oh yes; Mr. Lewis and Mr. Adamson discussed it quite thoroughly.

Mr. DAVIS. And did he seem to be satisfied that that amount had been allowed by the Shipping Board to the taxpayer?

Mr. TALBERT. That was Mr. Lewis's position. He seems to be thoroughly convinced of it.

Mr. DAVIS. Did you ever convey the impression to Mr. Lewis or to anyone, that this was just a lump-sum settlement, so to speak, without going into details of all of the items?

Mr. TALBERT. I did not intend to convey that impression. I do want to say that when I drew up the settlement, I had no information whatever as to the items that went into it, except the few small matters that they had not covered in their settlement, regarding our taking over certain commitments.

Mr. DAVIS. State whether or not that is the usual procedure in drawing these settlements.

Mr. TALBERT. It is almost 100 per cent our rule down there.

The CHAIRMAN. In other words, Mr. Talbert, if the settlement was absolutely relied upon by the Bureau of Internal Revenue, then there would not be one single item allowed for contractual amortization?

Mr. TALBERT. That is true. I do not know of a case—I can not recall to my mind one single case out of the thousands that we have handled there—where in a contract of settlement, they individualized the items, and said "this much is allowed for these various items."

Mr. DAVIS. Did you have a conference with anyone else besides Mr. Lewis, that you have mentioned here?

Mr. TALBERT. Mr. Hering came over a few days after that.

Mr. DAVIS. And did you talk to him?

Mr. TALBERT. Yes, sir.

Mr. DAVIS. What was the substance of that conversation?

Mr. TALBERT. Well, I told him in a little briefer manner my connection with the preparation of the contract.

Mr. DAVIS. Did he state his purpose in coming over there?

Mr. TALBERT. He seemed to be quite familiar with the case, and to have the information that Mr. Lewis had obtained, and was just making a little further examination.

Mr. DAVIS. Did he find fault with the report that Lewis had made; or did he make any suggestions with reference to the way the shipping board handled amortization?

Mr. TALBERT. He took the position that the contract of settlement itself made no mention of amortization, and that there were no definite figures in any report to the Shipping Board or to the claims board setting up just exactly how this was arrived at, and that therefore they had to consider it as a lump-sum settlement, and he stated that that was the position of the taxpayer, or Mr. Standifer. I thing he had with him a brief or argument submitted by Mr. Standifer, or a statement, wherein Standifer had stated that he did not know how the sum was arrived at. He seemed to be generally of the opinion that the contract ought to set out the amortization, or if the contract did not do it, some official report to the party making the determination. In this case, it seems that we had to go to two or three memoranda that had passed some time before, and come back to the original award, and make the deductions in order to determine just exactly what was allowed.

Mr. DAVIS. And did you explain that to Mr. Hering?

Mr. TALBERT. Mr. Adamson discussed this case to some extent with him. I told him in a general way about it, but left the details to Mr. Adamson. Mr. Hering apparently had looked into the matter to some extent, and had his mind pretty well made up on it.

The CHAIRMAN. Do I understand from your testimony that Mr. Standifer and his attorney came to you?

Mr. TALBERT. They did.

The CHAIRMAN. And asked you if you knew the details of the settlement?

Mr. TALBERT. Yes; if I knew the details of the settlement at the time I drew up the contract.

The CHAIRMAN. Then, when you told him you did not, did you know where they went to from there? What I am trying to get at is whether you know whether they went to some official of the Shipping Board?

Mr. TALBERT. Mr. Adamson and I occupied the same office at that time, and it was discussed more or less with Mr. Adamson there, and some questions were asked.

The CHAIRMAN. Did you hear the conversation that took place between the contractor and Mr. Adamson?

Mr. TALBERT. I did a part of the time. Now, Mr. Standifer was there twice, as I remember it.

The CHAIRMAN. And on both of those occasions, did he tell you that you were going to have a visit from the representatives of the Bureau of Internal Revenue?

Mr. TALBERT. Yes; I think he did. I think my first information that anybody was coming over to see me, came from Mr. Standifer. I think after that I got the call from Mr. Lewis.

The CHAIRMAN. Did he ask you specifically if contractual amortization had been allowed?

Mr. TALBERT. Oh, no; he did not ask me that. He was just asking me if I knew anything about it at the time the settlement was drawn up, and the terms of the settlement. I told him the settlement contract spoke for itself. It was just a lump sum of $998,000 mentioned, and that I had no information at that time as to what they had allowed or had disallowed.

Mr. DAVIS. I think that is all.

Mr. HARTSON. I have no questions. He has testified very fully as to his knowledge of it.

The CHAIRMAN. Have you any case to take up to-morrow morning, Mr. Davis?

Mr. DAVIS. I do not think we have any ready. We have Mr. Wright here, an engineer who knows further about this settlement.

Mr. MANSON. He negotiated the original Benson award.

The CHAIRMAN. I think we might hear Mr. Wright now. Do you think we had better do that now, Senator Jones?

Mr. DAVIS. He is available at any time. He is with us as one of our engineers.

Senator JONES of New Mexico. Then, we had better call him later.

Mr. DAVIS. He knows about the set-up of the 1921 Benson award, so to speak, and negotiated it.

The CHAIRMAN. With whom?

Mr. DAVIS. On behalf of the Shipping Board, with the taxpayer.

The CHAIRMAN. Oh, yes; so he can testify to the fact that the taxpayer knew that amortization was really allowed?

Mr. DAVIS. I am informed that that is true.

Mr. HARTSON. That is in the Benson award, a year and a month or two before the final settlement.

The CHAIRMAN. You will not have anything ready for to-morrow?

Mr. DAVIS. I do not believe so.

The CHAIRMAN. And on Monday you will have Mr. Wright here, and you will also have Mr. Swaren here?

Mr. DAVIS. Yes.

The CHAIRMAN. Then we will adjourn here until 10 o'clock on Monday morning.

(Whereupon, at 12.10 o'clock p. m., the committee adjourned until Monday, December 8, 1924, at 10 o'clock a. m.)

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

MONDAY, DECEMBER 8, 1924

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE THE
BUREAU OF INTERNAL REVENUE,
Washington, D. C.,

The committee met at 10 o'clock a. m., pursuant to adjournment of Friday.

Present: Senators Couzens (presiding) and Jones of New Mexico.

Present also: Earl J. Davis, Esq., and L. C. Manson, Esq. of counsel for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Nelson T. Hartson, solicitor, Internal Revenue Bureau; and S. M. Greenidge, head, engineering division.

Mr. HARTSON. Senator, this is a communication from the Commissioner of Internal Revenue with reference to the Standifer case. I should like to have that letter go into the record, if there is no objection by the chairman.

The CHAIRMAN. Yes.

Mr. DAVIS. Shall I read it?

The CHAIRMAN. You had better wait until some of the other members of the committee are present.

Mr. HARTSON. There is another matter, Mr. Chairman, with reference to the estate tax cases which I desire to introduce some further evidence on. Some member of the committee, as I remember it, requested that there be introduced in evidence a statement showing the cases which had come to the solicitor from the Estate Tax Unit, where the solicitor sustained the unit, and in that report indicate the names of the cases and the amounts involved, and I have such a report here.

In compliance with that request, I desire to introduce that list of cases.

Mr. DAVIS. Along with that, I would like to include a list of cases in which the solicitor reversed the unit, so that we will have the total of all of the cases covering that period.

Mr. HARTSON. Yes; you already have information with regard to the cases where the unit was reversed by the solicitor. This is a list of cases where the unit was affirmed by the solicitor, indicating the amount of taxes involved.

The CHAIRMAN. Have you all of the cases in which he reversed the unit, Mr. Davis?

Mr. HARTSON. Yes; you have.

Mr. DAVIS. So I will include the other list with these cases.

The CHAIRMAN. I understand that we already have that list in the record.

Mr. DAVIS. I do not think it is in evidence.

Mr. HARTSON. I do not think it is in evidence. The committee has the list, but it has not been put in the record.

Mr. DAVIS. If we are to put this list in, I would like to have the other list in, and then we will have a complete list of those cases, both those reversed and those affirmed.

Mr. HARTSON. I am not making a specific request that it go in the record. I am not concerned about that, except that my recollection is that I was asked to submit this list, and I now produce it.

The CHAIRMAN. I think that is correct, and it is perfectly appropriate that both of them should go in together, so that they may be compared. That will be done.

(The lists of the cases referred to are as follows:)

Estate tax cases in which the solicitor sustained the opinion of the Estate Tax Unit, period of January 27, 1923, to October 6, 1924

Estate of—		Estate of—Continued.	
James S. Armstrong	$439.68	Eugenia A. Ledyard	$1,660.79
Mary Hollister Banning	16,985.60	James H. McCord	12,614.45
Edson W. Baumgardner	2,173.03	Rebecca Mayer	24,569.41
M. S. Beltzhoover	54,634.55	A. Howard Merritt	341.24
John F. Boyd	96,032.14	Edith Anne Oliver	2,715,114.26
Annie Bradford	13,600.00	John B. Pierce	51,076.58
William Brett	55,457.97	Meyer L. Polaski	542.41
Peter C. Brooks	1,051,922.34	Max Pollack	4,959.21
J. S. Browning	31,223.47	Gustavo Preston	113,703.44
Lewis C. Bures	417.58	Elizabeth McC. Rodenbough	113,649.70
Abraham M. Byers	17,452.03	S. Leon Rosskam	1,780.09
Lucy E. Chandler	74,451.03	Lina K. Schlichter	31,200.00
Andrew Carnegie	663,800.13	Emma K. Sotter	4,194.04
George Douglass	113,066.40	Hattie C. Stevenson	65,737.36
Kalman Haas	24,142.49	Edwin C. Stewart	11,912.42
Harry Harkness	210,316.43	James Stewart	1,707.02
Isaac Hewitt	176.65	Peter E. Strauss	27,985.77
Richard D. Jewett	14,026.65	Frank Upman	1,200.00
Samuel R. Jewett	64.46	William W. Wright	59,699.94
Emma Chambers Jones	20,480.72		

Estate tax cases in which the solicitor reversed opinion of Estate Tax Unit, period of January 27, 1923, to October 6, 1924

Estate of—	Amount of transfer	Amount of tax	Estate of—	Amount of transfer	Amount of tax
Charles Kollstede	$285,048.00	$6,901.93	William Henry Smith	$110,000.00	$1,760.00
Henry L. Davis	356,355.87	9,754.23	Philip S. Post	94,000.00	1,380.00
Edward Oppenheimer	718,825.00	29,629.50	Lucy M. Mills	836,532.38	38,422.59
Moise L. Wolff	398,332.51	11,433.30	John M. Skaggs	285,720.40	6,928.62
Josephine Brooks	3,504,774.03	301,977.40	Francis M. Smithers	1,149,607.00	66,460.70
George F. Rand	3,083,200.00	259,320.00	William P. Hays	(1)	
James Hardie	383,811.62	10,852.46	Sigmund Schwabacker	1,110,609.28	62,560.93
Sarah Vesta Hermine Berwind	250,000.00	5,500.00	T. Jefferson Coolidge	(1)	
Charles M. Bailey	1,800,000.00	131,500.00	Laura T. Ripka		2,339.59
James Neville	(1)		Floyd Cranska	320,000.00	6,200.00
George R. White	3,411,649.00	292,664.90	Rosa Von Zimmerman	(1)	
William H. Parlin	2,856,000.00	236,100.00	George A. Joslyn	(1)	
James Nennen Jennings	200,000.00	4,000.00	William E. Hughes	(1)	

[1] Amount not given.

Mr. DAVIS. Mr. Wright.

TESTIMONY OF MR. EDWARD T. WRIGHT, ENGINEER

(The witness was duly sworn by the chairman.)

Mr. DAVIS. State your full name, and tell the committee what your business is.

Mr. WRIGHT. Edward T. Wright, engineer.

Mr. DAVIS. Of what school are you a graduate?

Mr. WRIGHT. Yale.

Mr. DAVIS. How long have you been engaged in the practice of your profession?

Mr. WRIGHT. Thirty years.

Mr. DAVIS. You are now employed by the Senate committee?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. In what work?

Mr. WRIGHT. In the metals valuations investigation.

Mr. DAVIS. You were formerly with the Shipping Board, were you?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. What work did you do with the Shipping Board?

Mr. WRIGHT. During the war period I was on production work. After the armistice I was on claims.

Mr. DAVIS. In your work on claims for the Shipping Board, did you come in contact with the Standifer case?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. What particular feature of it?

Mr. WRIGHT. I prepared the original recommendation to the Construction Claims Board.

Mr. DAVIS. Will you give us an outline of what that involved?

Mr. WRIGHT. The Standifer case was rather an involved case, and the settlement was a final settlement, involving not only cancellations but contract reimbursements and changes and extras—all features of the case, and in that all of the contracts that had been given to Standifer were settled, that is, tentatively settled, subject to audit.

Mr. DAVIS. Is that the so-called Benson award that you are talking about now?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. Was that about May, 1921?

Mr. WRIGHT. My recommendation was April 16; the construction claims board passed the claim, I think, on April 18, and the trustees of the Fleet Corporation on May 26, 1921. Admiral Benson approved that.

Mr. DAVIS. Have you an outline of that claim?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. Or the tentative settlement of that claim?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. Will you produce it?

Mr. WRIGHT. I think you have it over there.

Mr. DAVIS. Is this it [exhibiting paper to witness]?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. I wish you would put that in the record.

Mr. WRIGHT. I drew this off here on Saturday. Of course, it is three years and a half since I knew these figures at all, but I went over to the Shipping Board and went over my report. I have shown here on the first sheet the summary of the recommendation, which

was, as I say, subject to final audit. Then, on the right hand, I have shown the final audit figures. On the second sheet I have shown the contracts and the cancellations, the cancellation allowances and the amortization figures.

Mr. DAVIS. Will you read into the record the amortization figures with reference to those contracts?

The CHAIRMAN. Just a moment. I thought you were going to put this whole statement into the record.

Mr. DAVIS. I think you had better do that, Mr. Wright? You had better read the whole report in.

The CHAIRMAN. Unless they want it read we will just put it into the record without reading it. Do you desire to have it read, Mr. Hartson?

Mr. HARTSON. No; I have no desire to have it read. I agree with the chairman that it should go into the record too.

The CHAIRMAN. Yes; I think we had better have it go into the record.

(The statement referred to is as follows:)

G. M. STANDIFER CONSTRUCTION COMPANY—ORIGINAL SETTLEMENT

Recommendations by E. T. Wright to Construction Claims Board, April 16, 1921.

Recommendations passed by Construction Claims Board, April 18, 1921.

Resolution by trustees of United States Shipping Board Emergency Fleet Corporation, May 26, 1921.

Approval of above resolution by Admiral W. S. Benson for United States Shipping Board, May 26, 1921.

Recommendation based on cost basis for contract No. 3, contract basis of reimbursement, plus cancellation allowances and other credits and debits, subject to final audit.

Summary of recommendation

	Recommended	Final audit
CREDITS		
Surplus materials, contracts 3, 176, and 508	$544,493.84	
Ballin boiler settlement, contracts 3 and 176	201,262.56	
Surplus materials, contracts 156 and 503	1,903,113.04	
Contract No. 3, cost	7,308,328.52	$7,969,772.06
Contract No. 176	4,325,800.00	4,530,436.77
Contract No. 508	1,072,600.00	1,442,196.32
Contract No. 508, cancellation	340,000.00	
Contract No. 509, cancellation	738,809.65	738,809.65
Contract No. 156	19,521,200.00	20,379,138.98
Contract No. 503, cancellation	756,772.03	1,637,940.26
Undistributed carrying charges	25,000.00	10,815.78
Total	36,742,379.64	36,709,109.81
DEBITS		
Insurance premium	14,027.00	
Vancouver home project	162,500.00	162,500.00
General debits	33,774,127.57	35,196,997.99
Total debits	33,950,654.57	35,359,497.99
RECAPITULATION		
Total credits	36,742,379.64	36,709,109.81
Total debits	33,950,654.57	35,359,497.99
	2,791,725.07	1,349,611.82
Cash advance, June 8, 1923	500,000.00	
	2,291,725.07	
Deductions in final audit	942,113.25	
Balance due contractors	1,349,611.82	

Statement reflecting allowances made on cost of facilities in United States Shipping Board resolution of May 26, 1921

Contract No.	Contracted for		Ships canceled		Allowances	
	Ships	Price	Number	Price	Cancellation	Amortization
3 W. C.	10 wood	$5,000,000.00				[1]$163,059.14
102 W. C.	6 wood	4,320,000.00				
302 W. H.	4 wood	1,360,000.00	1	$340,000.00	$340,000.00	14,311.01
500 W. C.	6 wood	4,110,000.00	6	4,110,000.00	738,809.65	125,708.66
156 S. C.	10 steel	17,570,000.00				
403 S. C.	5 steel	9,000,000.00	5	9,000,000.00	756,772.03	369,555.19
Vancouver home project, balance of $350,000 loan unpaid.						187,500.00
Total	41	41,360,000.00	12	13,450,000.00		862,224.00

[1] Resolution allowed for costs on contract No. 3, including plant depreciation of $163,059.14.

Mr. DAVIS. The total of these figures is what, on amortization?

Mr. WRIGHT. $862,224. I would like to say that contract No. 3 was a cost settlement, as the Fleet Corporation paid costs, and involved in that figure is the figure of depreciation of $163,000, which was an application on cost of the facilities, and is included under amortization. There are three items on which were spread the amortization. That last item, $187,000, is the balance of $350,000, which was unpaid, and which also is an allowance on cost of the facilities.

Mr. DAVIS. You had meetings with the taxpayer pending settlement of this claim, had you?

Mr. WRIGHT. A great many of them; yes, sir.

Mr. DAVIS. And with his counsel?

Mr. WRIGHT. No; with his auditor.

Mr. DAVIS. Who was the auditor?

Mr. WRIGHT. Mr. Soule.

Mr. DAVIS. Was he familiar with every item of the tentative settlement?

Mr. WRIGHT. Every item; yes, sir. The depreciation figures, of course, was not known until the final audit, but depreciation was known to be included in the cost. The other figures were known in detail.

Mr. DAVIS. But the amortization figures were discussed with the taxpayer?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. He had been aware of the amount that that involved?

Mr. WRIGHT. Absolutely, except as to that item of depreciation. That figure was not known.

Mr. DAVIS. I believe that is all.

Mr. HARTSON. Then, do I understand, Mr. Wright, that included in this $862,000 there is some element of depreciation?

Mr. WRIGHT. Yes, sir.

Mr. HARTSON. So it can not be said that the entire $862,000 covers exclusively amortization of contracts?

Mr. WRIGHT. No sir; not as——

Mr. HARTSON. As such?

Mr. WRIGHT. As amortization is defined.

Mr. HARTSON. Yes. From the $862,000, can you deduct the amount which would leave a balance which could be clearly ascribable to contractual amortization?

Mr. WRIGHT. Yes sir.

Mr. HARTSON. Have you done so in this report?

Mr. WRIGHT. No; it is all included, but I have shown the specific amounts against contracts.

Mr. HARTSON. What is that total, the specific amounts against what?

Mr. WRIGHT. $862,000.

Mr. HARTSON. And that amount includes some other depreciation allowance?

Mr. WRIGHT. Yes, sir.

Mr. HARTSON. Which can not be clearly ascribable to contractual amortization?

Mr. WRIGHT. Not as amortization is defined, possibly.

Mr. HARTSON. Yes.

Mr. WRIGHT. But it is in result; it is an allowance on the cost of special facilities.

Mr. HARTSON. Of course, we are dealing with contractual amortization in a technical sense. I think we can agree on that, can we not, that the Income Tax Law provides that contractual amortization shall be considered when it has been allowed by some other government department, and, if I understand you correctly, there is an element of depreciation in this $862,000, which can not be ascribable to contractual amortization as it is technically known.

Mr. WRIGHT. Contract No. 3; yes, sir.

Mr. HARTSON. Can you make a segregation between the amount that can be technically described as contractual amortization and the amount that must be ascribable to depreciation?

Mr. WRIGHT. Yes, sir; it is all in that report.

Mr. HARTSON. Well, it is all in the $862,000, if I understand you, but do I understand that there has been that segregation between those two elements?

Mr. WRIGHT. Yes, sir.

Mr. HARTSON. Then how much, Mr. Wright, do you report as being ascribable to contractual amortization as it is technically known?

Mr. WRIGHT. That would be the difference between the total amount of $862,000 and that hundred and sixty and some odd thousand depreciation.

Mr. HARTSON. I understand.

Mr. WRIGHT. They are shown in detail.

Mr. HARTSON. Mr. Adamson, on the stand on Friday, I think, said that the entire $862,000, according to his view, was an allowance by the Shipping Board of contractual amortization, and your view is that this hundred and some odd thousand dollars of that amount can be ascribed to contractual amortization?

Mr. WRIGHT. There is no doubt that on No. 3 there was no amortization allowed. It was depreciation.

Senator JONES of New Mexico. Mr. Hartson, is it you contention that if the Shipping Board had taken into consideration depre-

ciation it was not the duty of your branch of the Government to also consider that?

Mr. HARTSON. Yes, sir; that is my view, that our regulations require us to deduct from cost of plant facilities an amount specifically allowed, as such, by another department for contractual amortization.

Senator JONES of New Mexico. Well, would you not consider an allowance for depreciation a part of the amortization?

Mr. HARTSON. I would not, Senator. No; I think that is another element which may be of the same character and fall in the same general class, but we can not go to——

Senator JONES of New Mexico. Then you would ignore that absolutely in your branch of the service? You would ignore anything that they allowed for depreciation in the Shipping Board?

Mr. HARTSON. Yes; because I think our regulations limit us to a consideration of contractual amortization.

Senator JONES of New Mexico. We are considering here the question as to whether the regulations are right or not, or whether the law is right or not.

Mr. HARTSON. Yes, sir.

Senator JONES of New Mexico. And what we are getting at is this: If one branch of the Government has made allowance for any depreciation or amortization, of whatever character and in whatever way, should not every other branch of the Government recognize that, and act accordingly?

Mr. HARTSON. I think there should be consistent action between the departments.

Senator JONES of New Mexico. Yes.

Mr. HARTSON. Certainly.

Mr. DAVIS. Now, Mr. Wright, you have included that $162,000 under amortization, have you not?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. What is the idea of including that in the amortization there? Is it of the same nature?

Mr. WRIGHT. Yes; because it is an allowance against the cost of the facilities.

Mr. DAVIS. And it has the effect of amortization?

Mr. WRIGHT. It has the same effect exactly as amortization.

Mr. MANSON. Do not the regulations state that amortization shall be inclusive of depreciation during the amortization period?

Mr. DAVIS. Is that right?

Mr. WRIGHT. I think so; yes.

Mr. HERING. They do; yes.

Senator JONES of New Mexico. If that is a part of the regulations, why is that regulation ignored, Mr. Hartson?

Mr. HARTSON. Well, I do not know that it has been ignored, Senator.

Senator JONES of New Mexico. Well, you just a while ago said, as I understood you, that you would ignore it.

Mr. HARTSON. I would ignore it in considering an allowance for contractual amortization. That is what I say.

Senator JONES of New Mexico. You said you would have no consideration for what the other bureaus did with regard to contractual

amortization, that you would consider your regulations in construing only technical contractual amortization?

Mr. HARTSON. Well, if the language of the regulations has not temporarily slipped my mind, I would certainly include such an allowance as would represent depreciation. I have not, in our discussion here this morning, been over the letter and the language of the regulations in this regard, but I certainly would not fly in the face of our regulations, Senator, because we are bound by them, and I think properly so, and they become part of the law itself.

Senator JONES. Then, what is the purpose of drawing this distinction between depreciation and so-called contractual amortization?

Mr. HARTSON. My purpose, Senator, is to bring out what my recollection was of a distinction in the regulations. I did not know that the regulations were so broad, and I would like to have it pointed out to me, if they are.

Mr. MANSON. I refer to Regulations 62, article 182:

> The allowance for amortization shall be inclusive of all depreciation during the amortization period on property subject to amortization.

Mr. DAVIS. Whatever this is, it is contractual, is it not, Mr. Wright, and it has the same effect as the technical amortization matters which you speak of?

Mr. WRIGHT. Yes, sir.

Mr. DAVIS. After you made up this tentative claim and the Benson resolution was adopted, was anybody from the Income Tax Unit in to see you and take the matter up with you?

Mr. WRIGHT. No, sir; I had nothing to do with the Standifer claim after the passage of the resolution by the trustees and Admiral Benson.

Mr. DAVIS. At any time after that did Mr. Standifer come in to talk to you about his tax matter?

Mr. WRIGHT. No, sir; except that after he had made a settlement with the Fleet Corporation, I met him in the hall, and he said he had been "badly dished"; he had not gotten what he thought he should. He was very much peeved, in fact.

Mr. DAVIS. His tax matter, however, was never discussed with you?

Mr. WRIGHT. No, sir.

Mr. DAVIS. That is all.

Mr. HARTSON. Just a moment, Mr. Wright. I should like to point out to the committee what occurs to me to be a distinction between the provisions of article 182 as read by Mr. Manson, and the specific thing that we are dealing with here. Article 181 is the portion of the regulations which deals with contractual amortization having been allowed by another Government department, and it reads as follows:

> All allowances made to a taxpayer by a contracting department of the Government or by any other contractor, for amortization specifically as such, shall be treated as a reduction of the cost of the taxpayer's plant investment.

Then, article 182 is as Mr. Manson has read it, and it may be argued that that refers to amortization on the cost of war facilities, with no reference to an allowance of amortization by any other Government department. In the original instance, it refers to a taxpayer's erecting facilities during the war, and then it provides,

when that is done, that the allowance for amortization shall be inclusive of all depreciation during that period.

The CHAIRMAN. I would like to ask you, then, if you are satisfied that all of these items should be added together under those rulings?

Mr. HARTSON. I am satisfied that depreciation should not be considered when amortization is allowed; in other words, that amortization should include depreciation when the plant is erected by the taxpayer during the war for the purpose of manufacturing articles to prosecute the war. Now, I am not satisfied that the contractual amortization allowed by another department is broad enough to include this depreciation of contracts. I think it should all be under the same head, but I have not had an opportunity to study it to the point where I would want to give it as my final opinion. It has come up suddenly, and that is the reaction. I think it can be argued that they contemplate two different situations.

Senator JONES of New Mexico. Well, Mr. Hartson, you can argue almost anything, but, after all, in taking the statutes by and large and taking the regulations in the same way, is it not perfectly plain that when one branch of the Government has made an allowance for these things, it should be recognized by the other branches of the Government dealing with it afterwards?

Mr. HARTSON. I agree with you, Senator.

Senator JONES of New Mexico. Well, that is all.

Mr. HARTSON. Now, Mr. Wright, this computation which you worked on in determining the allowance which should be made to the Standifer Corporation, was made by you during the spring of 1921?

Mr. WRIGHT. Yes, sir.

Mr. HARTSON. And I believe your testimony is that that finally took the form of what we have called here in this investigation the Benson award?

Mr. WRIGHT. Yes, sir.

Mr. HARTSON. That Benson award was later canceled by some technical defect which it was alleged to have contained, was it not?

Mr. WRIGHT. Not that I know of.

Mr. HARTSON. Was it not signed and approved by Mr. Standifer, and then did not the question arise as to Admiral Benson's authority to sign it?

Mr. WRIGHT. Not that I know of.

Mr. MANSON. In order that we may have the record straight here, I would like to call attention to the fact that the testimony of Mr. Adamson was that the Benson award was not carried out because of a defect, but that subsequent to the establishment of the new Shipping Board it was reaffirmed by letters in writing which passed between the Shipping Board and Mr. Standifer.

Mr. HARTSON. That was my understanding of Mr. Adamson's testimony. You knew, however, that a question was raised?

Mr. WRIGHT. No, sir.

Mr. HARTSON. As to Admiral Benson's authority to sign that original award.

Mr. WRIGHT. No; I know that his authority was questioned right along, his general authority, but I did not——

Mr. HARTSON. Did you work on this case after the so-called Benson award was arranged?

Mr. WRIGHT. No, sir.

Mr. HARTSON. And your knowledge of the case is confined to that period?

Mr. WRIGHT. Yes; to the original resolution.

Mr. HARTSON. That is all.

Mr. DAVIS. That is all.

Senator JONES of New Mexico. Mr. Hartson, I understood the other day that you were to furnish us a list of the cases in which your branch of the Government refused to go behind the face of the contract itself, in order to ascertain whether or not amortization had been allowed by the Shipping Board. Am I correct in that?

Mr. HARTSON. I had no such understanding, Senator. There was a list of cases which I was to furnish, which involved the spread of amortization, which question arose in the Berwind-White coal case, and I am prepared to submit that. I did not know that the Senator desired a list——

Senator JONES of New Mexico. Well, I was not clear in my own mind about it, and that is the reason I asked the question. Then, I should like to know whether or not the practice indulged in in this case was the general practice, and if not, to what extent it did not obtain in the department. In other words, if it had been the practice of your bureau to refuse to go behind the contract in terms in order to ascertain whether or not there was actual amortization allowed, we would like to know it. That is the important thing, it seems to me, in this investigation. It is quite clear to my mind that at the present time, at least, if the department or the bureau has followed the course as shown in this case, it ought to be broken up, and we ought to go back and go into all of these cases where a similar course was followed, because I think it is clear that if one branch of the Government has allowed for depreciation or amortization anything which was not, as a matter of fact, taken into account by this bureau, it should be done, and I hope we will find that there are not so many cases closed so that it can not be done yet. If consistent with the views of the chairman here, I would like to suggest that the bureau at once go into all of these cases and find out whether this course has been followed, so that we may readjust these matters.

The CHAIRMAN. I think that is perfectly proper, and in that connection I would like to ask counsel for the committee if they have checked any other cases besides these?

Mr. DAVIS. The engineers have other cases. I can not tell you how many now, Mr. Chairman, but there are other cases.

Senator JONES of New Mexico. Of a similar nature?

Mr. DAVIS. Of a similar nature, I understand. Of course, we have not checked the entire field.

Senator JONES of New Mexico. No; we can understand that that has been impossible, but I think the bureau ought to at once, without any delay whatever, find out to what extent this has been done. I understand this particular case was not called to the attention of

the solicitor and was not called to the attention of anybody in the legal department, but that it was left absolutely to auditors and engineers, and to my mind, it is perfectly clear that this procedure is wrong and in direct violation of the statute and of the regulations of the department as well. I think we ought to know to what extent this thing has occurred and get the whole matter readjusted as soon as possible. Is that your view, Mr. Chairman?

The CHAIRMAN. I think that is perfectly proper and I hope the department will do that.

Mr. MANSON. I would suggest that Mr. Thomas, who is working with counsel for the committee, work with the bureau engineers in getting this data.

Senator JONES of New Mexico. Sure; we want someone from the committee detailed to aid in that work, and as large a force should be put on it as possible so that we may know to just what extent it has been done and how far we may be able to remedy this situation.

Mr. GREENIDGE. I can assure the Senator that all the men available in the department will be put on such work immediately.

Senator JONES of New Mexico. Very good, sir.

Mr. GREENIDGE. It will be started this afternoon.

Senator JONES of New Mexico. I assume that time is of the essence of the situation, to some extent.

Mr. GREENIDGE. Oh, yes; because of the tolling of the statute.

Senator JONES of New Mexico. Yes; and a full report will be made to the committee of the record.

The CHAIRMAN. It might be appropriate to read this letter into the record at this time, to show the disposition of the bureau. This is a letter addressed to myself as chairman, and it is dated December 5, and says:

> In line with the suggestion made this morning by Mr. Hartson to the Senate committee investigating this bureau, of which you are chairman, I have determined to refer the settlement of the case of the G. M. Standifer Construction Co., of Portland, Oreg., to a new and impartial committee for review.
>
> I understand that certain members of your committee have criticized the bureau's adjustment of this case, and in order to safeguard the Government's interests in every way I have decided to take this action. I propose to designate the best qualified men available for this review and will take pains to see that those who consider it will have had no previous knowledge of the matter whatsoever. I have been informed that if a mistake has been made it is not too late to correct it.
>
> With assurances of my desire to cooperate at all times with your committee in every way, I am.

That letter is signed by D. H. Blair, commissioner.

Senator JONES of New Mexico. I am sure that every member of the committee appreciates the spirit in which that letter is written and the offer of cooperation on the part of the commissioner.

The CHAIRMAN. I would like to ask before we adjourn whether you have computed the amount of the additional tax in the Standifer case, has it been acted on in accordance with our theory?

Mr. HARTSON. I have the computation here, Senator. It has been given me by Mr. Greenidge, chief of the engineering section. It contains an analysis, too, of the computation, and is the result of the adjustment in the Stanifer case, figuring the tax on what

we call the statutory basis. As was pointed out to the committee, the Standifer Co. accompanied its claim with a claim for what is called special assessment, that is, a tax arrived at by the use of comparatives, comparing the taxpayer's rate with the rate paid by other representative concerns engaged in similar business. This, of course, does not figure that in, and it has never been a decided question, because it was unnecessary to decide whether they would have been entitled to have their tax computed by the use of sections 327 and 328 of the 1918 act.

This computation, which should all go in, has this set out: 1918, none; 1919, $106,210.92; 1920, $607,857.87; 1921, $6,404.70; 1922, refund, $107,778. The net difference in tax would be $612,695.49.

The CHAIRMAN. Do you desire to put all of this statement in the record?

Mr. HARTSON. Yes, I do; and with this observation, that the taxpayer in 1922, received $998,000, as I recollect it, from the Shipping Board; $612.69 .49 would have been the additional tax that he would have had to pay, had contractual amortization by the Shipping Board been figured into the bureau's computation of his tax. It is plain to see that he would have been compelled to pay substantially two-thirds, in additional taxes, of the amount that he received in final settlement from the Shipping Board, had that been figured into the tax. What he would have done, I do not know. I merely suggest that.

The CHAIRMAN. I think that is obvious.

(The statement is as follows:)

DIFFERENCE BETWEEN TOTAL TAX LIABILITY AS COMPUTED BY REVENUE AGENT WITHOUT CONTRACTUAL AMORTIZATION AND AS COMPUTED DEDUCTING CONTRACTUAL AMORTIZATION FROM ASSET COSTS—G. M. STANDIFER CO.

1918	None.
1919	$106,210.92
1920	607,857.87
1921	6,404.71
1922 (refund)	107,778.00
Difference in tax	612,695.49

SCHEDULE 1

	1918	1919	Total
Depreciated cost	$3,175,281.46	$185,222.91	$3,360,504.37
Contractual amortization	814,715.46	47,508.54	862,224.00
Reduced cost on which amortization is allowed	2,360,566.00	137,714.37	2,498,279.37
Residual value as herein computed and post-war depreciation	649,332.50	45,956.74	695,289.24
Amortization allowed for tax purposes	1,711,233.50	91,757.63	1,802,991.13

Amortization spread:

1918	None.
1919— 90.58	$1,633,149.37
1920— 9.42	169,841.76
100.00	1,802,991.13
Income used for spread:	
1919 without amortization	1,774,882.19
1920 without amortization	184,603.64
	1,959,485.83

Forty-three three hundred and sixty-fifths of $1,566,948.43.

SCHEDULE 2.—*Computation of Tax 1918*

Net loss shown on return	$10,705.98
Net loss corrected by field examination	[1] 63,006.83

SCHEDULE 3.—*Computation of Tax 1919*

Net loss shown by examining officer		$29,519.25
Less allowance for amortization in arriving at above loss		1,804,401.44
Net income before correct allowance for amortization		1,774,882.19
Less amended allowance for amortization considering contractual amortization		1,633,140.37
Corrected income for 1919		141,732.82
Invested capital 1919:		
Capital stock	$20,000.00	
Paid-in surplus	917.22	
	20,917.22	
Net income		141,732.82
Excess-profits credit:		
8 per cent of $20,917.22	$1,673.38	
Exemption	3,000.00	
	4,673.38	
War-profits credit:		
10 per cent of $20,917.22	2,091.72	
Exemption	3,000.00	
	5,091.72	
Net income	141,732.82	
Excess-profits credit	4,673.38	
Subject to tax at 30 per cent	137,059.44	
Exemption over 20 per cent	489.94	
Taxable at 65 per cent	136,569.50	88,770.18
Net income	141,732.82	
War-profits credit	5,091.72	
Taxable at 80 per cent	136,641.10	109,312.88
Tax computed under section 302, revenue act, 1908		102,486.26
Net income	$141,732.82	
Excess-profits and war-profits tax plus exempt.on	104,486.26	
Taxable at 10 per cent	37,246.56	3,724.66
Total tax 1919		106,210.92

SCHEDULE 4.—*Computation of tax, 1920*

Net income revenue agent's report	$706,170.74
Add amortizat.on disallowed	860,813.69
Correct amortization	1,566,984.43
	169,841.76
Net income subject to tax	1,397,142.67

[1] No amortization was allowed in figuring the above net loss. None was taken on the return for tax purposes. No change therefore results.

Invested capital 1920:			
Capital stock		$20,000.00	
Paid-in surplus		917.22	
Deficit	$109,236.96		
Less adjustment 1919 income	141,732.82		
		32,495.86	
		53,413.08	

Can not adjust 1919 tax in invested capital so capital stock and paid-in surplus must be used for invested capital purposes.

Excess-profits credit:			
8 per cent of $20,917.22	$1,673.38		
Exemption	3,000.00		
	4,673.38		
War-profits credit:			
10 per cent of $20,917.22	2,091.72		
Exemption	3,000.00		
	5,091.72		
Net income		$1,397,142.67	
Less excess-profits credit		4,673.38	
Subject to tax at 30 per cent		1,392,469.29	None.
Less exemption over 20 per cent		489.94	
Taxable at 65 per cent		1,391,979.35	$904,786.58
Net income		1,397,142.67	
Less war-profits credit		5,091.72	
Taxable at 80 per cent		1,392,050.95	1,113,640.76
Tax computed under section 302, revenue act of 1918, at 1918 rates			1,106,814.14

Computation of tax at 1920 rates

Net income		1,397,142.67	
Excess-profits credit		4,673.38	
Subject to tax at 20 per cent		1,392,469.29	None.
Exemption over 20 per cent		489.94	
Taxable at 40 per cent		1,391,979.35	556,791.74
Tax computed under section 302, revenue act of 1918, at 1920 rates			552,191.74

Percentage of income received from war contracts to total income

Total income (100 per cent)	$1,397,142.67
War work (54.03 per cent)	846,731.14
Other income (45.97 per cent)	550,411.53

Computation of tax, 1920

Total amortization	$169,841.76	
54.03 per cent	$91,765.50	
45.97 per cent	78,076.26	
	169,841.76	
Net income		$1,397,142.67
Income from Government work	$846,731.14	
Less amortization apportioned (54.03 per cent)	91,765.50	
	754,965.64	

Percentage of $754,965.64 to total income as above, 54.04 per cent.

54.04 per cent of $1,100,814.14 (excess-profits tax applicable to Government contract)	$598,122.36	
45.96 per cent of $552,191.74 (excess-profits tax applicable to other income)	253,787.32	
	851,909.68	
Net income		1,397,142.67
Less excess-profits tax	$851,909.68	
Liberty-bond interest	18,224.72	
Exemption	2,000.50	
		872,134.40
Taxable at 10 per cent		525,008.27
Tax at 10 per cent		52,500.83
Excess-profits tax		851,909.68
Corrected tax		904,410.51
Previously assessed		407,717.08
Additional tax		496,693.43
Overassessment on report		111,164.44
Net change in tax		607,857.87

SCHEDULE 5.—*Computation of tax 1921*

Capital stock		$20,000.00
Paid-in surplus		917.22
Difference between agent's income and that now used for this computation	$862,224.00	
Surplus December 30, 1920 (agent)	302,036.22	
		1,164,260.22
		1,185,177.44
Reserve for 1920 income tax		296,552.64
		1,481,730.08

Deductions:		
Tax 1919	$106,210.92	
Tax 1920 prorated	382,203.88	
Dividends	727,397.26	
Inadmissible, 2.7 per cent	7,179.79	
		$1,222,991.85
Corrected invested capital		258,738.23
Net income		540,141.78
Excess-profits credit, 8 per cent	$20,699.06	
Exemption	3,000.00	
	23,699.06	
Net income	540,141.78	
Exemption	23,699.06	
	516,442.72	
Amount taxable at 20 per cent	28,048.59	5,609.72
Amount taxable at 40 per cent	488,394.13	195,357.65
Total excess-profits tax		200,967.37
Net income	$540,141.78	
Less excess-profits tax $200,967.37		
Interest United States obligations 31,658.53		
	232,625.90	
Taxable at 10 per cent	307,515.88	30,751.59
Corrected tax		231,718.96
Previously assessed		163,110.12
		68,608.84
New additional tax	$68,608.84	
Old additional tax	62,204.14	
Additional 1921 tax	6,404.70	

SCHEDULE 6.—*Computation of tax 1922*

Net income		$2,930,531.71
Less contractual amortization		862,224.00
Taxable at 12½ per cent		2,068,307.71
Correct tax	$258,538.46	
Previously assessed	307,664.56	
(Overassessment)	49,126.10	
Overassessment above indicated		49,126.10
Agent's figures		58,651.90
Reduction in tax		107,778.00

The CHAIRMAN. We will adjourn here until 10 o'clock to-morrow morning.

(Whereupon, at 11.30 o'clock a. m., the committee adjourned until to-morrow, Tuesday, December 9, 1924, at 10 o'clock a. m.)

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

TUESDAY, DECEMBER 9, 1924

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE THE
BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to adjournment of yesterday.

Present: Senators Couzens (presiding) and Jones of New Mexico.

Present also: Earl J. Davis, Esq.

Present on behalf of the Bureau of Internal Revenue: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Nelson T. Hartson, Solicitor Internal Revenue Bureau; and S. M. Greenidge, head engineering division.

The CHAIRMAN. You may proceed, Mr. Davis, when you are ready.

Mr. DAVIS. The next case that our engineers have prepared for us in reference to amortization is the case of the Northwest Steel Co., Portland, Oreg.

It appears from the report of the engineers that this concern was organized in 1903 and that along in the years 1915–16 there was an urgent demand for ships by foreign interests as well as our own interests. It further appears that this concern, recognizing that demand, desired to enter the shipbuilding business. They had certain equipment in their steel business that could be used in the manufacture of ships, and another concern, under the style of the Willamette Iron Works of the same place, had a large machine shop and other necessary equipment that could be used in outfitting ships after they had been put together up to that point.

The Northwest Steel Co. saw the advantages of having the Willamette Iron Works do the outfitting work in connection with the work that they were doing in the building of these ships, and they entered into a sort of an arrangement, which they called a joint account. The money that they received from the building of ships was to be paid into this joint account and the Northwest Steel Co. was to get 57 per cent of the payments for ships, while the Willamette Iron Works was to receive 43 per cent of the payments for ships.

This arrangement continued for the first contract for the building of eight ships that they entered into with certain Norwegian interests on April 12, 1916. Thereafter, in July, 1917, a second contract was entered into under this arrangement with French interests for the buildings of eight ships. However, on this contract the Willamette Iron Works refused to go on under this arrangement, and the taxpayer, the Northwest Steel Co., then took it upon itself to go

ahead with the responsibility for the building of the ships, including the outfitting thereof.

A settlement was then had on this joint account, and the taxpayer proceeded to build the ships. Later, our Government, through the United States Shipping Board, requisitioned eight of the French ships and six of the Norwegian ships. I might say that I do not refer here to the French and Norwegian Governments, but I mean interests or parties living in those countries. At the time that the ships that I have spoken of were requisitioned, eight vessels were contracted for by the Shipping Board.

In March, 1918, the Shipping Board gave an additional contract for 8 ships, and in August, 1918, another contract for 10 additional ships. On November 6, 1919, the last of these vessels were delivered, and this date establishes the end of the amortization period.

The summary then of the work by the taxpayer under this arrangement is as follows:

Thirty-four vessels delivered to the United States Shipping Board, two delivered to private interests, and six canceled by private interests.

After the cancellation, the taxpayer proceeded to build these ships, and I think built three or more additional ships.

The engineer then made a survey of the property, and this engineer, one Ira J. W. Van Schaick, submitted a report in reference to the same. We gather that the amortization claim of $815,762 was disallowed by this engineer, and this disallowance was approved, I believe, by Mr. de la Mater, chief of the section, and by Mr. Fisher, acting chief engineer.

It appears from our engineer's report that a great portion of the property used in the shipbuilding industry was not subject to amortization, because acquired prior to the time when our country entered the war and before the manufacturing of materials used for war, and therefore there should be no amortization on that part of it.

There are three things that our engineer takes up in his report.

The first one is that in arriving at the residual value of the taxpayer's plant and facilities, the Income Tax Unit accepted as a fair value the amount realized by the taxpayer from the sale of the plant and facilities to three persons who were employees of the taxpayer, and one of whom was a son of the second vice president of the Northwest Steel Co. With reference to this, it would seem that there was some claim made that this was not a bona fide sale, and was simply a sale made between the steel company and these parties who were a part of it and interested in it to turn this property over, that it was not a bona fide sale, but made in order to get out of paying the income tax. The second point is that the taxpayer was suspected of fraudulent practice, and the case was investigated by the special adjustment bureau, but no detailed record of findings of said bureau was kept. I think it will be shown that Mr. Thomas, engineer, and Mr. Parker, visited the special adjustment bureau, sometimes referred to as the fraud section unit, and there found no record of how this complaint was disposed of or what was done with it.

The third point is that the Income Tax Unit amortized certain plant facilities and equipment which had been purchased, installed, and put into operation in 1915 and 1916, and which were used in

the regular business of the taxpayer prior to the beginning of the war. This amortization amounted to $242,360.55.

The CHAIRMAN. You mean that was the amortization, or that was the amount of the tax?

Mr. DAVIS. That was the amount of the amortization.

I think, in brief, Mr. Chairman, that covers about what this case involves.

I will ask Mr. Thomas to be sworn.

TESTIMONY OF MR. RALEIGH C. THOMAS, ENGINEER

(The witness was duly sworn by the chairman.)

Mr. DAVIS. Mr. Thomas, you have been sworn heretofore in these proceedings, I believe, and you have stated your qualifications?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. You have made an examination of the Northwest Steel Co. of Portland, Oreg., have you?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. Have you your report before you?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. I wish you would give us a statement of the case, by referring to your report, and I will ask you to make that statement as complete as you can.

Mr. THOMAS. As Mr. Davis has just recited the history of the taxpayer's connection with the shipbuilding activities, I will pass that over, except to say that in the agreement with the Willamette Iron Works in connection with this joint account, at the end of the joint account, or when it was liquidated, the taxpayer took out of the so-called joint account the facilities which were on his own property and in lieu of that, paid into the joint account the sum of $300,000, and that the Willamette Iron Works took out of the facilities which were situated on their property and in lieu of same, put in, I think it was $65,000. They divided it on the basis of 57 per cent and 43 per cent, respectively.

Mr. DAVIS. What was the total amount of amortization claimed in this case?

Mr. THOMAS. $815,762.46.

Mr. DAVIS. And what was the amount allowed?

Mr. THOMAS. $615,762.46.

Mr. DAVIS. I wish you would go down to the history of the case in your report there and read that synopsis of the case as you have made it out for us.

Mr. THOMAS. The synopsis of the case?

Mr. DAVIS. Yes; the history of the case.

Mr. THOMAS. The Northwest Steel Co. was organized in 1903 as a steel-fabricating concern. In the winter of 1915–16 the demand for ships by foreign interests became urgent, and the taxpayer considered the advisability of entering the shipbuilding business. At this time the company had no building ways or machine shop, so made arrangements with the Willamette Iron Works, who had a large machine shop and the necessary equipment for outfitting ships, whereby the two companies were to sign joint contracts with certain Norwegian interests for constructing and outfitting a number

of ships. Under the agreement with the Willamette Iron Works a "joint account" was created into which all moneys received for the building of these ships was paid. Ways were to be built and additions were to be made in order to have a complete shipbuilding and outfitting plant, the cost of same to be taken from the "joint account." The Northwest Steel Co. was to do all ship construction up to the point where outfitting began, when the Willamette Iron Works was to carry the work to completion. As the work progressed and as payment for the vessels were received by the "joint account," the taxpayer was to receive 57 per cent of the payments made and the Willamette Iron Works 43 per cent of same. Each concern was to supply all material and labor necessary to carry on its respective work.

The first contract under this arrangement was entered into with certain Norwegian interests on April 12, 1916, and was for eight steel ships. In July, 1917, the taxpayer entered into a contract with certain French interests for eight ships. The Willamette Iron Works, however, refused to continue work on these ships under the "joint account" agreement, so the taxpayer assumed the entire responsiblity for the their construction and outfitting. In order to accomplish this, it was necessary to close out the "joint account," and an agreement was reached whereby the taxpayer was to take over the ways, etc., adjacent to their original fabricating plant and in lieu thereof was to pay to the "joint account" $300,000 cash. The Willamette Iron Works was to take over all equipment located at their plant, for which they were to pay into the "joint account" $65,000. This was done and the "joint account" closed out, the taxpayer receiving 57 per cent thereof and the Willamette Iron Works 43 per cent. The original cost of the equipment involved in this transaction was approximately $450,000.

Subsequently, the taxpayer arranged with the Willamette to do all of the outfitting for the eight ships for the French interests on a cost plus 10 per cent basis.

During the course of construction of these vessels, the United States Shipping Board requisitioned the 8 French ships and 6 of the 8 Norwegian ships and gave a contract to the taxpayer for 8 more vessels. The same arrangements were made with the Willamette Iron Works for outfitting these vessels. In March, 1918, the Shipping Board gave the taxpayer another contract for eight additional ships. When it came to arrange for the outfitting of these vessels, the Willamette Iron Works demanded a greater percentage of profit, and as a consequence all negotiations on the subject fell through and the taxpayer proceeded to install its own outfitting plant and do its own work. Again, on August 14, 1918, the Shipping Board gave the taxpayer a third contract for 10 additional ships. Of these, six were canceled. The last Shipping Board vessel was delivered on November 6, 1919, which date establishes the end of the amortization period. Summing up the foregoing, a total of 34 vessels were delivered to the Shipping Board, 2 vessels were delivered to private interests, and 6 vessels were canceled by the Shipping Board.

Sufficient materials had been ordered by the taxpayer to complete three of the six canceled ships, so the taxpayer decided to carry through their construction on its own account, with the purpose

of selling them. This they proceeded to do. The taxpayer further decided to retire from the shipbuilding business upon the completion of these vessels.

Mr. DAVIS. Now, Mr. Thomas, I think you can tell us about the rest of that. There was an alleged sale some time after this of the interests of the taxpayer?

Mr. THOMAS. The taxpayer sold to three individuals, who were former employees of the taxpayer company.

The CHAIRMAN. Was that a sale to three individuals in separate parcels, or three individuals collectively?

Mr. THOMAS. As a partnership, sir. The original fabricating plant, the whole plant that was sold them, was sold in piecemeal, so to speak.

Mr. DAVIS. Under what name was it bought by these parties?

Mr. THOMAS. It was bought under the name of the Northwest Bridge & Iron Works. It is the same as a partnership. On the first sale, they bought the original fabricating plant and leased certain other facilities of the original plant of the taxpayer, with an option to buy. Later on, they bought this property, but at a reduced price from that stated in the option, and a little more property was thrown in. It might be said that all of this property at the time of the sale was a hundred per cent in use, and the amount realized from the sale was only about 25 per cent of the cost price.

Mr. DAVIS. I will ask you now to refer to Exhibit A in your report. What document is that?

Mr. THOMAS. This is a copy of a letter from Mr. Ira J. W. Van Schaick, engineer of the Income Tax Unit, to Mr. James Furse, chief, amortization section.

Mr. DAVIS. Will you read that?

Mr. THOMAS. It is dated October 17, 1920, Seattle, Wash., and is addressed to Mr. James Furse, chief, amortization section, Washington, D. C.:

MY DEAR MR. FURSE: I have sent you under a separate cover my report on the Northwest Steel Co., Portland, Oreg. I am not pleased with it at all for this reason. The taxpayer is not entitled to the amortization they have claimed and I have allowed on the basis of a sale.

The sale of this property to the three men, a nephew and a former foreman of the plant and a foreman of an adjoining plant, was made in my judgment for the sole purpose of defrauding the Government out of $800,000 on which taxes should be paid, but they have so cleverly complied with the law there was nothing left for me to do but allow the claim, although I am not satisfied with their explanations of how the money was obtained by these three men who had always been working on a salary to raise $265,711.41 to do this is not clear.

In conference with Mr. Kramer, the agent, he was of the opinion also that they were putting over a fake sale—perhaps I shouldn't put it this way. I will say they were using very sharp practice and getting away with it.

What I would have liked to do in this case was to disallow this claim for $815,762.46 entirely.

They openly boast that anything can be gotten at Washington with money enough. They have complied with the law, I must admit, but I am not or never will be convinced this claim is a just one.

This letter is entirely confidential to you and I wish it treated as such and put in your personal files, for if it goes to the public files the Northwest Steel Co. will have a copy of it inside of two months.

Very truly yours,

IRA J. W. VAN SCHAICK.

Mr. DAVIS. Following that appears to be the engineer's report with reference to this matter, does it not?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. Will you read that report to us?

Mr. THOMAS (reading):

In re Northwest Steel Co., Portland, Oreg.

In complying with my order of June 1, 1920, to examine the income, excess profits, and munitions tax, if any, of the above taxpayer, the writer proceeded to Portland, Oreg., arriving Tuesday morning, October 12, 1920.

I reported to the revenue agent, Mr. Kramer, at his office in the custom-house, and we had a conference for over an hour on the case of the Northwest Steel Co.

At this time I advised him that I would be at work on this case several days, and upon its completion advised him I was through and leaving the city for Seattle.

In conversation with Mr. Kramer I informed him that the taxpayer's claim for amortization was determined as a result of the sale of their property and that a copy of my report would be furnished him through our office when this report had been typed.

The writer investigated the amortization claim of the Northwest Steel Co., Portland, Oreg., between October 12 and October 16, 1920, meeting and having conferences with Mr. O. D. Boles, vice president, and Mr. W. B. Beebe, vice president and secretary, and Mr. J. R. Boles, the president of the company.

This company was formed in 1903 for the purpose of fabricating structural steel. In 1917 they acquired contracts to build steel ships for our Government. In all they constructed and turned over to the United States Emergency Fleet Corporation 36 steel ships.

A piece of ground 24 acres in extent was purchased at the foot of Sheridan Street, city of Portland, having a frontage on the Willamette River of about 800 feet on which to lay out their yards and shipways.

There are four ways with all necessary cranes, blocking, etc., an ideal location to launch ships endwise.

The buildings under construction are all new, built of heavy timber mill construction, on concrete foundations with steel sides. They are well adapted to the use to which they are put and are well laid out to handle plates and other steel parts entering into ship construction quickly and efficiently.

They have all the necessary cranes, shears, punches, lathes, and all other machinery to successfully fabricate ships at this point.

The steel storage yard is across the street in front of the plant and is well laid out with receiving tracks for cars of materials, with an overhead crane running on a trestle its entire length, which serves to handle the heavy lumber as well as the steel plates, forgings, boilers, etc., from cars to storage and from storage to factory.

In conference with Mr. J. R. Boles, the president, I was informed of the sale of the Northwest Steel Co. to the Northwest Bridge & Iron Co., and others.

The sale of the entire facilities of the Northwest Steel Co. to the Northwest Bridge & Iron Co. a partnership consisting of former employers of the Steel company and a son of an officer of the Steel company appears to have been an arrangement intended to conclusively establish a large claim for amortization. The Northwest Bridge & Iron Co. is a partnership composed of the following: Mr. L. R. Banks, Mr. W. H. Cullers, and Mr. W. R. Boles.

Mr. Boles is a nephew of the president and the son of a stockholder and vice president of the Northwest Steel Co.

Mr. Banks was the superintendent for the Northwest Steel Co. during its war activities.

Mr. Cullers was the superintendent for the Columbia River Shipbuilding Corporation during its war activities and whose yard adjoined that of the Northwest Steel Co.

The sale of the war properties of the Northwest Steel Co. to the Northwest Bridge & Iron Co., under date of March 20, 1919, covering various assets, was for an aggregate sum of $74,215.80. Under date of December 20, 1919, additional properties were sold to the amount of $105,000 and sundry other sales between January 1 and July 1, 1920, amounted to $86,485.61, making a total aggregate salvage value realized from the sale of this property of $265,711.41.

This later sale of property between January 1 and July 1, 1920, was instituted at the completion of the taxpayer's war contracts.

The cost of this property to the taxpayer has been verified by our auditor, Mr. Childester, as being $1,095,008.44, and the amortization claimed by them is $815,762.45 and was determined by them as follows:

Cost of war properties	$1,095,008.44
Depreciation deducted in 1917	13,534.57
Depreciated value Jan. 1, 1918	1,081,473.87
Amount realized from sale of plant	265,711.41
Amortization claimed	815,762.46

Mr. DAVIS. I think you can now go to the summary and omitting the figures and data in between there, give us that summary, if you will.

Mr. THOMAS. Do you want that in detail, Mr. Davis?

Mr. DAVIS. Yes, sir; the summary. I am referring to the page that I now show you.

Mr. THOMAS. Yes, sir. [Reading:]

Summary Northwest Steel Co., Portland, Oreg.

Cost of property on which amortization is claimed	$1,095,008.44
Amortization claimed	815,762.46
Amortization allowed	None.

All these facilities were 100 per cent in use on which amortization is claimed.

The sale of the property in question, in the writer's opinion, was to create a large claim for amortization and if possible avoid payment of taxes.

It is my recommendation that the taxpayer's claim for amortization, amounting to $815,762.46, be disallowed.

Mr. Childester has been advised of my findings and the value of facilities and the amount received from the sale of property has been verified by him.

Maps will be found in the files of the amortization section.

Schedules are herewith submitted showing taxpayer's claim.

IRA J. W. VAN SCHAICK,
Engineer.

Submitted October 16, 1920.
Reviewed December 7, 1920, by F. Fischer, acting chief of engineers.
Reviewed by S. T. De LaMater, chief of section.

The CHAIRMAN. Was the actual cash turned into the corporation for this property that was sold to the partnership?

Mr. THOMAS. I do not know, sir.

The CHAIRMAN. Is there anything in the records to indicate that?

Mr. THOMAS. I did not find anything.

Mr. DAVIS. I will ask you, Mr. Thomas, if, after you saw the allegation that this sale was questionable, in the files, from the engineer's report, did you inquire of the fraud section?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. Who went with you?

Mr. THOMAS. Mr. Parker, the chief engineer.

Mr. DAVIS. Whom did you see in that section?

Mr. THOMAS. We first visited the office of the head of the section. The head of the section was busy, and inasmuch as we only wanted to get to the files to examine them, we were turned over to the assistant head. I think his name is Dannaker. Mr. Dannaker went out to look in the file room, I believe, and came back and stated that there were no files on the case, except a card file, which

showed that the papers in the case—the record in the case had been returned on a certain date. I do not recall the date.

The CHAIRMAN. Returned to where?

Mr. THOMAS. Evidently to the amortization section because they had been received from the amortization section.

Mr. Parker and I then inquired into their method of keeping records of that kind and we were told that no records were kept of cases which their bureau investigated and in which they found no fraud. They did not find fraud and the papers were simply returned. I asked the question if they did not send a letter of transmittal with the papers, and he said no, that the only record they kept was the card record showing when the record was received by them and when it was returned.

Mr. DAVIS. Then, in your search you could find no report or no findings with reference to this sale and the allegation that it might not have been a bona fide sale?

Mr. THOMAS. I could find no record of it.

Mr. DAVIS. Did the party in the section whom you talked to about the matter know anything about the facts in connection with it?

Mr. THOMAS. If he did, he did not state any, other than that they had the record sent to them, and had returned it.

Mr. DAVIS. There was another report made in this case by an engineer, Harry W. Carlson, was there not?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. You have reviewed that report, have you?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. What is the substance of that report?

Mr. THOMAS. Mr. Carlson reviews the history of the case, as did Mr. Van Schaick, and allows or recommends for allowance the sum of $615,000 for amortization.

Mr. DAVIS. Is that a field report or an office report?

Mr. THOMAS. This must be a field report. Let me see.

Mr. DAVIS. Or does it not show?

Mr. THOMAS. It may be either.

Mr. DAVIS. Does it not show?

Mr. THOMAS. It does not show. It does not say that he was out in the field.

Mr. DAVIS. What is the amount involved with reference to property acquired before the amortization period?

The CHAIRMAN. Before he answers that question, I would like to ask if, in connection with his recommendation that some $615,000 should be allowed, he makes any arguments as to why he differs with the original engineer's report?

Mr. THOMAS. Yes, sir.

The CHAIRMAN. I think it would be relevant to have that.

Mr. DAVIS. We are going to give you all of that. It might be well to put in here, Mr. Thomas. I wish you would read that portion of engineer Carlson's report, wherein he refers to the matter that we have been discussing. You might start with the second paragraph of that.

Mr. THOMAS. I might state that this is from my own report—I am commenting on Mr. Carlson's report.

The CHAIRMAN. You have not Mr. Carlson's report?

Mr. THOMAS. Yes; I can read from it, if you prefer.

Mr. DAVIS. There are quotations from Mr. Carlson's report that bear on this question, Senator.

The CHAIRMAN. All right.

Mr. THOMAS. While the engineer agrees that this is a question open to dispute it is pointed out that by including these pre-war facilities in the property to be amortized the taxpayer incurred a loss, as very little of this pre-war property was included in the final sale in 1920; further, that the loss sustained in its sale would have been taken, almost entirely, in the year 1919 (the year of sale). It so happens that the taxpayer had a higher tax rate in 1919 than in 1918. Therefore, by treating the loss as one due to a sale of capital assets, practically all of the deductions would fall in the year 1919, which carried with it the higher tax rate, whereas, by treating it as a part of amortization, it would have been divided about equally between 1918 and 1919. The taxpayer signified its willingness to bear this loss rather than reopen the old tax returns for 1916 and 1917. To present this side of the matter in the langauge of the engineer we quote from his report as follows:

Of the cost shown, $329,844.48, $300,000 represents the purchase of the joint account property described earlier in this report. The taxpayer contends that title to the property covered by this $329,844.48, which was all purchased by the joint account prior to April 6, 1917, was vested in a separate entity, namely, the "joint account," until the date of purchase by the taxpayer, August 1, 1917. Therefore, the taxpayer contends that they had no rights in it until the date of purchase, and that this date being subsequent to April 6, 1917, the property cost is subject to amortization. They further contend that they acquired it on August 1, 1917, for the specific purpose of using it on Shipping Board vessels.

Now, I might say at this point that I investigated as to the date of the first contract between the Shipping Board and the taxpayer for building ships. That was in December—I think December 27—1917, or nearly six months after the purchase had been made.

On the other hand, the taxpayer had always had an interest in this property through the joint account, and it had actually been purchased by the joint account, prior to April 6, 1917, for the taxpayer's use in executing their part of contracts which were not war contracts. The question arises in the writer's mind as to whether the joint account can be considered as a separate entity—a third party, so to speak—and whether the sale of property, in which the taxpayer had an interest through that entity, to the taxpayer on a date later than April 6, 1917, can be taken as establishing the right to amortization by its cost.

Considerable discussion was had on the subject with the taxpayer, and they brought out the fact that if their contentions were overthrown the result would be in their favor. In other words, if this property is now allowed to remain in the amortization schedule, it will have to be treated with other pre-war property, and the loss sustained in its sale will be taken almost entirely in the year of sale, 1919. Very little of this property was included in the final sale in 1920. It so happens that the taxpayer has a higher tax rate in 1919 than in 1918. Therefore, by treating the loss as one due to sale of capital assets, practically all of the deduction would come in the year 1919 with the highest tax rate, while if treated as amortization, the loss would be divided very nearly equally between 1918 and 1919. Notwithstanding this fact, the taxpayer expressed a desire to have this item remain in amortization, because its elimination would mean reopening the 1916 and 1917 returns on account of the depreciation and effect on invested capital involved, and they would rather pay the additional tax involved than have to go through this reopening of old returns.

Considering this attitude of the taxpayer, the fact that they do have some good arguments in favor of their contention, and the fact that their interpretation really results in an addition to their tax, it is deemed advisable to allow the item to remain in the amortization schedule, and it is so recommended.

Mr. DAVIS. Now, give us the conclusion that you have placed on that interpretation of the engineer, following that.

Mr. THOMAS. The writer can not agree with the accepted theory, upon which the engineer has based his recommendation. Even assuming that this theory is correct, it is not believed that the tax unit's regulations have been properly applied in this case.

Section 214 (a) 9 of the revenue act of 1918 reads:

In the case of buildings, machinery, equipment or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer. * * *

Article 184 of regulations 45 under the revenue act of 1918 in the treatment of costs which may be amortized reads:

The total amount subject to amortization shall be the difference between the original cost of the property if constructed, erected, installed or acquired on or after April 6, 1917, or if acquired partly before and partly after April 6, 1917, then that part of the cost incurred on or after April 6, 1917, and properly entered on the books of the taxpayer on or after that date, less any amounts deducted for depreciation, losses, etc., prior to January 1, 1918, and the value of the property on any of the bases indicated below. * * *

Again in article 185 of regulations 45, we find:

The amortization allowance shall be spread in proportion to the net income (computed without benefit of the amortization allowance) between January 1, 1918 * * * and either of the following dates. * * *

From the foregoing, it is readily seen that any property subject to amortization must have been "constructed, erected, installed, or acquired," partly or in whole, on or after April 6, 1917. Further, that the beginning of the amortization period is established as being January 1, 1918.

In this case it is freely admitted that property which cost $329,844.48 and which was included in the amortization schedule, was purchased, installed and operated prior to April 6, 1917, on work which was in no way connected with the prosecution of the war.

Mr. DAVIS. Now, Mr. Thomas, a statement has been made that the reason for allowing amortization on these facilities was that by so doing the taxpayer was obliged to pay a greater amount in taxes than it would have paid had the facilities been treated otherwise.

Mr. THOMAS. That was one reason.

Mr. DAVIS. And what was the next reason?

Mr. THOMAS. I can read that right from the engineer's report.

Mr. DAVIS. All right.

Mr. THOMAS. The taxpayer signified its willingness to bear this loss rather than reopen and revise the old tax returns for 1916 and 1917, which would have become necessary had the facilities in question been treated as pre-war facilities. That was the second reason.

The CHAIRMAN. Has there been any computation made as to the amount involved?

Mr. DAVIS. He has that here, Senator. I am coming to that. I wish you would continue there, Mr. Thomas.

Mr. THOMAS. The writer is of the opinion that the question of whether or not the taxpayer is obliged to pay a greater or less amount in taxes by treating these facilities in the amortization schedule should not be considered. The question seems rather to be should the claim of this taxpayer be treated differently from a similar claim of another taxpayer, in other words, should not the rules and regulations of the Income Tax Unit be applied in the same way to all taxpayers having similar claims?

As to the first reason, attention is called to the fact that the contention of the taxpayer and the statement of the engineer are in error. The writer took occasion to consult with Mr. Charles R. Turner, auditor consolidated returns, audit division, of the Income Tax Unit, who is thoroughly familiar with the methods used by the unit in computing taxes of taxpayers engaged in this line of business, with the result that computations were made to ascertain just what the difference in actual tax amounted to in this case, assuming that the facilities in question had been treated as pre-war facilities and had been depreciated rather than amortized. This computation disclosed the following—I now quote here from a memorandum of which I have the original copy, handed to me by Mr. Turner.

Mr. DAVIS. Mr. Turner is the auditor that you speak of?

Mr. THOMAS. Yes. [Reading:]

Additional taxes to be paid when assets are depreciated instead of being amortized. Statutory basis.

I might explain that he made these computations on two different bases, statutory and special assessment.

The CHAIRMAN. Did he make those computations at the time the tax matter was in controversy, or just at your request?

Mr. THOMAS. At my request, sir. They were made on Saturday.

Mr. DAVIS. Explain that statutory and special-assessment basis, Mr. Thomas.

Mr. THOMAS. Additional tax for 1918, $57,855.98; less overpayments, 1916, $328.84; 1917, $18,722.07; 1919, $25,173.59; or a total of $44,224.50. Net additional tax, $13,631.48. It was thus handled on the regular method of the statutory basis.

Now, if it had been handled under the special-assessment basis, the additional tax for 1918 would have been $52,837.01; less overpayments, 1916, $328.84; 1917, $13,776.61; 1919, $16,235.54; or a total of $30,340.99. Net additional tax, $22,496.02.

The CHAIRMAN. Let me se if I get that straight. As I understand it, this $22,000 would have been an additional tax had it been carried through on the taxpayer's suggestion that if he opened up those years he would have received a benefit; is that the idea?

Mr. THOMAS. Yes, sir.

Mr. DAVIS. Just read your conclusion, Mr. Thomas, along the lines of the Senator's question there.

Mr. THOMAS. Hence, it will be seen that had these facilities been treated as pre-war facilities, as in the writer's opinion they should

have been, the taxpayer would have paid an additional tax of either $13,631.48 or $22,496.02, dependent upon whether the treatment of the taxes was based on a statutory basis or on a basis of special assessment.

Mr. DAVIS. I wish you would go on and finish your comment on that.

Mr. THOMAS. It seems clear that in this case, both the rules and regulations of the unit and the intent of the law itself have been disregarded and whether or not this taxpayer was obliged to pay a greater sum as a result of the unit's action in this instance it is not only possible, but probable that other taxpayers, having similar claims, may be relieved of paying large amounts in taxes should the same ruling be applied, and it is believed that in this instance a dangerous precedent has been set, which at some future time may bring serious results.

Mr. DAVIS. I believe you have in your file there, among the exhibits, this paper [exhibiting paper to the witness].

Mr. THOMAS. Yes, sir.

Mr. DAVIS. Read that, if you will.

Mr. THOMAS. This is a letter from J. R. Bowle, president of the Northwest Steel Co., Portland, Oreg., under date of July 11, 1921, to the Internal Revenue Commissioner, Washington, D. C.; subject, "Income tax reports for 1917, 1918, and 1919":

In the matter of the item in plant account, $300,000 covering the value by purchase of certain shipbuilding plant originally owned by the joint account (Willamette Iron & Steel Works and Northwest Steel Co.) acquired after April 5, 1917, by purchase, and amortized along with the remainder of the plant, we hereby waive right hereafter to eliminate from "Amortization" and treat by "Depreciation" and "Sale of capital assets," notwithstanding that, by some far-reaching conclusion, we might have the right to treat in the manner last above named with considerable apparent saving in taxes to the corporation.

Yours very truly,

NORTHWEST STEEL CO.,
J. R. BOWLE, *President.*

Mr. DAVIS. Now, Mr. Thomas, this concern was still a going shipyard, with contracts ahead, at the time that these engineering reports were made, was it not?

Mr. THOMAS. According to the record; yes, sir.

Mr. DAVIS. What work were they engaged in?

Mr. THOMAS. I might say that, in ordering material for Shipping Board vessels, they had enough material on hand to complete three of the cancelled ships. They decided to build those three ships for their own account, with a view to selling them. They had that work on hand. Then, they had the work of completing the contract for the Shipping Board, and it developed later that some foreign interests, the France-Canada and Swiftsure Oil Co., wanted some tankers built, and they built those tankers. I think there were 9 of them—for these other people. The Shipping Board financed that deal for this France-Canada Swiftsure Oil Co. combination.

The CHAIRMAN. On what date was that that the Shipping Board financed that deal?

Mr. THOMAS. What date, sir?

The CHAIRMAN. Yes.

Mr. THOMAS. If I may read from the engineer's report, I will do that.

The CHAIRMAN. If it is brief.

Mr. THOMAS. Yes, sir; it is.

Mr. HARTSON. What report is that?

Mr. DAVIS. This is Mr. Carlson's report.

Mr. HARTSON. There were reports made by two engineers.

Mr. THOMAS. This is Mr. Carlson's report. [Reading:]

Mr. J. R. Bowles was in Washington, D. C., in January, 1920, trying to negotiate a settlement with the Shipping Board. The taxpayer had claims against the board on account of cancellation of six ships. It was suggested by the officials of the Shipping Board that the taxpayer take a contract for building seven tankers [it was seven instead of nine] for France-Canada Steamship line and the Swiftsure Oil Co. The Shipping Board was to finance and pay the taxpayer for the construction of the vessels.

That evidently then was in 1920, sir.

The CHAIRMAN. Were you previously with the Shipping Board?

Mr. THOMAS. Yes, sir.

The CHAIRMAN. Did it finance shipbuilding deals as late as that?

Mr. THOMAS. Oh, I think so; yes, sir—later than that, even. By so doing, as I understand it, in this particular instance, Senator, the Shipping Board was relieved of the taxpayer's claim against the Shipping Board.

The CHAIRMAN. By doing that?

Mr. THOMAS. Yes, sir.

The CHAIRMAN. It was a financial benefit to the country to do that?

Mr. THOMAS. Yes, sir.

The CHAIRMAN. At this point I would like to know if anyone has made any computation as to the difference in the amount of the tax that the taxpayer would have paid, had the attorney's suggestion been carried out instead of the views of the bureau?

Mr. DAVIS. I have not, Senator.

The CHAIRMAN. Will somebody get those for us?

Mr. DAVIS. Are we able to do that?

Mr. THOMAS. I do not quite understand you, Senator.

Mr. DAVIS. Has there been any computation of the tax made, if our contention here is correct?

Mr. THOMAS. As to amortization?

Mr. DAVIS. Yes.

Mr. THOMAS. The one I have just read was the result, had these facilities been treated under depreciation instead of amortization.

Mr. DAVIS. Well, if the sale had been set aside?

Mr. THOMAS. Oh, no. That has not been gone over.

The CHAIRMAN. You can get that computation for us?

Mr. THOMAS. I think so.

Mr. DAVIS. We will put it in the record in the morning—that is, if we can get it by to-morrow morning.

Mr. THOMAS. I would not like to say that we can do that.

Mr. DAVIS. The bureau officials may be able to do that.

Mr. HARTSON. We will be glad to do it.

The CHAIRMAN. Are you through with Mr. Thomas?

Mr. DAVIS. That is all.

The CHAIRMAN. Do you want to ask him any questions, Mr. Hartson?

Mr. HARTSON. Yes, sir. Mr. Thomas, you have just referred to certain contracts which this taxpayer had to construct vessels for some Canadian interests in 1920. Do you know whether those contracts were with the taxpayer or with the taxpayer's successor?

Mr. THOMAS. They were with the partnership.

Mr. HARTSON. Yes.

Mr. THOMAS. Yes; they were with the partnership.

Mr. HARTSON. They were entered into, according to your testimony, after this sale took place?

Mr. THOMAS. Well, about the same time, I should say, because I think that was one of the reasons for this partnership—so that they would have an absolutely complete plant. In other words, that agreement between the Shipping Board, the taxpayer, and the partnership was a triangular one and was, as I understand it, an inducement for the purchaser, the partnership, to buy the rest of the plant. I think the engineer states that.

Mr. HARTSON. The work, however, was carried on by the partnership?

Mr. THOMAS. Yes.

Mr. HARTSON. Which was really the successor of the corporation?

Mr. THOMAS. Yes. My answer to that question was largely to bring out the fact that this plant was a full, going plant and in 100 per cent use, and under these contracts could be continued as such for some time.

Mr. HARTSON. Well, Mr. Thomas, if this sale had taken place and if it were a bona fide transaction for the purposes of any amortization allowance to the taxpayer, speaking of the corporation, it would be entirely immaterial whether the successor's business was prosperous, or whether it was engaged in business or not, would it not?

Mr. THOMAS In one way; yes, sir.

Mr. HARTSON. The fact that it was continuing in some successful business might go to determine the consideration for which the sale had taken place?

Mr. THOMAS. Yes, sir.

Mr. HARTSON. But for purposes of any amortization allowance it would be entirely immaterial——

Mr. THOMAS. No.

Mr. HARTSON. What the succeeding business was, would it not?

Mr. THOMAS. No; I can not say that it was entirely immaterial, because if the business is a going one, and if there is business ahead, naturally a plant is going to be worth more than if there is no business ahead.

Mr. HARTSON. Well, that would have a bearing on the price.

Mr. THOMAS. That would have a bearing on the residual value, which, in turn, would have a bearing on amortization.

Mr. HARTSON. But amortization in this case, Mr. Thomas, as you have pointed out, I think, was predicated on a loss in 1919, by reason of a sale to the partnership?

Mr. THOMAS. Oh, yes.

The CHAIRMAN. I think this ought to be cleared up. I understood Mr. Thomas to answer, in response to my question about the loaning of money by the Shipping Board as late as 1920, that that was done

for the purpose of reducing the Government's loss through the cancellation of contracts; in other words, that it was done to prevent the loss of the investment that was originally made for war purposes, and if that is so, then how would the Shipping Board be doing business with the new corporation, and thereby relieve itself of its responsibility to the old corporation, which had sold out to this new partnership?

Mr. HARTSON. Mr. Thomas testified that the Shipping Board agreements were triangular in their nature, and that they included the new partnership and the old corporation.

The CHAIRMAN. Even if that were so, then the Government did not save by lending money at that late date, because the Bureau had already agreed on, or later agreed to allow amortization of over $600,000.

Mr. THOMAS. Possibly, I did not make my answer clear, Senator. The Shipping Board was relieved of its claims through the France-Canada and Swiftsure Oil people. They assumed the claims.

The CHAIRMAN. And for assuming those claims, they loaned the money to the shipbuilding company?

Mr. THOMAS. No, sir; I think they loaned the money to the Swiftsure Oil Co. and the France-Canada people. That is my understanding of it, but I am not particularly informed on that phase of the case, because I did not investigate the relation between the Shipping Board and the foreign interests. I can determine that for you.

The CHAIRMAN. I would like to know why the Shipping Board was loaning money as late as that to foreign interests for the building of ships?

Mr. THOMAS. I would be glad to look that up.

The CHAIRMAN. And the object which it hoped to attain by doing that?

Mr. THOMAS. I would be glad to find that out for you.

The CHAIRMAN. You will get that up for me?

Mr. HARTSON. In the beginning of your testimony, Mr. Thomas, you referred to certain charges of fraud that had been made by Engineer Van Schaick.

Mr. THOMAS. Yes, sir.

Mr. HARTSON. Regarding the contract of sale between the Northwest Steel Co. and the bridge company, which was the partnership successor, I believe you read a confidential letter written by Mr. Van Schaick, addressed to his chief here in Washington?

Mr. THOMAS. I read a copy of the letter. I have seen the original.

Mr. HARTSON. You have seen the originals?

Mr. THOMAS. Yes, sir.

Mr. HARTSON. Have you seen the reply to Mr. Van Schaick's letter?

Mr. THOMAS. No, sir; I could find no reply. We did not find any reply.

Mr. HARTSON. In view of the fact, Mr. Chairman, that the letter from Mr. Van Schaick has gone into the record, I should like to ask the witness to read into the record the reply of Mr. James Furse to that letter. It is material here.

The CHAIRMAN. That is perfectly proper.

Mr. THOMAS. This is a carbon copy of a letter reported to be from James Furse, chief of section, to Mr. Ira J. W. Van Schaick, Imperial Hotel, Portland, Oreg., under date of October 30, 1920:

DEAR Mr. VAN SCHAICK: We are returning herewith your reports on the amortization claim of the Northwest Steel Co., of Portland, Oreg., together with schedule of taxpayer's claim.

We have carefully considered this report in connection with your letter of October 17 to Mr. Furse. Not only does your letter indicate the evident attempt of the taxpayer to establish a large amount for amortization, but in your report itself you say "appears to have been an arrangement intended to conclusively establish a large claim for amortization." It is not understood with such a statement in your report how you can allow this taxpayer's claim in full amount.

In view of the statements made in your letter to Mr. Furse it is plain that you do not consider this sale to have been made for any other purpose than that of reducing taxation. If you are so thoroughly convinced of this fact, you do not have to allow their claim and you should not do so. If there is any question in regard to the sale, you should disallow the claim entirely, setting forth your reasons for considering the sale to be not justified. The entire burden of proof is on the taxpayer. It would then be his privilege to protest and make claim for reconsideration and at this time he would have to submit conclusive evidence to justify the determination of the tax on the basis of the sale. We had a case in this office just recently, very similar in nature, and action was taken as above indicated, the entire claim being disallowed.

It is suggested that you confer with Mr. Chidester and revise the report along the above lines, as in its present form we can not approve it.

Your recommendations should always be in accordance with your findings and your best judgement of the facts. A sale may have been strictly legal, so far as the technical features of it are concerned, and still have been done with a purpose which will not admit of its being recognized in tax matters.

Yours truly,

JAMES FURSE, *Chief of Section.*

Mr. HARTSON. It is apparent from the reading of that letter that the report of Mr. Van Schaick which you read into the record, or portions of which you read into the record, was prepared and submitted following the receipt by Mr. Van Schaick of this letter of October 30 from Mr. Furse.

Mr. THOMAS. What is the date of that?

Mr. HARTSON. This is dated October 30.

Mr. THOMAS. Evidently not. Mr. Van Schaick's report was submitted on October 16, 1920.

Mr. HARTSON. Well, Mr. Van Schaick's first report, as indicated in his letter of Mr. Furse, dated October 17, 1920, allowed amortization, and he accompanied that report with this letter of October 17, which you commented on and read into the record, and in which he said he did it with reservations, because he thought the sale had been fraudulent.

Mr. THOMAS. No, sir; not as I read it. Mr. Van Schaick's report is dated October 16, 1920.

The CHAIRMAN. I recall that the same as the Solicitor does. He did allow amortization, although he protested against it.

Mr. HARTSON. The report of October 16, that the witness has reference to is the report in which amortization was allowed. That was accompanied by this letter of October 17, which reads as follows:

I have sent you under a separate cover my report on the Northwest Steel Co., Portland, Oreg. I am not pleased with it at all for this reason. The

taxpayer is not entitled to the amortization they have claimed and I have allowed on the basis of a sale.

The sale of this property to the three men, a nephew and a former foreman of the plant, and a foreman of an adjoining plant was made in my judgment for the sole purpose of defrauding the Government out of $800,000 on which taxes should be paid but they have so cleverly complied with the law there was nothing left for me to do but allow the claim although I am not satisfied with their explanation of how the money was obtained by these three men who had always been working on a salary to raise $265,711.41 to do this is not clear.

We then have another letter——

Mr. THOMAS. May I make a remark here, Senator?

The CHAIRMAN. Yes.

Mr. THOMAS. I think it might clear this up, sir.

Senator JONES of New Mexico. Just a moment. Mr. Hartson, that letter from which you have just read an extract was a personal letter, was it not?

Mr. HARTSON. Yes; it was.

Senator JONES of New Mexico. I would like to inquire if that answer to it which you have read, was a personal or official letter?

Mr. HARTSON. It was an official letter.

Senator JONES of New Mexico. An official letter in reply to this personal letter?

Mr. HARTSON. That is correct. I say the reply was official, based on the fact that it was on the letterhead of the department and carried the usual symbols, and was signed by James Bruce, chief of section; so that, in my opinion, that would be an official reply to a personal letter.

Senator JONES of New Mexico. I note that that letter bears the initials, and that it was written on official stationery.

Mr. DAVIS. Mr. Thomas, did you find a copy of the letter in the files, that the solicitor has just read?

Mr. THOMAS. The original was in the files.

Mr. DAVIS. No; I mean a copy of the letter that the solicitor has just read, in reply to the one that the engineer wrote.

Mr. THOMAS. The one that I just read?

Mr. DAVIS. Yes; the one he asked you to read some time ago.

Mr. THOMAS. No, sir; I did not see it in the files.

Mr. DAVIS. You did not see it in the files?

Mr. THOMAS. No.

Mr. HARTSON. Would you say it was not there?

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

The CHAIRMAN. Evidently, then, Mr. Furse did not treat this as a confidential letter, but as a part of the bureau files.

Mr. THOMAS. I can not reconcile the statement in the letter from Mr. Van Schaick to Mr. Furse with the recommendation made in the report which accompanied that letter.

The CHAIRMAN. His letter is perfectly plain to you, is it not?

Mr. THOMAS. His letter is, yes; but in the report, on page 4, is this statement:

> It is my recommendation that the taxpayer's claim for amortization, amounting to $815,762.46 be disallowed.

That is in the report that accompanied the letter to Mr. Furse, in which letter he states he did not like to allow it, but inasmuch as they had complied with the law, he thought he had to.

Senator JONES of New Mexico. And yet in his report he had disallowed it.

Mr. THOMAS. He had disallowed it; and there is a summary, sir; amortization claimed, $815,762.46; amortization allowed, nothing, and that is followed by the recommendation that this taxpayer's claim for amortization be disallowed.

Mr. HARTSON. I might clear this point up; I am not sure that this is the explanation, but I believe it to be: When this matter was again referred to Mr. Van Schaick by means of the letter from Mr. Furse which has been read into the record, Mr. Van Schaick altered his original report without changing the date. I do not know that to be a fact, but in the light of this letter, which is dated November 22, 1920, addressed to Major De La Mater from Mr. Van Schaick, making further reference to his change in his report, I believe that is probably the explanation. I will ask Mr. Thomas to read that letter of November 22.

Mr. THOMAS. This letter is dated Seattle, Wash., November 22, 1920, and is addressed to Maj. S. D. De La Mater, chief of section, 2567 Treasury Annex No. 2, Washington, D. C.:

SIR: I am herewith sending you my report on the Northwest Steel Co., Portland, Oreg.

Mr. Furse's letter of September, date I can not recall, to Mr. Chidester on this case had us to believe if we could not disprove the legality of the sale of this property we must of necessity allow their amortization claim. I did not agree with this former letter or did revenue agent Kramer, but did not see any other way to do than I did about this case at that time.

I heartily agree with your letter of October 30, 1920, and return my report on that basis.

Very truly yours,

IRA J. W. VAN SCHAICK.

Mr. HARTSON. Now, the letter of October 30?

Mr. THOMAS. Is that the one that I have read.

Mr. HARTSON. That is the one I believe you read.

Mr. THOMAS. Maybe you can find it here?

Mr. HARTSON. That letter of October 30 is the one from Mr. James Furse, chief of section, in which he tells him to report according to his own views, and if he has any doubt about it, to set out the doubt and give his opinion on the facts as he sees them.

Mr. THOMAS. I can only say that I found no record of a former report from Mr. Van Schaick in this case where he, according to your statement, did recommend an allowance against his better judgment, maybe. The only record that I have of Mr. Van Schaick reporting on the subject is in this report of October 16, 1920, in which he distinctly disallows it, both in his set-up of figures and in his remarks.

Mr. HARTSON. I am not surprised that you did not find the contrary report, because, as I have suggested here, I believe that when he submitted the contrary report, in which he allowed amortization, it was returned to him by Mr. Furse, with the suggestion contained in Mr. Furse's letter of October 30, and thereupon Mr. Van Schaick changed his report and disallowed amortization, which is now the final report of Mr. Van Schaick in this case, in which no amortization is recognized at all.

The CHAIRMAN. That is rather a sloppy way of doing it, is it not, to change the original report?

Mr. HARTSON. Yes; but I believe that the files here are sufficiently complete to bear out that explanation, and I believe it to be the proper one, that Mr. Van Schaick originally reported that amortization could be allowed, but he accompanied that with a confidential letter to his chief, in which he said he thought fraud had been committed, and as soon as his chief received the confidential letter, he sent the report back to Mr. Van Schaick and said, "If you believe there is fraud in this case, so report it; report it the way you think the facts to be." Then it came back and now it is in the files in final form, together with the disallowance of amortization.

The CHAIRMAN. I would like to ask if Mr. Hartson or any of his staff knows of any record here of the investigation by the fraud section?

Mr. HARTSON. Yes, sir; we have, Senator.

The CHAIRMAN. You may complete with the witness, if you choose to do that, and then put that in.

Mr. HARTSON. Yes. I would like to clear up this fraud question first, and it may be more appropriate to put that in by another witness, so if I have any other questions of Mr. Thomas, he no doubt will be here, and I can question him then.

The CHAIRMAN. Yes.

Mr. THOMAS. I will ask Mr. Hering to take the stand.

TESTIMONY OF MR. JAMES C. HERING, AUDITOR, BUREAU OF INTERNAL REVENUE

(The witness was duly sworn by the chairman.)

Mr. HARTSON. Mr. Hering, what was done in the Income Tax Unit with this report in which charges had been made of a fraudulent action by the Northwest Steel Co.?

Mr. HERING. Speaking from the record in the case, I find a letter from the chief of the amortization section dated December 9, 1920, calling the attention of the head of the division to the alleged allegation of fraud.

The CHAIRMAN. The head of what division?

Mr. HERING. The special audit division, Mr. S. Alexander. Mr. Alexander's division included the amortization section, and I think at this time it also included what we called the fraud section. Am I correct in that?

Mr. HARTSON. That is correct.

Mr. HERING. I will read this letter.

Mr. HARTSON. Yes.

Mr. HERING. This is dated December 9, 1920:

Memorandum for Mr. S. Alexander, head special audit division.
(Attention special assignment section, Mr. P. F. Cain, *Chief.*)

There is inclosed copy of engineer's report on the amortization claim of the above taxpayer.

From this report and from other information which has been received, it would appear that taxpayer's claim for amortization may be fraudulent for the purpose of evasion of tax, as it is based on an alleged sale which does not appear to be bona fide, having been made to three men, a nephew, a former foreman of the plant, and foreman of an adjoining plant—all men who have been on salaries and whose ability to raise the $265,711.41 might very properly be doubted.

Information has also reached this office that taxpayer openly boasts that anything can be gotten at Washington with money enough.

If it is found that sufficient evidence of fraud exists to impose the fraud penalty, all papers will be forwarded to you for final disposition.

If it is found that sufficient evidence of fraud to warrant the imposition of the fraud penalty does not exist, you are requested to return engineer's report and the case will be closed in this section.

S. T. DE LA MATER, *Chief of Section.*

And marked with inclosure.

Mr. HARTSON. What happened after Mr. Alexander received the case with that memorandum of transmittal?

Mr. HERING. The records will fully show that, after being investigated, the case was transmitted to the fraud section by this memorandum, and they gave it some consideration.

Mr. HARTSON. Referring to the fraud section, explain to the committee what section that is, and where it is.

Mr. HERING. As I understand it, the particular function of that section is to determine whether fraud exists in a case or not. They make an examination, if necessary, I understand; an investigation in the field, and audit the case, and their recommendations are transmitted to the solicitor for further consideration, if they think there is fraud.

I find a further memorandum under date of April 18, 1921.

Mr. HARTSON. Is that the memorandum which transmitted the case to the solicitor?

Mr. HERING. This is a memorandum bringing it back from the solicitor, and I have the solicitor's report here also. Do you deem it material to read the other one?

Mr. HARTSON. I would like to have you point out, if the record so discloses, that the case was transmitted to the solicitor's office.

Senator JONES of New Mexico. Why not take it up in chronological order?

Mr. HARTSON. That is what we are trying to do, Senator.

Mr. HERING. Here is a copy of a memorandum by the Solicitor of Internal Revenue, dated March 24.

The CHAIRMAN. I understood you were going to put in the transmittal to the solicitor first.

Mr. HARTSON. If the file so discloses it, I would suggest that the memorandum go in. I do not know whether it does or not. In every case, there is a memorandum of transmittal to indicate the issues, and to advise the solicitor why the case is being forwarded to him.

Mr. HERING. I think I can explain the missing link. The file that I am reading from is the file of the amortization section. The other section, the special assignment section, probably has its own record of the letter transmitting the case to the solicitor.

The CHAIRMAN. I think there is no use going ahead with the solicitor's opinion until we know the information that was submitted to the solicitor when the case was transmitted to him.

Mr. DAVIS. That is what we are trying to do, to find out what went into the fraud section, and what came out of it, what they found, and what they did with it.

Mr. HERING. I think the recitals in the opinion will be sufficient to show that, Senator.

The CHAIRMAN. We do not know whether it contains a complete report from the fraud section or not, and I do not think the com-

mittee will be interested until we get that report from the fraud section.

Mr. DAVIS. We will have to have the facts showing what the findings of the solicitor are based on.

Mr. HARTSON. What the solicitor did was to ask for a further investigation, if there were charges there with nothing to substantiate them; so that it came to the solicitor a second time, with the supplemental report.

The CHAIRMAN. Is there not anyone here from the bureau who can show what the fraud section did or found out from the time it was transmitted to it until it first went to the solicitor's office?

Mr. HARTSON. I think there is a report there following the first consideration by the solicitor, of a further examination in the field and further investigation.

Senator JONES of New Mexico. What did the fraud section do with it when it first got it?

Mr. HARTSON. It sent it to the solicitor's office.

The CHAIRMAN. Without any investigation?

Mr. HARTSON. With reports as they stood at that time; namely, Mr. Van Schaick's report, and which, as has been pointed out, contains charges and references to suspicious circumstances. The solicitor reviewed that and said, "I can not charge a man or assess a man with a fraud penalty upon such a showing, and we want a further examination." That was done and it came back a second time to the solicitor's office.

The CHAIRMAN. If agreeable to the committee, I would like to pass that over for further consideration and find out what was submitted to you with this request. Can you give us that?

Mr. THOMAS. I can only say that when I visited the so-called fraud section I was told that there was no memorandum at all, or no record of the findings of the fraud section, and I was told that it had not been sent to the solicitor's office because it did not find fraud.

Mr. HARTSON. Of course, that is obviously incorrect, because the files here show, and have shown it right along, that it was in the solicitor's office twice, and he expressed himself on two different occasions.

The CHAIRMAN. So as to temporarily deal with this, then, reserving the right to come back to it again, let us hear what the solicitor said when the case was first brought to his office.

Mr. NASH. May I suggest this, Mr. Chairman: The organization as it is to-day is entirely different than the organization that was in the bureau in 1920 and 1921 with respect to handling fraud cases. At that time what is now called the fraud section or special adjustment division was a small section under the special audit division, and Mr. Alexander, who was then head of the special audit division, had the special assignment section or special adjustment section, as it has been called, and also the amortization section. It was a transaction within his division, going from one section to another. But when we reorganized the bureau a little over a year ago it was decided to place this fraud work directly under the deputy commissioner and keep it away from all other divisions. That is where it is now. I presume that is why the records may

be incomplete in the present fraud section. I think the records of this case are probably down in the old special audit division.

The CHAIRMAN. Well, they can be found?

Mr. NASH. I am quite sure they can.

The CHAIRMAN. Is it not called the special adjustment division?

Mr. NASH. The special adjustment division and the fraud division, which is really a clearing house for fraud cases on their way to the solicitor's office. We have fraud alleged in hundreds of cases, and the solicitor's office is a very busy body. Fraud cases are first referred to this fraud division, and that division goes into them in detail, and if they determine that there is fraud, then they go on their way to the solicitor's office.

I think Mr. Hering's testimony might be corrected to this extent, that the fraud division does not make any field investigations; they just examine the record of the case as it comes to them, and if further investigation is necessary, it is handled by the solicitor's office or by the deputy commissioner.

Mr. DAVIS. Then, Mr. Nash, according to that the fraud section must have found fraud if this case found its way to the solicitor's office?

Mr. NASH. They must have determined that there was enough evidence there to indicate that there might be fraud and that it ought to have the solicitor's attention.

The CHAIRMAN. Just tell us what the solicitor said when he sent this back to the fraud section, please?

Mr. HERING. It did not go back direct to the fraud section. It went back to the amortization section, possibly through the fraud section, however.

This is a memorandum to the solicitor, dated March 24, 1921:

In re Northwest Steel Co., Portland, Oreg.

Acting Deputy Commissioner BATSON.

(Attention Mr. S. Alexander, head special audit division):

Reference is made to your letter of March 14, 1921, with which you transmitted a copy of the engineer's report on the amortization claim of the above-named company, and in which you request the opinion of this office as to whether a penalty should be assessed for filing a false and fraudulent return in connection with such claim for amortization.

This company was organized in 1903. Its business, prior to the war, was fabricating structural steel. During the year 1917 they obtained certain contracts to construct steel ships for the Government, and under these contracts constructed and delivered to the United States Emergency Fleet Corporation 36 steel ships. In the prosecution of this work certain land was acquired in Portland, Oreg., and buildings constituting the works were constructed. The plant has all necessary cranes, shears, punches, lathes, and other machinery, and is properly and fully equipped to build steel ships. It is stated that the cost of this war property was $1,095,008.44.

Between March 20, 1919, and July 1, 1920, several distinct sales of various assets of this plant were made to the Northwest Bridge & Iron Co., for the aggregate sum of $265,711.41, and the amortization claimed by the Northwest Steel Co. is $815,762.45. The shipbuilding in the city of Portland and surrounding territory appears to be entirely a war measure as all yards are closed or completing their contracts with no new business in sight.

The Northwest Bridge & Iron Co., to whom the above-mentioned assets were sold, is a partnership composed of L. R. Banks, who was the superintendent for the Northwest Steel Co. during its war activities; W. H. Cullers, who was superintendent for the Columbia River Shipbuilding Corporation during its war activities and whose yard adjoined that of the Northwest Steel Company; and W. R. Bowles, who is a nephew of the president, and the son of a stockholder and vice president of the Northwest Steel Co. The report states

that the sale of the facilities of the Northwest Steel Co. to the above partnership appears to have been an arrangement intended to conclusively establish a large claim for amortization. No other facts are available from the report and no effort seems to have been made to obtain evidence which would show or tend to show, the bona fides of the transaction. No attempt was made to interview the members of the partnership or to ascertain if there was any evidence to substantiate the transfers of property above enumerated, or the state of accounts between the parties.

A recital of the facts above makes it apparent that there is no evidence upon which a charge of fraud could be predicated. The fact that the plant was sold at approximately 25 per cent of its cost, and that the sale was made to a partnership, the members of which were a former employee of the vendor, and the son of the vice president of vendor, while, indeed, sufficient to cast suspicion on the good faith of the transaction, are in and of themselves insufficient to establish fraud.

It is recommended that a full and complete investigation of this transaction be made, and upon receipt thereof, that it be again submitted to this office for consideration.

The papers are being returned herewith.

That is signed "Solicitor of Internal Revenue."

Mr. DAVIS. To whom did that letter go from the solicitor?

Mr. HERING. That was addressed to Acting Deputy Commissioner Batson for the attention of Mr. S. Alexander, head of the special audit division.

The CHAIRMAN. Who signed it?

Mr. HERING. It was signed by the Solicitor of Internal Revenue.

Mr. HARTSON. Mr. Mapes was solicitor at that time.

The CHAIRMAN. That is why I asked who signed it.

Mr. HARTSON. The carbon copy does not appear to be signed.

Mr. HERING. No, it is not.

Mr. HARTSON. Mr. Carl A. Mapes was Solicitor of Internal Revenue at that time.

The CHAIRMAN. Is there any evidence to show where the solicitor got his information that the plant was closed down and out of business, and that there were no further activities there?

Mr. DAVIS. Not to my knowledge.

Mr. NASH. Mr. Chairman, I think the solicitor's opinion refers to a letter of transmittal dated March 14, 1921, and that evidently is what is missing. That letter of March 14 quite likely is the letter of transmittal for the entire file in the case.

The CHAIRMAN. And that particular letter has not been discovered in the files?

Mr. HERING. That would probably be in the files of the other section.

Mr. DAVIS. In the letters that you read a little while ago from Mr. De La Mater, chief of section, he said "from other engineer reports and other information received."

Mr. HERING. Yes, sir.

Mr. DAVIS. What was the other information and where did it come from?

Mr. HERING. I do not know what he meant. Possibly he had reference to that confidential letter of Mr. Van Schaick's; I do not know; that is only a guess.

Mr. NASH. Mr. Davis, I might say that in glancing through the file this morning, I find that it shows that Revenue Agent Kramer and Field Agent Chidester worked on this case, and I assume that there are reports in it from those agents.

Mr. DAVIS. There is a reference in this letter that we are talking about from Engineer Van Schaick which says:

In conference with Mr. Kramer, the agent, he was of the opinion, also, that they were putting over a big fake.

Is that the Mr. Kramer that you refer to?

Mr. NASH. Yes; I saw that in the file.

The CHAIRMAN. This information seems to be incomplete, and, as it is getting near time to adjourn, I think we ought to find out whether the records show that this money was actually placed in the treasury of the Northwest Steel Co. The matter should be looked into, to see whether that money was actually paid in by these employees to the treasury of the Northwest Steel Co.

Mr. HERING. I think I can answer that fairly well, Senator. If all of Mr. Carlson's report had been put in evidence, it would show the facts in the case.

The CHAIRMAN. Well, let us put it in. Do you admit that, Mr. Davis?

Mr. DAVIS. I will be glad to have it all in, or any part of it. We read a portion of the report.

Mr. HERING. You did not read what the Senator asks for, which was Mr. Carlson's explanation as to the bona fides of this sale.

Mr. DAVIS. If it is the report, I would be glad to have it read—or all of it.

Mr. HARTSON. Before you go into that, Mr. Hering, the matter was then referred by a memorandum of April 20, 1921, to the field for further investigation, was it not; and if so, will you read that memorandum or letter accompanying Mr. Carlson's report?

Mr. DAVIS. This memorandum is dated April 20, 1921:

Memorandum for Mr. Carlson:

Reinvestigation of the case of the Northwest Steel Co., Portland, Oreg., is being assigned to you. This claim was investigated by Engineer Van Schaick, who reported under date of December 7, 1920, recommending that the entire claim be disallowed. This report was transmitted to the solicitor for opinion as to whether a penalty should be assessed for filing a false and fradulent return.

Attached herewith is memorandum from the head of division, transmitting copy of a communication from the solicitor, dated March 24—

Which is the one I have just read, I think—

in which it is held that no facts have been indicated sufficient to establish fraud. You will note the solicitor's recommendation that a full and complete investigation be made of the transaction (i. e., the sale of the facilities), and a report submitted for consideration.

The assignment of the case is made to you for the purpose indicated in the solicitor's memorandum. Please make such complete investigation as may be necessary, and submit a report embodying the result of your investigation into the question of the bona fides of the alleged sale. The solicitor's letter and the memorandum of transmittal should be placed in the files after review by yourself. It is suggested that you carefully review the original report by Engineer Van Schaick, and that you make notes of any facts therein contained or of any other papers in the files which it may be advisable for you to have.

S. T. DE LA MATER, *Chief of Section.*

Mr. HARTSON. I think that gives in chronological order, now, Mr. Chairman, the way the case got to Mr. Carlson, who made the second report. When Mr. Thomas was on the stand, there was no explanation of why Mr. Van Schaick, who had first reported, was super-

seded in the investigation and another engineer was sent out to make a report on it. I think this explanation is the correct one, of how he got out there.

The CHAIRMAN. Have you this engineer's report here?

Mr. HARTSON. Yes. Mr. Thomas read into the record portions of Mr. Carlson's report which deal with an allowance for amortization, but does not go into the facts connected with that sale and the surrounding circumstances, which have a bearing on the bona fides of that sale.

The CHAIRMAN. Can you read that into the record?

Mr. HERING. Yes, sir; I will be glad to do so.

Mr. HARTSON. I am sure Mr. Davis will have no objection to having the entire report of Mr. Carlson go into the record. I think the entire report should go in. Otherwise, there will still be that gap, Mr. Chairman, that you spoke about with reference to the fraud question.

The CHAIRMAN. You will look that up?

Mr. HERING. We will supply that. I am reading from Mr. Carlson's report:

A partnership composed of three employees of the taxpayer, one of whom was a son of one of the above-mentioned principals, purchased the plant in three parcels. None of the members of the partnership were stockholders in the tax-paying corporation.

Amortization is claimed by the taxpayer in regard to the facilities acquired subsequent to April 6, 1917, the amount of the claim being based on the sale of the same to the partnership.

The amortization claim is shown in Exhibit No. 1. Claim is made for amortization in the sum of $815,762.46 in respect of property whose original cost was $1,095,008.44, whose depreciated cost (depreciation to January 1, 1918, only) was $1,081,473.87, and whose sale price was $265,711.41.

Because of the close relationship of at least one of the purchasing partnership to a principal in the taxpaying corporation, and the close business relations of the other partners to the taxpayer, the question arises as to the reasonableness of the sales consummated between them. To get a proper view of the entire transaction, it must be remembered that in addition to the property on which amortization is claimed, the partnership also purchased the original pre-war plant of the taxpayer, the book value of which, on April 5, 1917, was $226,137.73, and for which the taxpayer received $95,081.80, practically all being purchased by the partnership. For the purpose of comparison we will tabulate it thus:

When purchased	Cost or depreciated cost as of Jan. 1, 1918	Sale price
Prior to Apr. 6, 1917	$186,089.97	$95,081.80
After Apr. 6, 1917	1,081,473.87	265,711.41
Total	1,267,563.84	360,793.21

This shows that the taxpayer realized 28½ per cent of the cost as of the above date of the above total sale price; $317,395.23 was paid by the partnership in question, the balance coming from small sales to others.

Looking at it from the standpoint of the taxpayer, was the sale of their assets as above a reasonable one?

In the first place, at the time the first part of the plant was sold, it was rapidly becoming evident that the shipbuilding business on the Pacific coast was coming to an end. Under any normal conditions, the Atlantic coast yards would have a heavy advantage over the Pacific coast yards on the item of freight rates above as all steel must come from the East. In addition,

most ships would be built for eastern owners if at all, which generally meant the expense of bringing the ship to the Atlantic coast before it would be put to use. The desire of the taxpayer to retire from shipbuilding was therefore a logical one.

In the next place, the entire plant, was erected on leased ground, most of the leases running from 20 to 30 years. By passing all these leases to the purchasing partnership, the taxpayer disposed of a liability over that period that totaled some $130,000 in rents plus taxes estimated at $80,000 more.

In the third place, they escaped the responsibility for putting the leased ground into its orignal condition as required by the leases, which would cost no inconsiderable sum.

In the fourth place, by disposing of the plant as a whole, or practically so, they saved the selling cost that would be entailed in a piecemeal sale, which would have been their only alternative had the partnership not purchased it.

In the fifth place, one of the largest considerations that does not appear in the sale was the cancellation of certain bonus obligations. Messrs. Culler and Banks, in the early stages of the shipbuilding work, had been guaranteed certain bonus payments based on tonnage. The business of the taxpayer expanded to such an extent, however, that these bonuses grew to enormous proportions. For 1917 and 1918, Mr. Culler received $106,025.71 and Mr. Banks $70,683.81. When the first sale of part of the plant was made to the partnership of which these men were members, they had bonus credits accrued to them of $189,343.62 and $123,277.42, respectively, or a total of $312,621.04, with some $200,000 more coming, had the taxpayer completed the shipbuilding instead of turning it over to the partnership. All of this bonus was canceled as one of the considerations at the time of purchase. This canceled bonus is herein considered as a part of the return received from the sale.

He is referring to the $200,000 which explains the difference between the allowance and the taxpayer's claim.

Mr. HARTSON. Mr. Hering, may I interrupt there? Do you understand that a portion of this $265,000 which was a consideration for the transfer from the corporation of that property to the partnership, and that a portion of the consideration was the cancellation of these bonus agreements that the corporation had with certain members of the partnership?

Mr. HERING. Yes sir.

Mr. HARTSON. Or was that a consideration in addition to the $265,000?

Mr. HERING. No; I think that probably the bonus that had not been paid was a part of the $265,000.

Mr. HARTSON. It was a part of the $265,000. Then, assuming that there was a liability in favor of these individuals for bonuses by the corporation of $200,000, when they came to purchase the plant of the corporation, they only paid in cash the balance of $65,000?

Mr. HERING. No; you are not quite correct.

Mr. HARTSON. My question was to bring out what the fact is.

Mr. HERING. I understand that they had actual accrued bonuses. The cash that they had paid amounted to $265,000. Mr. Carlson admits that if they had gone on—that is, if the taxpayer had gone on—and completed certain ships that were then in an unfinished condition, the taxpayer would have been under obligation to pay $200,000 more bonus, and he adds that $200,000 to the $265,000, which they had actually paid or canceled, and he estimates that the total receipts from the sale of the property were $465,000.

Mr. HARTSON. I see.

The CHAIRMAN. That would automatically reduce the amortization, would it not, if that is a correct interpretation of it?

Mr. HERING. Yes; and it did reduce it accordingly.

Continuing from Mr. Carlson's report, as I had not quite finished his reasons:

Therefore, by the quick and entire disposition of the plant as was accomplished, the taxpayer received in addition to the sale price of $360,793.21—

I think there is a clerical error there and that he meant received in addition the sale price of $360,000, etc.

The elimination of eventual payments for rent and taxes that would amount to some $210,000.

The elimination of liability for returning the leased land to its original state.

The elimination of the selling costs involved in a piecemeal disposition of the assets.

The cancellation of a bonus liability that would eventually amount to over $500,000.

The accomplishment of the desire of the principals in the taxpaying corporation to retire.

In regard to the latter, it must be borne in mind that neither of the Messrs. Bowles are young men and that their desire to retire is perfectly reasonable.

It is therefore concluded that the sale of the plant as consummated was not only a reasonable one from the taxpayer's standpoint, but a very favorable one as well.

The sale price above shows a higher percentage on cost than most, if not all, Pacific coast shipyards that have been disposed of.

On the other hand what was the standpoint of the purchasing partnership as to the sale?

Then, he goes on and shows that the partnership actually lost money, even in buying the plant at the price which it did buy it at. I can read that if you desire it.

The CHAIRMAN. I do not think that is necessary.

Mr. HARTSON. I want all of Mr. Carlson's report to go into the record, but it is not necessary to read it in.

(The report of Mr. Harry W. Carlson, engineer, on amortization claim of Northwest Steel Co., of Portland, Oreg, is as follows:)

REPORT ON AMORTIZATION CLAIM OF NORTHWEST STEEL CO.

In accordance with instructions contained in memorandum of April 20, 1921, and subsequent letter of June 16, 1921, the undersigned engineers proceeded with the examination of the amortization claim of the Northwest Steel Co. on July 6, 7, 8, and 9, 1921. Conferences were held with the following:

J. R. Bowles, president; C. D. Bowles, second vice president; W. B. Beebe, secretary and treasurer; George Black, public accountant.

Prior to 1916 the business of the taxpayer was the fabrication of structural steel, and the selling of steel in general. The company was organized in 1906, and the fabrication plant owned by them in 1916 was built in 1913.

In the winter of 1915 and 1916 the demand for ships by European interests began to assume large proportions, and the taxpayer began to consider the possibility of securing contracts for building a few vessels. They had a fabricating plant, but no ways or outfitting plant. An arrangement was finally concluded with the Willamette Iron Works, who had a large machine shop and the equipment necessary for outfitting ships, whereby the two companies were to sign joint contracts with Norwegian interests for the building of a number of ships. It was arranged that a "joint account" be created, and that all moneys received for the vessels to be built be paid into that account. There the joint account was to install the necessary ways, etc., on leased land adjacent to the taxpayer's plant, for the erection of the vessels.

The joint account was also to make the necessary additions in the way of facilities needed at the Willamette Iron Works plant in order that the outfitting be complete. It was further agreed that the taxpayer undertake the fabrication of steel for the vessels and the erection of the same up to the

point when the outfitting began. Then the Willamette Iron Works undertook to do the outfitting of the vessels and complete them. As the work progressed, the taxpayer was to receive from the joint account 57 per cent of the price paid to the shipowners, and the Willamette Iron Works 43 per cent, each to furnish the labor and material to perform the part of the work assigned to it.

The first contract with Norwegian interests under this arrangement was signed on April 12, 1916. A total of eight vessels were contracted for by the taxpayer and the Willamette Iron Works under the arrangement.

In July, 1917, the taxpayer contracted for eight more ships to be built for French interests. The Willamette Iron Works refused to continue on these vessels under the joint account agreements and the taxpayer undertook the entire responsibility. They still had no ways or outfitting equipment. On August 1, 1917, the purpose of the joint account having been fulfilled, its property was sold to the two parties composing it, namely, the taxpayer and the Willamette Iron Works. The taxpayer took over the ways, etc., adjacent to their fabricating plant, paying the joint account $300,000 cash therefor, and the Willamette Iron Works took over the equipment of the joint account located at their plant, paying some $65,000 for it. The joint account was then wound up, the distribution being on the 57–43 basis before mentioned. The original cost of the equipment, thus sold for about $365,000, was approximately $450,000.

A further agreement was then made between the taxpayer and the Willamette Iron Works, whereby the latter was to do the outfitting of the eight French vessels on a basis of cost plus 10 per cent.

All but the first two of the 16 vessels above described as contracted for were requisitioned by the Shipping Board. In December, 1917, another 8 vessels were contracted for by the taxpayer for the Shipping Board. This called for speeding up, and the fabricating plant was enlarged and new equipment added to it. The Willamette Iron Works undertook the outfitting of these vessels on the same basis as the French vessels, namely, cost plus 10 per cent.

On March 29, 1918, the Shipping Board gave the taxpayer a contract for 8 more vessels. When it came to arranging for the outfitting, the Willamette Iron Works wanted more profit, and all negotiations on the subject fell through. The taxpayer then proceeded to install its own outfitting plant.

A further contract from the Shipping Board was given the taxpayer on August 14, 1918, for 10 additional ships. Of these, 6 were eventually canceled. The last vessel under this contract was delivered to the Shipping Board on November 6, 1919, which establishes the end of the amortization period.

Thus, we see that a total of 34 vessels were delivered to the Shipping Board and two to private interests. Enough additional material had been secured for the Shipping Board contracts, and Mr. J. R. Bowles explained that as no action or intimation could be secured from the Shipping Board as to a final settlement, they decided to complete the three vessels for their own account and take a chance on selling them. This they proceeded to do. They also decided at that time to abandon shipbuilding, and in fact to retire entirely from active work. Mr. J. R. Bowles, Mr. C. D. Bowles, and Mr. Beebe were the owners of practically all the stock of the taxpayer. That this intention was bona fide is borne out by the fact that none of these three men have done any active work either in this company of any other since that time.

The first intention was to dispose of the plant as quickly as possible, either by selling as a whole, or scrapping it. Among the employees of the taxpayer were Mr. W. H. Cullers, chief engineer, Mr. L. R. Banks, superintendent, and Mr. W. R. Bowles, son of Mr. C. D. Bowles, an engineer. None of these three men had any stock in the Northwest Steel Co., taxpayer. They formed a partnership, under the name Northwest Bridge & Iron Co., and on March 20, 1919, bought from the taxpayer, their original structural-steel fabrication plant in its then condition for $74,215.80. As these three men had been the active elements in the taxpayer's plant, they desired to continue the original business of structural-steel fabrication. However, the taxpayer still had a number of Shipping Board ships to complete, and a contract was made with the partnership whereby the latter were to do all fabricating for the uncompleted Shipping Board vessels at a fixed price of $60 per ton. As the partnership would need the use of the plant shop, mold loft, etc., for this fabrication, they agreed to pay the taxpayer $25,000 rental on these facilities

for the period they would use them. There was also included an option of purchase of these facilities by the partnership for $125,000.

Thus, the taxpayer had disposed of its original fabricating shop, but still held all of the balance of the shipyard. They also had material for building three vessels which they had determined to do for their own account, so as to dispose of the material. On September 8, 1919, a new agreement was entered into with the partnership, whereby the latter were to complete the work previously contracted for on the $60 a ton basis at a fixed sum of $420,000. Further, the partnership was to pay the taxpayer $196,483.73 for the extra material on hand and was to complete the three extra vessels, having the use of the shipyard for this purpose for a nominal rental of $1. The partnership was also to accept to pay for all other materials on order for these ships.

By this arrangement the taxpayer got out from the active operation of the yard and the winding up of the shipbuilding program, passing it entirely to the partnership. At the time these negotiations were being carried on, the taxpayer offered to sell the entire shipyard to the partnership, but the latter refused to entertain the idea, and would only undertake to do the work as above described. Copies of the correspondence on this subject and of the contract finally consummated are attached for the files of the amortization section.

The last of the three vessels was launched in December, 1919, and completed in January, 1920, by the partnership.

On December 20, 1919, the partnership purchased from the taxpayer the plate shop, mold loft, and other facilities that they had previously had an option on at a price of $125,000, and also some additional facilities incident thereto, all for the sum of $105,000. It was the intention of the partnership to use suitable parts of this equipment in their fabricating business and to dispose of the balance.

About this time, early in January, 1920, there appeared a demand for tankers and there seemed to be a possibility of some business along this line. However, the taxpayer had unloaded a very considerable portion of its plant, and did not want to reenter shipbuilding. The partnership was not interested, their intention being to continue only in the fabrication of sale of structural steel.

Mr. J. R. Bowles was in Washington, D. C., in January, 1920, trying to negotiate a settlement with the Shipping Board. The taxpayer had claims against the board on account of the cancellation of six ships. It was suggested by the officials of the Shipping Board that the taxpayer take a contract for building seven tankers for the France-Canada Steamship Line and the Swiftsure Oil Co. The Shipping Board was to finance and pay the taxpayer for the construction of the vessels, the France-Canada and Swiftsure people would then pay the board on long-term payments, and also assume the responsibility for the taxpayer's claims against the board. Thus the board got rid of the taxpayer's claims, the France-Canada and Swiftsure got the financing they needed, and the taxpayer got a definite promise of payment on claims plus a contract for seven tankers. However, the taxpayer still did not want to continue shipbuilding, and furthermore were not in a position to do so, as the fabricating end of their plant had been sold to the partnership. Mr. Bowles then proposed a tripartite contract, whereby the partnership was to undertake the construction of the seven tankers and take the balance of the shipyard off the hands of the taxpayer. Such a contract was finally made on April 13, 1920, under its terms.

The Shipping Board financed the tanker construction, receiving therefor release from the taxpayer's claims on the six cancelled vessels.

The France-Canada and Swiftsure people received the long-time financing they needed in return for assuming the taxpayer's claims.

The partnership received a contract at a good price for building seven tankers.

Coincident with this contract another was drawn on the same day whereby the partnership purchased from the taxpayer the entire remainder of their shipyard for the sum of $138,179.43.

The taxpayer had now succeeded in winding up all their affairs in a satisfactory way.

The above history goes into some detail in order to bring out the various conditions surrounding each transaction. Summarizing, the salient facts are there:

The taxpayer was engaged in shipbuilding during the Great War.

They expanded their plant in 1917 and 1918 to such extent as was required in order that they could complete their contracts.

On the completion of war work, the principals in the taxpaying corporation desired to retire from active work and proposed to sell or scrap the plant.

A partnership, composed of three employees of the taxpayer, one of whom was a son of one of the above-mentioned principals, purchased the plant in three parcels. None of the members of the partnership were stockholders in the taxpaying corporation.

Amortization is claimed by the taxpayer in regard to the facilities acquired subsequent to April 6, 1917, the amount of the claim being based on the sale of the same to the partnership.

The amortization claim is shown in Exhibit No. 1. Claim is made for amortization in the sum of $815,762.46 in respect to property whose original cost was $1,095,088.44, whose depreciated cost (depreciation to January 1, 1918, only) was $1,081,473.87 and whose sale price was $265,711.41.

Because of the close relationship of at least one of the purchasing partnership to a principal in the taxpaying corporation, and the close business relations of the other partners to the taxpayer, the question arises as to the reasonableness of the sales consummated between them. To get a proper view of the entire transaction, it must be remembered that in addition to the property on which amortization is claimed the partnership also purchased the original pre-war plant of the taxpayer, the book value of which on April 5, 1917 was $226,187.73 and for which the taxpayer received $95,081.80, practically all being purchased by the partnership. For the purpose of comparison we will tabulate it thus:

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After Apr. 6, 1917	1,081,473.87	265,711.41
Total	1,267,563.84	360,793.21

This shows that the taxpayer realized 28½ per cent of the cost as of the above date of the above total sale price, $317,395.23 was paid by the partnership in question, the balance coming from small sales to others.

Looking at it from the standpoint of the taxpayer, was the sale of their assets as above a reasonable one?

In the first place, at the time the first part of the plant was sold it was rapidly becoming evident that the shipbuilding business on the Pacific coast was coming to an end. Under any normal conditions the Atlantic coast yards would have a heavy advantage over the Pacific coast yards on the one item of freight rates above, as all steel must come from the East. In addition, most ships would be built for eastern owners, if at all, which generally meant the expense of bringing the ship to the Atlantic coast before it would be put to use. The desire of the taxpayer to retire from shipbuilding was, therefore, a logical one.

In the next place, the entire plant was erected on leased ground, most of the leases running for 20 or 30 years. By passing all these leases to the purchasing partnership the taxpayer disposed of a liability over that period that totaled some $130,000 in rents plus taxes estimated at $80,000 or more.

In the third place, they escaped the responsibility for putting the leased ground into its original condition as required by the leases, which would cost no inconsiderable sum.

In the fourth place, by disposing of the plant as a whole, or practically so, they saved the selling cost that would be entailed in a piecemeal sale which would have been their only alternative had the partnership not purchased it.

In the fifth place, one of the largest considerations that does not appear in the sale was the cancellation of certain bonus obligations. Messrs. Culler & Banks, in the early stages of the shipbuilding work, had been guaranteed certain bonus payments based on tonnage. The business of the taxpayer expanded to such an extent, however, that these bonuses grew to an enormous proportions. For 1917 and 1918 Mr. Culler received $106,025.71 and Mr. Banks $70,683.81. Where the first sale of part of the plant was made

to the partnership of which these men were members they had bonus credits accrued to them of $189,348.62 and $123,277.42, respectively, or a total of $312,621.04, with some $200,000 more coming, had the taxpayer completed the shipbuilding instead of turning it over to the partnership. All of this bonus was canceled as one of the considerations at the time of purchase. This canceled bonus is herein considered as a part of the return received from the sale.

Therefore, by the quick and entire disposition of the plant as was accomplished, the taxpayer received in addition to the sale price of $360,793.21.

The elimination of eventual payments for rent and taxes that would amount to some $210,000.

The elimination of liability for returning the leased land to its original state.

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The cancellation of a bonus liability that would eventually amount to over $500,000.

The accomplishment of the desire of the principals in the taxpaying corporation to retire.

In regard to the latter it must be borne in mind that neither of the Messrs. Bowles are young men and that their desire to retire is perfectly reasonable.

It is therefore concluded that the sale of the plant as consummated was not only a reasonable one from the taxpayer's standpoint but a very favorable one as well.

The sale price above shows a higher percentage on cost than most, if not all Pacific coast shipyards that have been disposed of.

On the other hand, what was the standpoint of the purchasing partnership as to the sale?

In the first place, all three men were financially responsible to a considerable extent, two of them having received heavy bonuses, and the third, Mr. W. R. Bowles, being the son of C. D. Bowles, having means of his own. Mr. C. D. Bowles stated specifically that he did not finance his son in this matter.

In the second place, these three men were young and active, and in view of the closing up of the taxpayer's business in which they had been employed for years, it was up to them to provide themselves with work. It was therefore a most logical desire on their part to acquire the original fabricating shop by the taxpayer and to continue the business that had been a success prior to the war, and with which they had been intimately connected.

In the third place, having acquired the fabricating plant and undertaken the completion of the remaining vessels for the taxpayer, the tanker proposition presented an opportunity for profitable work, and, of course, the acquirement of the balance of the shipyard was a condition to the securing of the contracts. In this connection it is to be noted that in the price paid in the final purchase of the shipyard ($138,179.43) no value was attached to the ways, and the price was really paid for the outfitting equipment. The reason for this was that the original ways, of which there were four, were for 8,800-ton ships, and would not accommodate the tankers, which were 20,000-ton vessels. It was therefore necessary to remove the old ways entirely, and three new ones were erected by the partnership at a cost of about $150,000. It was calculated that the price paid in this part of the sale amounted to about 50 per cent of the cost of the usable part of the yard.

In the fourth place, the partnership was assuming the various responsibilities under the leases, and two of the partners were canceling large bonus credits.

On the whole, therefore, the partnership seems to have paid a price that was reasonable, considering the factors that do not enter into the price, and the fact that they were expecting to put it to use and had good contracts in hand.

To show further that the sale was particularly advantageous to the taxpayer, a little of the experiences of the partnership will be related. They, of course, completed the various vessels contracted for, after which there was absolutely no prospect of further use for the shipyard. They also engaged in some structural work, but found that they could not get enough in volume to make the enlarged shop a paying proposition. The upshot of it all was that they decided to abandon the proposition and sell out the assets. The greater part of the machinery and fixtures has now been sold, and Mr. W. R. Bowles submitted the information that so far they have realized $131,068.25.

The best bid on the remainder is for $30,000, so that they will probably realise not more than $165,000 or possibly $170,000. This does not include buildings, but as salvage the buildings have no value, and they are hoping to get some credit on the buildings from the owners of the land when they negotiate for the termination of the leases. In any event, the partnership will realize less than $200,000 on the property for which they paid the taxpayer $317,395.28 in cash.

It is therefore finally concluded that under the existing circumstances at the time the sale of the partnership by the taxpayer was a reasonable one; that the partnership received no undue favors or consideration in the setting of the price; and that the taxpayer actually received a higher price for the plant than could have been realized in any other way.

It should be stated that the writer examined carefully all of the contracts and papers relating to the transactions which have been described and found them to be in good order and apparently covering all points necessary to make the transactions proper and binding.

This sale, then, together with the other minor sales to other parties and the canceled bonus will be taken as governing the allowable amortization.

Reference is again made to Exhibit No. 1. In respect to the first 13 items there are no questions, all being purchased subsequent to April 6, 1917, and prior to the end of 1918. The amortization as claimed is recommended as allowable.

Item No. 14, however, presents a problem. Of the cost shown, $329,844.43, $300,000 represents the purchase of the joint account properly described earl er in this report. The taxpayer contends that title to the property covered by this $329,844.43, which was all purchased by the joint account prior to April 6, 1917, was vested in a separate entity, namely, the joint account, until the date of purchase by the taxpayer, August 1, 1917. Therefore, the taxpayer contends that they had no rights in it until the date of purchase, and that this date being subsequent to April 6, 1917, the property cost is subject to amortization. They further contend that they acquired it on August 1, 1917, for the specific purpose of using it on Shipping Board vessels.

On the other hand, the taxpayer had always had an interest in this property through the joint account, and it had actually been purchased by the joint account prior to April 6, 1917, for the taxpayer's use in executing their part of the contracts, which were not war contracts. The question arises in the writer's mind as to whether the joint account can be considered as a separate entity—a third party, so to speak—and whether the sale of property, in which the taxpayer had an interest through that entity, to the taxpayer on a date later than April 6, 1917, can be taken as establishing the right to amortization of its cost.

Considerable discussion was had on the subject with the taxpayer, and they brought out the fact that if their contentions were overthrown the result would be in their favor. In other words, if this property is not allowed to remain in the amortization schedule it will have to be treated with other pre-war property, and the loss sustained in its sale will be taken almost entirely in the year of sale, 1919. Very little of this property was included in the final sale of 1920. It so happens that the taxpayer has a higher tax rate in 1919 than in 1918. Therefore, by treating the loss as one due to sale of capital assets, practically all of the deduction would come in the year 1919 with the highest tax rate, while if treated as amortization, the loss would be divided very nearly equally between 1918 and 1919. Notwithstanding this fact, the taxpayer expressed a desire to have this item remain in amortization, because its elimination would mean reopening the 1916 and 1917 returns on account of the depreciation and effect on invested capital involved, and they would rather pay the additional tax involved than have to go through this reopening of old returns.

Considering this attitude of the taxpayer, the fact that they do have some good arguments in favor of their contention, and the fact that their interpretation really results in an addition to their tax, it is deemed advisable to allow the item to remain in the amortization schedule, and it is so recommended.

Attached to this report is a waiver signed by the taxpayer, waiving any right they might have to a reduction in their tax through the transfer of this item from amortization to sale of capital assets.

It is therefore recommended that the active claim for amortization submitted by the taxpayer and shown in Exhibit No. 1 be allowed.

EXHIBIT No. 1.—*Northwest Steel Co., Portland, Oreg.—Summary sheet of amortization claim*

Property unit	Actual cost on which claim for amortization is claimed	Depreciation prior to Jan. 1, 1918	Depreciated Value on which amortization is based	Amount recovered from sale	Total amortization suffered against each unit
1. Portland office fixtures	$28,396.07	$543.11	$22,752.96	$9,019.29	$13,733.67
2. Plant	45,463.48	6,620.20	38,843.28	7,741.27	31,102.01
3. Plant equipment	165,568.95	4,122.09	161,446.86	31,846.97	129,619.89
4. Rivet shop equipment	48,426.55	1,975.26	46,451.29	9,960.70	36,490.59
5. Yard equipment	7,041.37	273.91	6,767.46	4,644.32	2,123.14
6. Automobile equipment	24,657.31	----------	24,657.31	5,226.75	19,430.56
7. Chicago office fixtures	262.70	----------	262.70	91.94	170.76
8. Seattle office fixtures	334.00	----------	334.00	66.00	268.00
9. Outfitting plant	213,322.61	----------	213,322.61	53,330.65	159,991.96
10. Emergency yard extension	25,235.51	----------	25,235.51	6,632.14	18,603.37
11. Outfit plant equipment	77,692.36	----------	77,692.36	19,423.09	58,269.27
12. Hesse-Martin equipment	34,003.12	----------	34,003.12	17,000.00	17,003.12
13. Cafeteria	99,839.93	----------	99,839.93	13,244.36	86,595.57
14. Ship plant and equipment	329,844.48	----------	329,844.48	87,493.93	242,360.55
15. Canceled bonuses	----------	----------	----------	200,000.00	----------
Total	1,095,008.44	13,534.57	1,081,473.87	465,711.41	615,72.466

PORTLAND, OREG., *July 11, 1921.*

INTERNAL REVENUE COMMISSIONER,
Washington, D. C.

Income-tax reports for 1917, 1918, and 1919.

GENTLEMEN: In the matter of the item in plant account, $300,000, covering the value by purchase of certain shipbuilding plant originally owned by the joint account (Willamette Iron & Steel Works and Northwest Steel Co.) acquired after April 5, 1917, by purchase, and amortized along with the remainder of the plant, we hereby waive right hereafter to eliminate from "Amortization" and treat by "Depreciation" and "Sale of capital assets," notwithstanding that by some far-reaching conclusion we might have the right to treat in the manner last above named with considerable apparent saving in taxes to the corporation.

Yours very truly,

NORTHWEST STEEL CO.,
J. R. BOWLE, *President.*

Summary

	1917–18
Cost on which amortization is claimed	$1,081,473.87
Cost on which amortization is allowed	1,081,473.87
Cost on which depreciation is to be allowed	None
Amortization claimed	815,762.46
Amortization allowed	615,762.46
Amortization disallowed	200,000.00

It is recommeded that amortization be allowed the Northwest Steel Co. in the amount of $615,762.46 on property cost as indicated above. All costs are subject to check by the auditor assigned to this case.

Depreciation on facilities acquired in 1917 has been deducted.

The end of the amortization period is November 6, 1919.

The amount allowed as amortization ($615,762.46) should be spread in proportion to the net income from January 1, 1918, to November 6, 1919.

Submitted July 11, 1921.

HARRY W. CARLSON, *Engineer.*

Approved:

S. T. DE LA MATER,
Chief of Section.

The CHAIRMAN. Have you any further questions, Mr. Davis?

Mr. DAVIS. No.

The CHAIRMAN. We will adjourn now until 10 o'clock to-morrow morning.

(Whereupon, at 11.55 o'clock a. m., the committee adjourned until to-morrow, Wednesday, December 10, 1924, at 10 o'clock a. m.)

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

WEDNESDAY, DECEMBER 10, 1924

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE THE
BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The committee met at 10 o'clock a. m., pursuant to adjournment of yesterday.

Present: Senator Couzens (presiding).

Present also: Earl J. Davis, Esq., of counsel for the committee.

Present on behalf of the Bureau of Internal Revenue: Mr. C. R. Nash, assistant to the Commissioner of Internal Revenue; Mr. Nelson T. Hartson, Solicitor, Internal Revenue Bureau; and Mr. S. M. Greenidge, head engineering division.

The CHAIRMAN. You may proceed, gentlemen.

Mr. HARTSON. Mr. Chairman, late yesterday afternoon I went to my own files—I mean the files of the solicitor's office—and found the original memorandum, which was properly included in the solicitor's files, dated March 14, 1921, which is the memorandum we were searching for yesterday.

The CHAIRMAN. You might read that into the record.

Mr. HARTSON. That memorandum is dated March 14, 1921, and is from the special assignment section, bearing the symbols "IT:SA:ZMS:P-115." [Reading:]

SOLICITOR OF INTERNAL REVENUE:

In re Northwest Steel Co., Portland, Oreg. There is transmitted a copy of the engineer's report on the amortization claim of the above company for your opinion and recommendation as to whether a penalty should be assessed for filing a false and fraudulent return. The auditor states that there is no other evidence of fraud in the case.

From the report of the examining officer, it is disclosed that the properties of this company originally cost $1,095,008.44, and is alleged to have been subsequently sold to three individuals, having a doubtful financial standing, for a consideration of $265,711.41, which resulted in a claim having been made for amortization in the sum of $815,762.42.

The fact that there seems to be considerable doubt as to whether this sale is a bone fide transaction, and the boastful statements made by an official of the company, would indicate that a deliberate and willful attempt has been made to evade taxation.

S. ALEXANDER,
Head Special Audit Division.

That is the memorandum which originally referred the case to the solicitor's office, and which gave rise to the solicitor's memorandum dated March 24, 1921.

The CHAIRMAN. The last memorandum referred to was read into the record yesterday?

Mr. HARTSON. Yes; the memorandum of March 24, 1921, is the one that was read into the record yesterday, which recommended that an additional field investigation be conducted.

The CHAIRMAN. Yes; I recall that. That indicates, then, that the special assignment section or the fraud section, whatever you may call it, made no inquiry of its own, but just simply passed through this information that they received from the amortization section; is that correct?

Mr. HARTSON. I think that is correct, Senator, and I think that in 1921 that was the practice. There has always been a considerable amount of discussion in the bureau as to just how much participation the auditing branch should have in determining whether a false or fraudulent return had been filed. The lawyers for the bureau have thought, and the commissioner has evidently concurred in that view, that before a taxpayer is notified that he is under charges of fraud and that the bureau proposes to assess the so-called ad valorem penalties against him, there should be a legal scrutiny of such evidence as has been developed by the field agents. At this time, that is, in March, 1921, or during that general period, I believe the so-called fraud subsection in the unit was composed of relatively few auditors, and their function was to go over the reports and do the mechanical work connected with the adjustment of the tax, following some definite recommendation by the solicitor. When the field agent reported that, in his judgment, fraud had been committed, it invariably found its way to the solicitor's office, unless some dereliction occurred in the unit through failure to observe the usual procedure and the instructions that were definitely given.

But this case came to the solicitor's office; the files here show evidence of the fact that the fraud section did not function on the case, really. They just passed it through to the solicitor's office, and there the recommendation was made that a further examination be had. Then it came again to the solicitor's office by further memorandum, which is dated August 24, 1921, from the special assignment section, bearing the symbols "IT:SA:JWC." [Reading:]

SOLICITOR OF INTERNAL REVENUE:

Pursuant to request made in your memorandum of March 24, 1921, that a further investigation be made relative to establishing fraud in the case of the Northwest Steel Co., Portland, Oreg., there is transmitted herewith copy of report, dated August 17, 1921, of Engineer Harry W. Carlson.

The question of fraud in this case was in connection with the amortization claim filed by the taxpayer. Will you, therefore, kindly consider the attached report and render your opinion as promptly as possible?

S. ALEXANDER,
Head Special Audit Division.

On August 29, 1921, the solicitor replied to the memorandum that I have just read. The solicitor's memorandum bears the symbols "SOL:P:JJM." [Reading:]

In re Northwest Steel Co., Portland, Oreg.

DEPUTY COMMISSIONER BATSON,
(Attention Mr. S. Alexander, Head Special Audit Division.)

Reference is made to your memorandum of August 24, 1921, with which you have transmitted the report of the engineer on the amortization claim of the above-named taxpayer made on recommendation of this office in a memorandum of March 24, 1921. The file was submitted for the opinion of this office as to whether ad valorem penalties should be assessed for filing fraudulent amortization claim.

The reinvestigation by the amortization engineer goes into the case fully and claim is analyzed from the standpoint of both the taxpayer and the Government. From the facts set forth it is apparent that the sale of the plant by taxpayer to the Northwest Bridge and Iron Co. was in reality an advantageous transaction by which they realized more from their plant than would have been realized in any other manner. Nothing is disclosed which in any way indicates that the transaction was wrongfully conceived or carried out, and on the contrary the utmost good faith is exhibited.

It is, therefore, recommended that no penalties be assessed in this case.

CARL A. MAPES,
Solicitor of Internal Revenue.

From my knowledge of the procedure that was in effect at that time—and I might add that I was not in the employ of the Government at the time this case was under consideration—it is apparent that there was no hearing conducted in the solicitor's office on the fraud charge in this case. The matter was referred to the solicitor on the correspondence that has been submited in the record here, namely, the first report of Engineer Van Schaick, and following a scrutiny by the solicitor of that report, he wanted additional evidence and further investigation. That went forward again to the field and came back again in the form of Mr. Carlson's report, Mr. Carlson being the amortization engineer who made the second report. Based on the evidence submitted by the agent in the field, Mr. Carlson, the solicitor found that there was no fraud.

The CHAIRMAN. In that connection, I would like to ask if, in reaching this latter conclusion, the engineer was in any way consulted or satisfied with the final decision?

Mr. HARTSON. I can answer that he was ever consulted. However, his report was before the solicitor, together with the second engineer's report.

The CHAIRMAN. Yes; but what I am trying to get at is this: The first engineer, Mr. Van Schaick, was quite disturbed about the situation and believed that there was fraud, and in that connection he quoted the officers of the Government. I would like to know if anything happened after that in which he participated?

Mr. HARTSON. I did not get the question, Senator.

The CHAIRMAN. Was there anything that happened after he wrote his confidential letter to the bureau which satisfied him that his original dissatisfaction with the sale and his apparent conviction that there was fraud, were not justified in this case?

Mr. HARTSON. I should say that the files do not disclose that he later concurred in the settlement that had been made by the solicitor, so far as the fraud features are concerned. I know of my own personal experience that frequently the people in the field and the people in the bureau have disagreed with an adjustment. We can not all reach the same view on these cases. It would not surprise me at all if Mr. Van Schaick has always thought that fraud had been committed in that case, whereas others, who considered it at the time, thought that no fraud had been committed.

The CHAIRMAN. In the payment to the Northwest Steel Co., as I recall the testimony, they allowed certain credits that were on the books of the Northwest Steel Co. to the individuals, at least to two of the individuals, who bought this company and organized the Northwest Bridge & Iron Works. I would like to ask whether or

not an income tax return was filed and a tax paid on this bonus which was credited to the purchase of this plant?

Mr. HARTSON. I think it would be very interesting to determine that, Senator. I have not made such an examination, but that can be made, and we will be very glad to do it.

The CHAIRMAN. Will you please look up the income tax returns of these men and see if they reported these amounts as income?

Mr. HARTSON. As individuals composing the partnership which purchased the assets of the old company?

Mr. CHAIRMAN. Yes. I think they received between $100,000 and $200,000 in bonuses to apply on the payment.

Mr. DAVIS. That would be individual income tax returns for the years 1917, 1918, 1919, and 1920, of Mr. W. H. Cullers, Portland, Oreg., Mr. L. R. Bangs, Portland, Oreg., and Mr. W. R. Bowles, Portland, Oreg., as well as the partnership returns of the Northwest Bridge & Iron Works for those years.

The CHAIRMAN. As I understand it, we have been dealing up to this time principally with the question of fraud?

Mr. HARTSON. Yes.

Mr. DAVIS. There is another question there, if I might ask it, Mr. Chairman.

The CHAIRMAN. Yes.

Mr. DAVIS. Mr. Van Schaick, in his report, sets forth that he conferred with the agent, Mr. Kramer, who was of the same opinion with reference to the sale that he was. Is there anything to show in the record there that Mr. Kramer, the agent, was consulted with reference to this matter, and what his idea of the sale was?

Mr. HARTSON. I think Mr. Kramer does not, so far as any of the records go, furnish his opinion with regard to the fraud features of the case. The only indication that he ever had an opinion, is contained in the report of Mr. Van Schaick that Mr. Davis has referred to. There is nothing in the files that I can find that is signed in any way by Mr. Kramer, and which expresses his view on this feature of the case.

Mr. DAVIS. I would like to ask, Mr. Solicitor, how fraud matters are handled to-day when complaint is made?

Mr. HARTSON. This is the procedure to-day. Disclosure of the fraud comes up in a great many different ways. Possibly, the most frequent method of disclosing fraud is through some informer. That is frequently done. Former employees who have left a business concern frequently have some personal feelings toward the concern that formerly employed them, and they come in and tell about some transaction which they think was unlawful. The revenue agents in the field examine these, make audits and investigate charges that may be made. Just now there has been a little change, in that the responsibility of these fraud investigations has been lodged with the Special Intelligence Unit which you have heard referred to. Men in that unit, as the name of the unit would signify, are men primarily concerned with fraud matters, both in regard to the bureau employees, in watching and scrutinizing their actions, and in examining charges and investigating charges made against the employees, together with an examination of fraud on the part of taxpayers.

Mr. DAVIS. Of what is this Special Intelligence Unit comprised?

Mr. HARTSON. That unit is directly under the personal supervision of the commissioner, and is in charge of Mr. Elmer Irey, who is chief of that section. Mr. Irey has under him about 90—I am speaking in round numbers—special intelligent agents. They are men who, I believe, have been selected on the basis of their qualifications as investigators. There are some auditors and some lawyers, and there are men who, in some instances, have had experience along that same general line in other branches of the Government. They are such men as Captain Fraiser, who pointed out the other day in these hearings that he used to be in the Army Intelligence Service. That is also true of Elmer Irey, he having been in the Army Intelligence Service. As I say, that organization is composed of about 30 men, who are spread throughout the country. They are usually placed in the big centers of the country, the largest unit working out of Washington.

The CHAIRMAN. They investigate cases like the Croker case?

Mr. HARTSON. Yes. The report, under the present procedure, is made by the special intelligence agent, and that is referred to the revenue agent in the field, who is an auditor, to assist in the actual computation of the additional tax that may be found to be due by reason of the fraud. That report is finally audited, and the taxpayer, before he is assessed any fraud penalty, is notified by letter of a proposal to assess a fraud penalty. The taxpayer then has a hearing in the unit, as he would have on an additional tax that was assessed against him without fraudulent intent being charged. That is reviewed in the solicitor's office and if, finally, as a result of that, it is determined that fraud is still present in the case, the taxpayer s then given a 60-day registered letter which is provided for under the new revenue law. The taxpayer could then appeal his case to the Board of Tax Appeals, which will hear him not only on the legality of assessing the additional tax but also on the correctness of any fraud penalty that is proposed to be assessed against him.

So that we have those three agencies in the determination of fraud; the Special Intelligence Unit, under the present procedure, is doing the investigating; it is doing the detective work, if you care to put it that way. The revenue agents in the field and the auditor for the Income Tax Unit audit their work and do the technical work of the computation of the additional tax, and render whatever other assistance is necessary from a purely technical standpoint. Then the lawyers in the bureau review that to determine whether the evidence as submitted is sufficient to warrant the commissioner in proposing to assess the fraud penalty, based on an allegation that the man deliberately and wilfully attempted to evade the tax. After that, it goes to the Board of Tax Appeals.

Mr. DAVIS. There was something said yesterday about an amortization claim allowed to the taxpayer with reference to property which was purchased prior to April 6, 1917, and that ran into figures of, I believe, about $300,000, as the report shows.

Mr. HARTSON. That is true, Mr. Davis.

I want to say to the chairman, in the first instance, that there is no one, apparently, now in the bureau that originally made this determination, and when I speak of "this determination" I refer

to the amortization allowance that Mr. Davis has referred to. All we are able to do is to find from the files just what the record shows.

I would like to have Mr. Tandrow take the stand, if he will. I think he has never been sworn in these hearings.

TESTIMONY OF MR. W. S. TANDROW, APPRAISAL ENGINEER BUREAU OF INTERNAL REVENUE

(The witness was duly sworn by the chairman.)

Mr. HARTSON. Mr. Tandrow, if you will, explain to the chairman what the files show with regard to this allowance of a $300,000 expenditure for property which, as Mr. Davis has said, was property acquired and purchased prior to April 6, 1917, the beginning of the war.

The CHAIRMAN. First, I would like to ask the witness how long he has been in the employ of the bureau?

Mr. TANDROW. About 27 months, as an engineer.

The CHAIRMAN. Were you in the employ of the department before that time?

Mr. TANDROW. No, sir.

The CHAIRMAN. That was your first connection with the Government?

Mr. TANDROW. That was my first connection with the Government.

The CHAIRMAN. And that was subsequent to this case?

Mr. TANDROW. Yes.

I believe that the treatment of that item is best explained in the report of Mr. Carlson. Would it not be well to read his argument, and then discuss other features in connection with the transaction?

Mr. HARTSON. My recollection is that Mr. Carlson's report on this case was read into the record yesterday, although I am not sure about that.

Mr. DAVIS. I think it was.

Mr. HARTSON. I think Mr. Thomas read it.

Mr. TANDROW. I disagree with you there. I do not believe certain sections were read.

Mr. DAVIS. There were certain portions of it read into the record. You may have reference to something which has not been read into the record. If you have, we will be glad to have you put it in the record.

Mr. TANDROW. The item in question is referred to in Mr. Carlson's report as Item 14. Reading from page 10 of his report, he states:

> Item No. 14, however, presents a problem. Of the cost $329,844.48, $300,000 represents the purchase of joint account property described earlier in this report. The taxpayer contends that title to the property covered by this $329,844.48, which was all purchased by the joint account prior to April 6, 1917, was vested in a separate entity, namely, the joint account, until the date of purchase by the taxpayer, August 1, 1917. Therefore, the taxpayer contends that they had no right in it until the date of purchase, and that this date being subsequent to April 6, 1917, the property cost is subject to amortization. They further contend that they acquired it on August 1, 1917, for the specific purpose of using it on Shipping Board vessels.
>
> On the other hand, the taxpayer had always had an interest in this property through the joint account, and it had actually been purchased by the joint account prior to April 6, 1917, for the taxpayers' use in executing their part of contracts which were not war contracts. The question arises in the writer's mind as to whether the joint account can be considered as a separate

entity—a third party, so to speak—and whether the sale of property in which the taxpayer had an interest through that entity to the taxpayer on a date later than April 6, 1917, can be taken as establishing the right to amortization of its cost.

Considerable discussion was had on the subject with the taxpayer, and they brought out the fact that if their contentions were overthrown, the result would be in their favor.

Mr. DAVIS. Pardon me, but I think Mr. Thomas read this.

The CHAIRMAN. Yes; I think he did. I was just about to raise that question at this point. I think that signifies the taxpayer's position as to title, but it raises a very interesting question in my mind, and that is as to whether, if that was concurred in, if the taxpawer's contention was concurred in—and the bureau evidently did concur in it, because they allowed it—then all that any industry would have to do would be to transfer all of the property to a joint account and then buy it back or take it back for war purposes, thereby evading the ownership of anything prior to the beginning of the war.

Mr. DAVIS. Further than that, the witness Thomas said yesterday, where the taxpayer claimed that this would result in its favor, it showed that it would not result in its favor, and there would be an additional tax.

The CHAIRMAN. I recall that.

Mr. DAVIS. Yes.

The CHAIRMAN. Now, what do you have to say in connection with that allowance, since you have read this report of the engineer?

Mr. TANDROW. I have not only read the report, but I have gone over the entire file. It occurs to me that it is not absolutely clear as to whether the transfer of the property from the joint account to this new company on August 1, 1917, was a legal sale; that is to say, whether the joint account, prior to April 6, 1917, was one entity, and the property owned by that entity was sold; although the same interests were involved, whether or not it was a legal sale in August, 1917. If this taxpayer can show that transaction was a legal sale, that is to say, within the laws of the State of Oregon, I would say that they are right in claiming amortization. The report, however, is not clear in that respect.

The CHAIRMAN. There is nothing in the files to show whether the department rules on that specific point, is there?

Mr. TANDROW. There is nothing directly in the files, but Engineer Carlson was assigned to this case and, of course, as you know, a charge of fraud had been made. I would say that Engineer Carlson went into that feature very carefully. I think he says some other features are considered, and from his investigation he was not able to definitely say that that was not, in fact, a sale, or he would have disallowed amortization on those particular items. I am quite confident of that; that is to say, just simply for no purpose at all he would not include $800,000 and regard that as amortizable, unless the taxpayer had produced during his examination very substantial evidence indicating that the transaction was a legal sale.

Mr. DAVIS. Let me read you the portion of his report with reference to that matter:

"Considering this attitude of the taxpayer"—that is, that it would be an advantage to him—"the fact that they do have some good arguments in favor of their contention, and the fact that their

interpretation really results in an addition to their tax, it is deemed advisable to allow the item to remain in the amortization schedule, and it is so recommended."

The CHAIRMAN. I think that was read before, and there was some controversy about the facts in that connection, but I still want to know if there is anyone in the department, superior to the engineer, who passed upon the question that he himself raised, as to whether this was a legitimate sale or transfer of property?

Mr. HARTSON. Mr. Chairman, I think I can answer that in this way, that this report of Mr. Carlson's, portions of which have been read, was approved by Mr. Gordon Reel, acting chief, engineering subsection, and also approved by S. T. De La Mater, chief of section.

The CHAIRMAN. I think that answers my question.

Mr. HARTSON. The report as submitted by Mr. Carlson, was approved, and then passed on to the auditors, who made the computation based on the allowance that the report recommended. That is just what occurred.

The CHAIRMAN. But there is nothing in the file to show that this report was discussed in the bureau after the engineer's report?

Mr. HARTSON. I do not know of any discussion at a later date than the approval of the engineer's report.

The CHAIRMAN. In that approval, that position on that particular point was not emphasized or dealt with?

Mr. HARTSON. Yes; the files bear me out when I say that there was no further discussion on this point after the approval of the engineer's report.

Mr. TANDROW. Yes; that is correct, although, during the field examination by the engineer, he conferred with the revenue agent in charge of this territory in regard to the investigation of this claim. Evidently the revenue agent concurred in his findings with respect to the claim in this particular item.

Mr. HARTSON. Is this item mentioned in the agent's report?

Mr. TANDROW. Not specifically; no.

Mr. HARTSON. How is it treated in the agent's report, do you know, Mr. Tandrow?

Mr. TANDROW. No; I could not say.

Mr. HARTSON. Is it treated on the same basis that Mr. Carlson recommended?

Mr. TANDROW. Yes; effect was given to the recommendations made by Engineer Carlson.

Mr. HARTSON. It was not specifically pointed out that there might be a question about it, and that it should be further discussed?

Mr. TANDROW. No. I have gone through all of the reports, and I can not find a reference to this particular item.

The CHAIRMAN. Let me see if I get this quite clear. It was the same identical property that was owned by the taxpayer prior to the war, or it was property that was bought during the war and put into a joint account. Now, when it was put into the joint account they put in specific pieces of property, not a sum of money, but specific pieces of property. After a disagreement between those who participated in the joint account, this same identical property was taken back by the original owners, and then amortization was claimed

on it because of this transfer in the first instance from the Northwest Steel Co. to the joint account, and then from the joint account back to the original owner, the Northwest Steel Co. Is that a correct story of it?

Mr. TANDROW. That is substantially correct. I have just one suggestion there. This property was acquired prior to April 6, 1917, in a joint account.

The CHAIRMAN. Just a minute. It was acquired in a joint account?

Mr. HARTSON. Yes.

Mr. TANDROW. Yes; it was acquired by a joint account prior to April 6, 1917. This joint account represented contracts that were entered into by the Willamette Shipbuilding Co. and the Northwest Steel & Iron Co. for the construction of ships for the Norwegian Government. This joint account maintained a separate set of books. In other words, it was a separate entity.

The CHAIRMAN. Then, in the first instance, when they created this joint account, all that they did was to put in cash; is that correct?

Mr. TANDROW. Yes.

The CHAIRMAN. And this cash bought the property?

Mr. TANDROW. That is correct; the cash bought the facilities.

The CHAIRMAN. They just put the cash in for the joint account?

Mr. TANDROW. Yes, and bought the facilities and the materials for the construction of these Norwegian ships. The work was completed for the Norwegian Government. Then, it was decided to undertake work for the French Government, and because of differences between the Willamette Iron Works and the taxpayer, it was decided to dissolve this joint account and close it out. To divide their property interests, these two companies holding a joint interest, agreed to close the joint account and the taxpayer, or those who are now known as the taxpayer, paid $300,000 into the joint account. The Willamette Shipbuilding Co. paid $65,000 into the joint account. Specific items of property were taken over by the taxpayer and specific items were taken over by the Willamette Shipbuilding Corporation. In other words, there was a direct separation of the physical property.

The CHAIRMAN. I think that will lend some difference to the interpretation of the matter, in view of the fact that they did not put property into the joint account, but put cash into it, and then turned around and bought property which was amortizable. Even though it was bought before the war, certainly the taxpayer did not get title to it until after the war.

Mr. TANDROW. Right.

Mr. DAVIS. But the property was always distinct property of each of the two parties to this joint account?

Mr. TANDROW. No, sir.

Mr. HARTSON. I do not so understand it, either, Mr. Davis.

Mr. DAVIS. I think the engineer's report here shows it.

Mr. TANDROW. Of course, you must understand that I am not looking solely at the engineer's report for my information. I have gone completely through the files, and I am relying on the statements disclosed by the files, as well as on the engineer's report.

Now, I say that the joint account, as outlined in this engineer's report, is not clear, for the reason that the taxpayer has shown by other documents that a separate set of books was maintained for this joint account.

Mr. HARTSON. Is that showing contained in the engineer's report?

Mr. TANDROW. No; not specifically.

Mr. HARTSON. Is there any reference made to the fact that this joint account maintained a separate set of books?

Mr. TANDROW. Not in the engineer's report.

Mr. HARTSON. Is it in the auditor's report?

Mr. TANDROW. It is in a brief that was submitted by the taxpayer and sworn to, protesting.

Mr. HARTSON. Is it in the auditor's report?

Mr. TANDROW. Yes; it is in the auditor's report.

Mr. DAVIS. The taxpayer had his plant at the beginning, had he not?

Mr. TANDROW. He had a plant at the beginning, a steel fabricating plant.

Mr. DAVIS. Yes; and the Willamette concern had its separate plant?

Mr. TANDROW. Yes.

Mr. DAVIS. The taxpayer was to build the ships up to the point of outfitting.

Mr. TANDROW. Correct.

Mr. DAVIS. And then they turned them over to the Willamette Co., which was outfitting them. That is true, is it not?

Mr. TANDROW. That is correct.

Mr. DAVIS. And in doing that they established this joint account; that is true, is it not?

Mr. TANDROW. Yes, sir.

Mr. DAVIS. In establishing the joint account, certain properties were added to each concern?

Mr. TANDROW. Yes.

Mr. DAVIS. They were at all times kept distinct in the separate concerns?

Mr. TANDROW. No; I would not agree to that, for the reason that these expenditures for facilities that were used in completing the contract for the Norwegian Government were charged to a distinct property account, which was known as the joint account.

Mr. HARTSON. So far as the properties are concerned, this established the segregation?

Mr. DAVIS. Yes; as a segregation.

Mr. HARTSON. The actual assets.

Mr. TANDROW. Of the physical facilities, yes.

Mr. DAVIS. And the purchases of property were made so that each party could execute its part of the contract?

Mr. TANDROW. Well, I am not quite thinking in your terms. In other words, you have two concerns interested in completing a given contract, which is handled under a joint account, both as to distribution of profits and the acquisition of physical facilities for the completion of a given contract. That joint account, as I gather from the record, refers not to a joint account which was divided between, we will say, the Willamette Shipbuilding Co., and the taxpayer, but a

joint account in every sense. In other words, they acquired facilities which were charged to a joint account without reference to the location of the facilities.

The CHAIRMAN. Did the joint account have an agreement whereby they were to divide the property on a certain date?

Mr. TANDROW. Yes, sir.

Mr. DAVIS. They did.

The CHAIRMAN. Let me see if I get this straight. If, for instance, a lathe or a milling machine was necessary to complete the contract, and no matter whether it was used by the Willamette Shipbuilding Co. or the Northeast Steel Co., it was bought by the funds in this joint account, and it could be placed at the most advantageous point in either plant for doing the work, but the title to the property was not in either the Northeast Steel Co. or the Willamette Shipbuilding Co., but the title to it was in the joint account; is that correct?

Mr. TANDROW. That is correct.

Mr. HARTSON. Yes; that is correct. To bear out this statement, I wish to read one sentence from Mr. Carlson's report. It is on page 1 of his report:

> There the joint account was to install the necessary ways, etc., on leased land adjacent to the taxpayer's plant for the erection of the vessels.

In other words, these facilities which it was necessary for both plants to acquire to complete these contracts were purchased to the credit or debited against the joint account.

The CHAIRMAN. Referring to the leased land that this property was on, was that in the name of the joint account? Can anyone answer that?

Mr. HARTSON. Yes; I understand it was. There then was the agreement as to the profits from the joint account, that the taxpayer was to receive from the joint account 57 per cent of the profits received from shipowners and the Willamette Iron Works was to receive 43 per cent, and each was to furnish the material and perform the labor on the work assigned to it.

Mr. DAVIS. Now, notwithstanding all of that, they took a contract, that is, the taxpayer did, in July, 1917, with French interests for eight additional ships, as the record shows.

The CHAIRMAN. I think that is admitted.

Mr. DAVIS. Yes. It appears, therefore, that the taxpayer had these facilities from July up until December, when they took the Government contract, and therefore they were not acquired to manufacture articles needed in the prosecution of the war. Is not that shown by the record?

Mr. TANDROW. No; I would not say that that was true. In respect to the manufacture and production of an article which contributed to the prosecution of the war the statute does not say that the production of an article must necessarily be for the Government of the United States, and it has been the uniform practice of the amortization section, or what is now the appraisal section, to allow amortization on facilities that were acquired for the production of articles which did contribute to the prosecution of the war, whether that article was produced under direct contract with the Government of the United States or any other government. The question is whether or not an article was produced.

Mr. DAVIS. Pardon me. These contracts were not with the French Government, were they?

Mr. TANDROW. Yes.

Mr. DAVIS. They were with French interests, were they not?

Mr. TANDROW. Well, practically any ship built during the war period—that is, subsequent to April 6, 1917—has been regarded as properly amortizable, because all ships were commandeered; that is, all ships on the ways when the Government of the United States entered the war, were commandeered by the Government.

The CHAIRMAN. What was the date on which the Shipping Board commandeered this plant?

Mr. DAVIS. Mr. Thomas says that it was on December 27, 1917.

The CHAIRMAN. Now, taking Mr. Davis's point, if he was trying to show that this was not amortizable, because of the fact that the Government had not yet given this company an order, then, in the case of the Berwind-White Co., the taxpayer would be in such a position that no property would be amortizable, because there is no evidence that the taxpayer in that case had at any time any contract with the Government. Is not that correct, Mr. Davis?

Mr. DAVIS. Well, they produced something that was being used to contribute to the prosecution of the war.

The CHAIRMAN. Is it your interpretation, then, that these ships were not used in the prosecution of the war?

Mr. DAVIS. From the record, if they were used by the French interests, they might have been, and they might not have been.

The CHAIRMAN. That would be true as to coal, too, would it not, or steel, or anything else, as a matter of fact, because, as I understand it, most of the amortizable material, whether it was for building cars or mining coal, or anything else, has all been reduced because of the fact that it was a commodity used in the prosecution of the war, whether it was used by private individuals or whether it was used by the Government.

Mr. DAVIS. I do not believe the record discloses, Mr. Chairman, that this joint account was an entity by itself and had title to any property, but that it was simply created for convenience, so that they could handle each by itself, its share of these contracts.

The CHAIRMAN. That may be so, and I think it is up to the department to further show that this was an actual holding of the property.

Mr. DAVIS. That is the question I raise—that the taxpayer was always the owner and always had control of this particular part of this property, whether a joint agreement existed or not.

Mr. HARTSON. Mr. Chairman, I am prepared to agree with Mr. Davis that this so-called joint account was not a separate entity, as an entity is known in law. It was not a partnership or association or a corporation, which, under the revenue laws, would be required to file a return; but my own view of this situation, based on such knowledge as I have been able to gain through looking through the files in the last two or three days is this, that these two concerns, the fabricating plant and the outfitting plant, entered into an agreement between themselves to purchase in what they termed a joint account certain facilities which necessarily had to be added to their respective plants, in order to complete contracts that they both had entered into with the Norwegian Government to build these ships.

The CHAIRMAN. Just at that point, then, the title to the property could not have been in the joint account if it was not a corporate entity or a partnership, could it?

Mr. HARTSON. No. The legal title, possibly, to the property was not in a joint account, or not in a separate entity, but by reason of their agreement, Mr. Chairman, I believe that each company owned what might be termed an undivided interest in certain facilities that necessarily had to be acquired to be added to each one of the plants.

The CHAIRMAN. Yes; but how could this joint account, not being a partnership or a corporate entity, have an undivided interest or right to a specific piece of property?

Mr. HARTSON. By reason of an agreement that the two companies had entered into.

The CHAIRMAN. Then, the title to the property must have been in the corporations.

Mr. HARTSON. I think it was in each one of them.

The CHAIRMAN. Then, if it was in each one of them, the property was certainly bought before this country entered the war.

Mr. HARTSON. Well, with this reservation, Mr. Chairman, and my admission as to my view of it here is going to follow a part of your last statement, to a certain extent, and this is as far as I would go. I think that a portion of these assets were acquired by this taxpayer prior to April 6, 1917, and a portion of this $300,000, which was paid by the taxpayer after April 6, to close out the joint account was not properly amortizable; but, nevertheless, when they closed out the account, the taxpayer acquired something that he did not have before; he acquired a fee interest—let us put it that way—to property which he did not own outright before; he only owned an undivided interest in it.

I would like to use an illustration here, so that we can see a picture of it better.

A and B, two separate individuals, buy on a 50-50 agreement three separate lots. It is agreed that their interest is an undivided one, but each had a 50 per cent interest in the three lots.

The CHAIRMAN. Who takes title to the lots?

Mr. HARTSON. It might be taken in A, and yet by reason of the agreement which is in existence, each has his 50 per cent share in the interest.

The CHAIRMAN. Then, if A wanted to dispose of that property, there being no record made of the fact that he owns it, B would be in bad shape to get his half if it was not a matter of record, would he not?

Mr. HARTSON. That might be true, but, this agreement could be of record, too, which would obviate the difficulty which the Senator suggests.

The CHAIRMAN. How would the innocent purchaser, know of the existence of that agreement as applied to the individual lots, these three lots?

Mr. HARTSON. He would not know, unless, as I have suggested, this agreement was placed of record, and then, of course, he would have constructive notice of it.

The CHAIRMAN. Was this agreement between the taxpayer and the Willamette Shipbuilding Co. filed with the bureau determining these points?

Mr. HARTSON. My answer is no. I have not seen in the files here a copy of this joint account agreement between these two companies.

The CHAIRMAN. Were the books of this joint account audited and checked by the bureau?

Mr. HARTSON. There is no question in the world but what there was a complete examination in the field of the books of this taxpayer and the Willamette Iron Works. The statement is made in the auditor's report, that there were four sets of books involved in the settlement of this taxpayer's tax liability—for separate ones.

The CHAIRMAN. What were those sets of books?

Mr. HARTSON. I remember that there was one set of books called the New York books. Apparently, this taxpayer had offices in New York and negotiated its financial affairs from New York City. It kept a so-called New York set of books, but I want to add that these books were all subject to audit and inspection. There was not any charge that they were trying to keep separate sets of books from a tax evasion standpoint. But there were these four sets.

A second set would be this joint account set, which was reported as having been kept, and the third set would be their own company books. I do not know that I can identify the fourth set. It might be the set of books of the Willamette Iron Works, the adjoining company, that was interested in this joint account.

In order to close the illustration that I had in mind, after the ownership has existed in these three lots of A and B, an undivided interest, they then come to divide their interest in that account. They each have a 50 per cent interest in it, but A wants two lots, because they may be adjacent to his plant, and B wants the third lot; but the two-thirds physical split of the property bears no direct relation to the 50-50 agreement or interest in these three lots, so A, in order to get the entire interest in two whole lots, pays something greater into the joint account, than B pays in, and then they split, when this sum is placed in the joint account, on a 50-50 basis, and A takes the two lots and B takes the one lot. That, however, does not mean that the entire amount paid by A to close out that account is subject to amortization, because, he, to a certain extent, is getting something back that he had before, that he had acquired before, because he had an undivided interest in it or any of it; but he did acquire something additional, and that amount I have not figured and personally am not capable of figuring it in this transaction here.

The CHAIRMAN. At this point, let me ask whether this case is closed by agreement or by statute limitation?

Mr. HARTSON. It is not closed; and I think it is not too late to make an additional assessment, if desired.

The CHAIRMAN. In view of the position which you have taken, I think the committee would be interested if you would have your auditors go over these figures and, taking your own interpretation of it, tell us what amount of taxes would be involved.

Mr. DAVIS. On that point, Senator, I would like to ask Mr. Thomas this question: The actual amount of amortization which you say should not be allowed was the sum of $242,360.55?

Mr. THOMAS. Yes.

Mr. DAVIS. What property, in particular, does that refer to?

Mr. THOMAS. As I interpret the record, that refers only to the property that was in use by the taxpayer before the joint account was established, which was the old plant, the fabricating plant, that was used to carry on work under the joint account. That particular plant was built in 1913, and it was long before the joint account was thought of and before he went into the shipbuilding business.

The CHAIRMAN. Did he pass that particular property that was built in 1918 to the joint account?

Mr. THOMAS. As I understand it, he did. They pooled their physical properties, the Willamette people and the taxpayer; but after these properties were pooled into the joint account they did not have sufficient facilities to carry on the shipbuilding business.

The CHAIRMAN. Just a minute there. The contention of the taxpayer is that this plant that was built in 1913 was transferred to the joint account, and title passed to the joint account, and then, when the joint account was dispensed with, he bought it back again, and thereby got new title to the property, and for that reason he is entitled to amortization.

Mr. THOMAS. That is the way I understand it.

Mr. DAVIS. That is, in effect, his contention.

Mr. THOMAS. Yes, sir.

Mr. HARTSON. Of course, that is not borne out by the reported facts here of the revenue agent.

The CHAIRMAN. I did not think it was, but I thought the record showed that the old plant, built in 1913, was only used in the execution of the work and did not pass title to a joint account.

Mr. THOMAS. I think the record, Senator, shows very distinctly that when the taxpayer paid in to the joint account $300,000 he took out this original plant, the fabricating plant, and other materials that had been purchased by the joint account, which I claim ought to be amortized because they were purchased for the joint account after the beginning of the war, and on which amortization has been allowed. Amortization was allowed in the sum of $615,000. That included pre-war facilities, including the fabricating plant, and material that he had prior to the war, and the amortization on that amounted to $242,000.

Mr. HARTSON. Mr. Thomas, there certainly could not be any expenditure made by the taxpayer prior to April 6, 1917, which was a proper subject of amortization.

Mr. THOMAS. That is my contention right straight through.

Mr. HARTSON. Yes; but I understand from your statement that this sum of $600,000 had been allowed, and it represented proper amortization, it having been expended for war purposes prior to April 6?

Mr. THOMAS. No; you misunderstand me. I said the property that was amortized, included in the $600,000, was property purchased by the joint account.

The CHAIRMAN. I think we have that clearly in the record; that there was a proper division between what property was used and purchased before the war and that which was purchased afterwards, and there is no argument, as I understand it, that some amortization is necessary and desirable and legal, and there is some that can be questioned. I think the solicitor agrees to that and I think, if that is admitted, it is the province of the department to get up a statement on that and submit it to our auditors, and see whether they agree, and then the committee can take it up again. If that is the case, I do not know whether there is anything further that counsel wants to go into or not.

Mr. DAVIS. I think that is all.

The CHAIRMAN. When we adjourn to-day, we will do so subject to call. As I understand it, some of the work is not completed yet, and I hope at the time of the next meeting of the committee, you will be in a position to give us the income-tax statements of these individuals and this other information that you have been asked for, so that we may complete this case before going into another case.

Mr. HARTSON. As to the specific information that the Senator wants, other than the information with regard to the individuals, it is the Senator's desire that the bureau get together with the representatives of the investigating committee to determine what additional taxes might properly be assessed by reason of the disallowance of all or a portion of this amortization which was allowed in this case?

The CHAIRMAN. I think that is correct.

Mr. DAVIS. That is right.

The CHAIRMAN. Yes; that is my understanding. Before we close this session, I would like to say that I hope no settlement will be made by the taxpayer while this inquiry is going on.

Mr. HARTSON. I beg your pardon, Senator.

The CHAIRMAN. I said I hope you will understand that the committee desires that no settlement of this case be had while the inquiry is going on.

Mr. HARTSON. Oh, yes; the Senator can be definitely assured that there will be no settlement arranged while the hearing is in progress.

Mr. Hering has called my attention to this, Senator, that one of the very important features of this case was this fraud feature, and it will be borne in mind that the taxpayer took, in 1919, a loss by reason of the sale of capital assets in that year. Now, we have produced to the committee all of the facts that we have with regard to the fraud features of the case. If the bureau directly withdrew any charge of fraud against the taxpayer, then that sale, of course, will have to be, as was done, recognized. The reason I am mentioning this is to limit on very definite lines the subject of negotiation that our bureau will have to conduct with the representatives of the committee in determining just what additional issues are involved.

The CHAIRMAN. I understand that the witnesses yesterday endeavored to assure the committee that practically $465,000 was paid for the plant, if credit was given for a possible accumulation of the bonuses, estimated at some $200,000. In other words, the department, at least from the testimony, as I recall it, seems to

have considered the fact that $200,000 bonus accrued to the employees who purchased it, if they had continued in the original corporate entity, and that by the sale of this property at $265,000, approximately, the possible liability of the taxpayer to the extent of $200,000 was waived. Therefore, it was considered that they got a much better return for the property than the $265,000 shown on the face of it. If that is correct, I would like to have that determined in your negotiations amongst yourselves. I would like to know whether you were justified in considering that, and if you did consider that, what effect it would have upon the individual income of the employee purchasers. I think that ought to be gone into.

Mr. DAVIS. With further reference to the sale, Mr. Thomas has just handed me data which show that there was a contract between the Shipping Board and the Northwest Steel Co., dated April 12, 1920, for seven tankers, involving $16,800,000. The date of that is significant, because the sale that we are talking about in this case from the Northwest Steel Co. to these former employees was the next day, April 13, 1920. Have I that right?

Mr. THOMAS. That is correct.

Mr. PARKER. One of the sales.

Mr. DAVIS. One of the sales.

Mr. PARKER. That was the final sale, when they bought the remaining part of the plant.

The CHAIRMAN. I think it is significant that this transfer was made. That contract is worthy of most serious consideration, as it was worth a million to two million dollars in profits, and if that is so, the taxpayer was simply turning over to his employees several million dollars of possible profit, which he did not have to turn over, as a matter of fact.

Mr. THOMAS. I think I will be able to determine just what the profits were on that contract, because the Shipping Board financed the whole transaction.

The CHAIRMAN. The Shipping Board did finance it?

Mr. THOMAS. Yes.

Mr. HARTSON. Mr. Hering wants to make a statement, Mr. Chairman, in regard to these bonuses, and I would like to have him express himself here. He has whispered something in my ear that I would like to have go into the record, and to have the chairman hear.

Mr. HERING. I just wanted to point out to the chairman that the disallowance of this $200,000 as amortization increased the taxpayer's liability rather than decreased it. The chairman has the wrong idea with reference to the effect of that disallowance.

The CHAIRMAN. I do not think I have any opinion with regard to the difference between the $800,000, approximately, claimed, and the $600,000 allowed. I have no opinion as to that.

Mr. HERING. Well, there is one other little point that I want to call attention to.

The $200,000 that was disallowed was disallowed in a lump sum from the total claim, and it has been contended that the approximately $242,000 was allowed on this contested item No. 14, which was purchased from the joint account. It seems to me it would be

only fair to apportion a part of this $200,000 which was disallowed to that $242,000, and if it were apportioned, according to the costs involved, it would amount to $61,000, as I recall, and would reduce the allowance on this questionable item from $242,000 odd to about $181,000.

The CHAIRMAN. I think that is a matter that you might agree upon yourselves. You might discuss it and explain your contentions or agreements, or disagreements, to the committee at the next hearing.

Mr. DAVIS. We would also like to take up certain matters with Mr. Thomas and with Mr. Parker, and have statements compiled with reference to the check-ups on the engineers' reports, as filed here.

The CHAIRMAN. That is all right. If I remember correctly, you also stated that there was considerable, or at least some, difference of opinion as to the price which the taxpayer received for the property in relation to prices received generally for shipbuilding properties, and I understand Mr. Parker can make a statement on that.

Mr. PARKER. Yes, sir; I was very familiar with the shipbuilding business, especially in relation to the valuations at that time and subsequent times. I have not all the data with me, but it is available in the old files of the Shipping Board. Either I myself or some of the men under me were engaged in the appraisal of approximately $200,000,000 of shipyard plant and material at that time.

At the time of the giving to the taxpayer of the benefit of the doubt on these three sales, the last sale being April 12, 1920, I would say that no one then realized the very great amounts of loss of useful value there would be in shipyard facilities. A year and a half after that it became very evident; two years afterwards it became more evident, but at that particular time it was not clear that the shipyard facilities would sink to any such price as they subsequently did. In other words, in determining whether this price of $260,000 and odd was a proper price for the facilities, it was a question of a retrospective appraisal as of that date, and forgetting the things that came after that date. The price received, I believe, was about 28 cents on the dollar for a going shipyard. The records of the Shipping Board down to date show that the average received for steel shipyards—that is, down to the present time—is 20 cents on the dollar, which was below that, it is true.

The CHAIRMAN. What was the price at that time?

Mr. PARKER. At that time, very few transactions had been made. In fact, at the time the engineer, Mr. Carlson, made his statement that all the other sales on the Pacific coast were at a much lower percentage of recovery, on cost up to date, we have been unable to find that any one steel shipyard had been transferred on the Pacific coast.

Mr. HARTSON. The Skinner & Eddy plant in Seattle was closed up and sold out in the same general way.

Mr. PARKER. That was long after his report.

Mr. HARTSON. They closed their business, stripped the Duthy plant, and every one of those steel-ship plants in the Northwest closed up in 1919.

Mr. PARKER. Those were not sold.

Mr. HARTSON. No; they might not have been sold. I do not remember the exact dates.

Mr. PARKER. What we are trying to get at is the actual market value as of that date.

Mr. HARTSON. I venture the assertion that the Skinner & Eddy plant, which was larger than any of the others in the Northwest, was sold under a plan, not unlike this, to another corporation, composed of some of the junior members of the old corporation, some of the young men connected with the old corporation, not later than 1920. I think it was sold sometime in 1919.

Mr. PARKER. I should qualify my statement and say the bona fide sale. It may be that there were reorganizations. What I mean by a bona fide sale is one that is strictly, on the face of it, to different interests. There was one made on January 1, 1922. That was the case of the Southwestern Shipbuilding Co. I think that is the right name of it—to the Bethlehem Shipbuilding Co.

The CHAIRMAN. I think the deparment might introduce the evidence that the soliciton speaks about, to justify the admission by the department that that was a legitimate sale, or, rather, a legitimate price. I know of my own information that there was a shipbuilding company near Detroit, the Great Lakes Engineering Co., which sold to some of its officers a plant at a very much lower price than the plant apparently was worth, and it is still, I think, in production; so that these so-called "wash" sales are not always profitable, even though they appear as "wash" sales in the first instance.

I think Mr. Thomas might tell us at our next meeting the profits on that particular job, which they evidently had in mind or were in possession of at the time they made this transfer. I do not know that that is going to be of any particular value, but it might answer the questions of some people who will read this record, and who will reach their own conclusions from it, because other Senators will have opinions based on this report, when we get through with it, in addition to the members of this committee.

If that is all, we will adjourn here, subject to the call of the Chair.

Mr. PARKER. As to that 20 cents on the dollar, I want to qualify by saying that those were dead shipyards, and not going shipyards, as this one was. Moreover, at that time, on the plant facilities sold in detail, or regulated propositions, I know that the average of our appraisals for the year 1920 was around 39 cents. That was about the price that they were transferring property at.

Further than that, we are interested in the study of methods, and I would like to find from the Solicitor's office if, in the case of the reorganization of a company, they allow valuations to be made where transfer is made by stock or in any other manner, and whether a valuation could properly have been made in this case to protect the interests of the Government.

Mr. HARTSON. I would like to have you state that question again, Mr. Parker.

The CHAIRMAN. Let the reporter read the question.

(The reporter read the question as above recorded.)

Mr. HARTSON. That question is pretty general, and it is not easily answered.

There are certain transactions which do establish value. The solicitor's office has made an attempt to look at the elements of a sale to determine whether there really was, in law, a sale. If there is any showing that the transaction was collusive, or had a purpose purely for tax evasion, as distinguished from lawful tax avoidance, it is looked through, and no new values are set up. The bureau refuses to recognize new values based on such a transaction, but there are transactions which are apparently made for the purpose of establishing a value, which are lawful transactions, and which have the eventual effect of tax reduction. We can not prevent it; at least, we conceive our duty to be such that we can not prevent it.

The CHAIRMAN. I will ask Mr. Davis if the work you are doing on the steel corporation is known to the bureau?

Mr. DAVIS. I told Mr. Nash the other day, I believe, that that would be the next case up, and I told him something about it; so I believe they have notice that we are going into the matter.

The CHAIRMAN. I mention that because I hope that as these matters come up you will confer with the department, so as to give them as much time to prepare their side of it, if they have a side to it, as is necessary, so that the work of the committee might be expedited, and so that we will not have to wait until after you have spent weeks of study on it and then wait for the department to use an equal number of weeks of study in making their reply.

Mr. HARTSON. It is quite possible, Mr. Chairman, if I might venture a suggestion—and I do not want the remark to be taken as in any sense a criticism of the procedure that has been followed heretofore, but it is quite possible that Mr. Davis and I could, through our associates in these cases, agree on a statement of facts before the committee, to be formally submitted to it. There will be disputes that Mr. Davis and I will be unable to get together on, but it would save time, I believe, if the things that we can agree on are submitted, in some proper way, thereby relieving the committee of the necessity, through an honest mistake having been made, of listening to what later develops to be a misstatement, and it will save the time involved in correcting an error or two.

I think I can speak for the men who are associated with me in these hearings, that they will honestly attempt to take anything out of these files that is there, and cooperate with the men representing the committee in developing any situation, whether it looks bad or looks well for the bureau. There will be things, however, as I say, that honest disagreements will occur in regard to, and those should be fairly presented to the committee for its consideration.

There are things that have occurred here where there has been honestly and through inadvertence, due to the fact that your representatives are busy and have tremendous files to go through, where there has been a mistaken impression created in the minds of the committee.

If the representatives of the two, the committee and the bureau, had gotten together in advance on those things there would not have been the necessity to later on correct it and to get together on some subsequent agreement.

The CHAIRMAN. I meant to imply, in part, that very thing. If a question is raised in the minds of our investigators, and the bureau can honestly satisfy them on that question, it is then lacking in

controversy, and it is not necessary to submit it to the committee. There may be cases, however, where errors have occurred that have been of benefit to the taxpayer, and which the bureau may admit ought to be presented to the committee, so that we may know the extent of these errors, and also whether other taxpayers have been unjustly treated through those methods or not.

Mr. DAVIS. I will say as to that, Mr. Chairman and Mr. Solicitor, that in the cases we are investigating, a good many of them show the policy and the way in which things were handled, and we do not like to take it upon ourselves to pass upon certain things, because we feel that that is within the function of the committee; where we say that a certain definite thing has been done, and we feel that it should not have been done in that manner, and our investigators feel the same way about it, we think those are matters that ought to be brought before the committee.

The CHAIRMAN. Oh, certainly. That is exactly what we want.

Mr. DAVIS. I do think, however, that we can give notice to the solicitor, when we are in a position to, of the things that we are going to bring up in reference to the cases that we are bringing before the committee, and in that respect I will endeavor to cooperate all I can.

Mr. HARTSON. I can readily concede that there would be cases that you would not even want to call to our attention.

The CHAIRMAN. No.

Mr. HARTSON. That for some reason, sufficient to this committee, you want to proceed entirely in your own way in regard to.

The CHAIRMAN. That is all right.

Mr. HARTSON. That is perfectly all right. I am not even suggesting an impropriety in that, but there are statements of fact which we could agree on, I believe, in some of these cases. When you get to a case like that of the United States Steel Corporation, that is so tremendously big that it would take a Philadelphia lawyer weeks and weeks to go through it. That case, by the way, is still in process; it has never been settled, and they are still working on it in the bureau.

The CHAIRMAN. We will adjourn now, subject to call.

(Whereupon, at 11.30 o'clock a. m., the committee adjourned, subject to call.)

INVESTIGATION OF BUREAU OF INTERNAL REVENUE

TUESDAY, DECEMBER 30, 1924

UNITED STATES SENATE,
SELECT COMMITTEE TO INVESTIGATE THE
BUREAU OF INTERNAL REVENUE,
Washington, D. C.

The CHAIRMAN. You may proceed, Mr. Manson, if you are ready.

Mr. MANSON. In the Berwind-White Coal Mining Co. case, I have the following statement from Mr. Parker for the purpose of clarifying the record.

Senator ERNST. Pardon me. Who is the witness?

Mr. MANSON. This is a statement from Mr. Parker for the purpose of correcting the record.

Senator ERNST. I thought you wanted to examine a witness.

Mr. MANSON. No; I will just read this statement:

On page 481 of the transcript of proceedings (No. 8) the following question was asked me by Mr. Manson:

"I now call attention to the allowance for depreciation as stated by you on page 3 of your report. Will you state at what rate depreciation was allowed to this taxpayer for the years 1918 and 1919 on power plants?"

To this I made the following answer:

They allowed the taxpayer on steam plants a rate of depreciation of 10 per cent; on electric plants of 15 per cent; and on buildings 5 per cent.

In order to clarify this record and other remarks alluding thereto, this statement is made, as the quoted answer, while not technically incorrect, is not complete and is probably misleading.

In regard to the depreciation on that portion of the costs of the new power plant on which depreciation was allowed, the rates were set for 1918 and 1919, as 15 per cent, 10 per cent, and 5 per cent on the electric units, steam plant and buildings respectively, as originally stated.

These were the only percentages of depreciation shown. As far as the record showed, depreciation for the old plant was not segregated from the plant as a whole. Subsequent information from the field agent in Philadelphia would point to a deduction of about $34,000 per year on the old plant for 1918 and 1919, or practically 5 per cent annually.

Several remarks were made in the testimony relative to the 5, 10, and 15 per cent rates wiping the old plant off the books prior to the war. Such statements in the light of the above should be modified as follows:

If the rates of depreciation allowed on the new plant for the years 1918 and 1919 had been applied to the old plant in pre-war years,

than the cost of same would have been written off the books before the war period began.

I wish to say now that, in presenting that case, in my remarks I laid considerable stress upon the point that if those rates of depreciation had been applied to the old plant, or rather, I stated that if the amount of depreciation which had been allowed during the war period had been charged off during the pre-war period, the old plants would have been wiped off. In the light of this correction, that statement in my remarks is not correct.

In the Northwest Steel Co. case I have the following report from Mr. Thomas, one of our engineers. This report is dated December 20, 1924, and reads:

Memorandum to Mr. L. H. Parker.

Subject: Income-tax returns of officers and employees of the Northwest Bridge & Iron Co. in connection with the bonuses paid by the Northwest Steel Co.

Pursuant to your direction, I have examined the income-tax returns of the following for the years 1916, 1917, 1918, 1919, 1920, and 1921: Northwest Steel Co., Portland, Oreg.; Northwest Bridge & Iron Co., Portland, Oreg.; Willamette Iron Works, Portland, Oreg.; J. R. Bowles, president Northwest Steel Co.; C. D. Bowles, second vice president Northwest Steel Co.; N. B. Beebe, secretary and treasurer Northwest Steel Co.; W. R. Bowles, employee, Northwest Steel Co., and officer of the Northwest Bridge & Iron Co.; W. H. Cullers, employee, Northwest Steel Co., and officer of the Northwest Bridge & Iron Co; N. C. Bowles; L. R. Banks.

This investigation was made for the purpose of checking up the report of the Income Tax Unit's engineer, Mr. Harry W. Carlson, who stated in his report on the amortization claim of the Northwest Steel Co., that certain bonuses had been paid to Messrs. Cullers and Banks during the years 1917 and 1918, aggregating $176,709.52; further, that there had accrued to the credit of Messrs. Cullers and Banks, certain other bonuses as of March 20, 1919, in the sum of $32,621.04; further that these two gentlemen had anticipated bonuses amounting to some $200,000.

From the records placed at my disposal, it was impossible to check these statement of Mr. Carlson, as for instance, in the tax return of Mr. Cullers, for the years 1917 and 1918, there are no bonuses returned, as such, and in 1917, according to these returns, Mr. Cullers's taxable income was only $5,843, while in 1918 his total taxable income was $42,029.02, which, if allocated for bonuses, would leave a difference of over $50,000 between the amounts reported and the amounts set forth in Mr. Carlson's report.

If you decide that this information is of sufficient importance to warrant further investigation, I would recommend that one of the Income Tax Unit's field auditors be sent to Portland to make a complete audit of the necessary books of both the Northwest Steel Co. and the Northwest Bridge & Iron Works. In this connection, I have been advised by Mr. Leary, head of consolidated returns section, that there would most likely be a man available in the Portland office or the Seattle office of the Internal Revenue Department, and that the expense incident to such an audit would not exceed $100 at most.

Attached hereto is tabulated summary of the returns examined by the writer, together with a pencil memorandum showing the income tax returns which could not be located by the unit.

Respectfully submitted.

RALEIGH C. THOMAS,
Investigating Engineer.

This report is O. K'd by Mr. Parker, who concurs in the recommendation of Mr. Thomas, that the Income Tax Unit make the necessary audit.

The CHAIRMAN. In that connection, let me say that I understood that the unit was going to make that investigation and report back to us. Is my understanding correct about that?

Mr. HARTSON. What happened, Mr. Chairman, is this: that Mr. Thomas has worked in connection with Mr. Leary, of the Income Tax Unit, and these figures, I think, are agreed on between them. I think they both have the impression that no accurate statement can be made to the committee as to how these bonuses were reported, if reported, without a check of the company's books. The bureau, if the committee desires it, will be very glad to put a field man on the work to make a check of the books in Portland, or wherever they are.

The CHAIRMAN. When the Northwest Bridge & Iron Co. bought out the Northwest Steel Co., it was bought out by two foremen and a nephew of one of the officers, as I understood it. The question was raised as to how they got the money to pay for this purchase, and the statement was made that it was due mostly to large credits due employees for bonuses on the previous output of the Northwest Steel Co. Then it was asked whether these bonuses, which ran up into the hundreds of thousands of dollars, were reported by the individuals as income. Is that correct?

Mr. HARTSON. That is right.

The CHAIRMAN. It is quite evident that they were not, and in view of the small amounts reported by the purchasers, I ask if the bureau does not think, outside of what the committee may think, it is justified in making inquiry as to whether those bonuses were reported as income.

Mr. HARTSON. I have had some talk, Mr. Chairman, with Mr. Leary about this matter, and there seems to be in Mr. Leary's mind this idea, that the Northwest Steel Co. carried on its books certain bonuses, which, on the face of the books, would indicate that the steel company was paying a bonus to these three individuals that the chairman has named. Mr. Leary says that according to the reports of the agents from the records, his impression is that there were bonuses carried on the books of the Northwest Steel Co., which were, in fact, not obligations of the steel company to these individuals, but were obligations of some other parties, some third parties, disassociated entirely from the Northwest Steel Co., to these individuals.

The CHAIRMAN. I did not get that point. How could a third party, disassociated from the steel company, have an account on the steel company's books?

Mr. HARTSON. The steel company collected money for these individuals and carried it on their books as if the steel company were liable for it. Now, there is not enough information tending to settle this question definitely, and I think the recommendation of your representatives would bear out that statement, that it is necessary to get some additional information. If it were available here we would, of course, be glad to produce it.

The CHAIRMAN. In any event, even though this money had been collected by the Northwest Steel Co. and placed to the credit of these individuals, it being so much per ton, as I understand it, for output, it would still be an income of the individual, would it not?

Mr. HARTSON. It would still be an income of the individual, yes.

The CHAIRMAN. And does not the bureau think it is justified in view of the facts which were disclosed, in investigating to see why this was not reported by the individuals?

Mr. HARTSON. I think it ought to, yes.

Senator WATSON. Of course, that ought to be shown. It is a strange thing that the steel company should act as a sort of collection agency for employees.

Mr. MANSON. I do not think this detailed statement here covering their investigations is material to the record, but if the committee has any curiosity as to the real, substantial effort that has been made by both Mr. Leary and Mr. Thomas to run this thing down, I submit this memorandum of their examination of these returns. They have exhausted every means of information that there is in the bureau in their mutual effort to get at these facts, but I do not think it is necessary to encumber the record with this large sheet.

The CHAIRMAN. If agreeable to Senator Watson, we will ask the bureau to go ahead and check that up, to find out what became of those bonuses.

Senator WATSON. Surely; that is all right.

The CHAIRMAN. Or to find out whether the bonuses ever existed.

Mr. HARTSON. Yes.

The CHAIRMAN. It is quite evident that the bonuses were deducted from the income of the steel company, in all probability, or has that been checked up? Do you know whether that has been checked up, whether these bonuses that were carried as a liability were deducted from the earnings of the company?

Mr. HARTSON. My recollection is that they were not deducted, and that was one of the reasons, if this was borne out in Mr. Leary's mind, that were at least strong enough to cause him to believe it to be true, that the company had certain accounts under the name of bonuses on their books, which really were not their own obligations.

The CHAIRMAN. I think it should be checked up.

Senator WATSON. Well, it is easy enough to find it out, I suppose.