[CONFIDENTIAL]

REVENUE ACT, 1936

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTY-FOURTH CONGRESS

SECOND SESSION

ON

H. R. 12395

AN ACT TO PROVIDE REVENUE, EQUALIZE TAXATION AND FOR OTHER PURPOSES

PART 11

MAY 28 AND 29, 1936

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REVENUE ACT, 1936

THURSDAY, MAY 28, 1936

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

The committee met in executive session pursuant to adjournment, at 10:30 a. m., in the committee room, Senate Office Building, William H. King presiding.

Present: Senators King (acting chairman), George, Walsh, Barkley, Connally, Bailey, Clark, Byrd, Lonergan, Black, Gerry, Guffey, Couzens, Keyes, La Follette, Metcalf, Hastings, and Capper.

Also present: L. H. Parker, Chief of Staff, Joint Committee on Internal Revenue Taxation, and members of his staff; C. F. Stam, Counsel, Joint Committee on Internal Revenue Taxation; Middleton Beaman, Legislative Counsel, House of Representatives; John O'Brien, Assistant Legislative Counsel, House of Representatives; Arthur H. Kent, Acting Chief Counsel, Bureau of Internal Revenue; C. E. Turney, Assistant General Counsel for the Treasury Department; L. H. Seltzer, Assistant Director of Research and Statistics, Treasury Department.

Senator KING. The committee will be in order.

Mr. Parker, have you any new procedural matters to bring before the committee?

Mr. PARKER. I have nothing more this morning, Senator.

Senator KING. Have any of the Treasury experts anything more to bring before the committee?

Mr. PARKER. I will say that we are working on the liquidation matter, but it is not absolutely necessary to take it up now. It is not complete.

Senator GEORGE. I have one matter here. I made a suggestion, and if the committee approves it in principle, it can be put in form, and I want to make this statement regarding it. It deals with these claims for refunds, stock tax refunds, and processing and windfall taxes. It deals only with those peculiar and particular taxes.

The proposed amendment is as follows:

TITLE III

SEC. —. Any person who is liable for the tax imposed by this title and who has filed any claim or claims for refund of any amount paid or collected as tax under the Agricultural Adjustment Act, as amended, may apply to the Commissioner of Internal Revenue for an adjustment of such liability for tax in conjunction with such claims for refund, and thereafter, the Commissioner, for such purpose, may, in his discretion, consider such liability and such claims as one case and, in his discretion, may enter into a written agreement with such person for the payment of the net amount of such liability, or of such refund, as the case may be. Such agreement shall be a final settlement of the liability for tax and the claims for refund covered by such agreement, except in case of fraud, malfeasance, or

misrepresentation of a material fact. In the absence of fraud or mistake in mathematical calculation, any action taken or any consideration given by the Commissioner pursuant to this section shall not be subject to review by any court, or any administrative, or accounting officer, employee, or agent of the United States.

Frankly, this is intended to place in the Commissioner or in the Treasury a rather wide discretion to make adjustments to those who collect refunds and to those against whom the windfall tax is asserted. It is not unacceptable from the Treasury Department, in fact I may say frankly that it is looked on with favor.

The situation is this and we might as well face it. You have got two questions on which the Supreme Court will probably hold against the Government; first, that a windfall tax, whatever we may say about it, is not income; it is not income at all.

Manifestly, if I have simply impounded my own money in the courts and awaited a decision of the court and get back my own money, if income at all, it was income before I impounded it. The mere fact of impounding it and getting it back can not constitute that kind of credit and income. I am just taking a common-sense view of it.

But if it is income, then you have a far more difficult problem of saying whether or not the courts would not hold that what we are doing here is a penalty rather than the imposing of a tax.

Those are the two vital points on which a decision of the courts are bound to fall and on which there may be established against the Government a liability of eight or nine hundreds of million dollars.

Senator COUZENS. May I ask if we can take the power away by legislative act of a man to go to court?

Senator GEORGE. No; we cannot, Senator.

Senator COUZENS. Then why do you put that language in?

Senator GEORGE. If they make an adjustment, we can do that.

Senator COUZENS. But if the taxpayer does not consent?

Senator GEORGE. Then he does not make it. It is purely a voluntary arrangement.

Senator COUZENS. Then why do you have to put in that inhibition about going to court? If he does not agree, he does there anyway.

Senator GEORGE. Yes, but if he does reach an agreement, it is a finality.

Senator COUZENS. If he does reach an agreement, he would not want to go to court, would he?

Mr. KENT. That is similar to the present closing agreements on which this is modelled.

Senator COUZENS. I do not get the purpose of it.

Mr. KENT. It is to make it clear that the agreement if entered into by the Commissioner and the taxpayer is final and conclusive except in the case of fraud.

Senator COUZENS. Why should he want to go to court if he entered into an agreement not to go to court? As a matter of fact, if he does not settle, he can go to court. I do not get the purpose of putting it in.

Senator LA FOLLETTE. That is one of the conditions precedent on which you arrive at a settlement. In other words, one of the advantages of this, as I understand it, is to attempt to avoid litigation.

Senator COUZENS. I understand that. But if a man entered into a conclusive agreement, of course he is not going to court.

Senator LA FOLLETTE. Well, I don't know. I think it ought to be final.

Senator COUZENS. He is not going back on his word after entering into a contract of settlement?

Senator LA FOLLETTE. I do not know.

Senator GERRY. Does that apply only to windfall taxes?

Senator GEORGE. Only to taxes that were levied in this bill by virtue of the fact that they were part of the Agricultural Adjustment program. It applies to any claim made for a refund by a taxpayer or any case in which the Government is of course asserting a right to collect the so-called windfall tax, and it applies only to those cases.

I wanted to make this statement. The industry, taken by and large, would like to close this whole controversy as far as possible, because even if there were heretofore received or recovered large sums of money, it would break up their general business adjustments, and their customers would be dissatisfied unless it would be passed on to them, et cetera, and very frankly I had in mind one of the particular classes of people or processors when I made this suggestion. This would enable the Commissioner to prevent the bankruptcy or the enforced bankruptcy of certain of the processing taxpayers who otherwise probably face it immediately, whatever might be the final determination or result, and I think that is particularly applicable to the small packers.

I understand that we would not want to give such a wide discretion ordinarily in taxes or the power to make these adjustments with respect to these particularly troublesome taxes, but it seems to me a wise provision and one that I think ought to result in the long run in a great deal of satisfaction to business and a great deal of profit to the Treasury, not in saving them money now, but in certainly foreclosing and ending much litigation that they can end.

Senator KING. You find a precedent, Senator, in the British tax system where those decentralized authorities in all parts of Great Britain have the authority to settle many claims and controversies.

Senator COUZENS. I quite agree with the principle of this amendment. I did not want to imply that I did not.

Senator GEORGE. I understand your view about it.

Senator KING. Is it your view and is it the view of the Treasury Department that the Treasury, by and large, will not sustain losses as a result of this?

Mr. KENT. They will not sustain losses on account of this.

Senator GERRY. I would like to ask one question about the processing tax. If you want to take a vote on this, I will withhold it.

Senator GEORGE. Yes, I would like a vote. This may not be in final form.

Senator BLACK. I am for it. I think it is excellent, but I want to call attention to the fact a number of us still think if it is possible for us to do so that we should get this amendment in the A. A. A. in this bill before it is finally passed by the Senate, so that it will include all of the law.

Senator GEORGE. You mean section 21 (d)?

Senator BLACK. Yes.

Senator GEORGE. I have no objection to that; in fact, I think if it is going to pass this Congress, this is the surest way to get it through.

Senator BLACK. If it does not, it leaves the processors without a right of recovery which the others have.

Mr. KENT. The bill which included the substitute of 21 (d) has been reported by the House Ways and Means Committee, and I was informed—I have not been in touch with it the last day or two—that the committee was planning to obtain a rule for its very speedy consideration.

Senator BARKLEY. If that bill is satisfactory, it seems to me that it is better to offer it as an amendment to this bill, either here or on the floor, as a committee amendment. As it is worked out, is it satisfactory?

Mr. KENT. Yes, it was reported unanimously for passage by the House Ways and Means Committee.

Senator LA FOLLETTE. Does it meet the approval of all three departments, the Treasury, the Department of Justice, and the Department of Agriculture?

Mr. KENT. It does.

Senator BARKLEY. It would certainly save time to incorporate it in this bill rather than to have to pass another bill.

Senator LA FOLLETTE. We might await its passage by the House and offer it as an amendment on the floor.

Senator KING. I think that would be the better way.

Mr. KENT. I think I have among my papers, one or two copies of the bill. I will be glad to get hold of some copies if any of the Senators would like to familiarize themselves with it.

Senator BARKLEY. I would like to get a copy of it. You do not have to do it right now.

Senator KING. Are you ready to vote on the amendment offered by Senator George? It will be referred to the drafting committee, of course.

Senator LA FOLLETTE. Senator Couzens has just suggested that it might save some discussion on the floor if it were adopted in this committee. The only thing I had in mind was that it might possibly be amended by the House. If it is taken up under the closed rule, however, that would not be true.

Senator COUZENS. If it were in somewhat different form, would we not have an opportunity to adjust it in conference for the difference in wording?

Senator BARKLEY. It will be better to put it on in the committee, because it will bring about less discussion on the floor, and then the House bill having nothing on the subject and we putting it in, the whole thing is open to conference.

Senator KING. Is it the view of the committee that the provision referred to in the House bill should be inserted?

Senator BARKLEY. I move that subject to correction or any change in language, that the bill as it reads in the House be offered an as amendment here.

Senator KING. We will vote on Senator George's amendment first. Those favoring the amendment offered by Senator George will say aye; contrary nay.

(The amendment was agreed to.)

Senator BARKLEY. I move that the bill subject to any technical changes, which has been reported in the House with respect to 21 (d) be incorporated as a committee amendment to this bill.

Senator KING. Those in favor of the motion just made will say aye; contrary nay.

(The motion was agreed to.)

Mr. KENT. May I say, however, that this bill shows two titles. The first title is the refunds of amounts collected under the A. A. A., and the second title contains miscellaneous amendments to the revenue act.

Senator BARKLEY. We are only dealing with 21 (d) here.

Senator LA FOLLETTE. What are the nature of those others?

Mr. KENT. They are certain amendments in which the Bureau and the Treasury are very much interested. Most of them are amendments seeking to avoid the needless payment of interest to which the Government is subjected under the present law. There is one amendment to correct a very unfortunate interpretation of a provision in the estate-tax law that threatens us with the loss of about twenty millions in revenue if it is not taken care of very promptly.

Senator BARKLEY. I see no objection to putting that whole thing in as an amendment.

Senator GERRY. I would like to hear what that is before we do that.

Senator BARKLEY. Subject to any changes.

Senator GERRY. I have not seen that, and I would like to see it before that goes in. I would like to look into that estate-tax matter, Mr. Chairman, before that goes in.

Senator KING. I am advised that neither Mr. Beaman nor Mr. Parker know anything about this.

Mr. KENT. I think this bill on the drafting angle was handled by Mr. Rice.

Senator COUZENS. Will you explain to us what that amendment to the estate tax is?

Senator GEORGE. It is a rather long bill. I thought it was the part in relation to section 21 (d) that Senator Barkley wanted.

Senator KING. Is it a comprehensive matter dealing with a number of subjects?

Mr. KENT. There are about eight or ten other amendments.

Senator COUZENS. Let us put in the proposal what Senator Barkley wants as to title I, and let the other go until we can look into it.

Senator GERRY. I know nothing about this at all.

Senator KING. Just explain the amendment offered by Senator Barkley.

Senator COUZENS. That has nothing to do with estate taxes, and I think Senator Gerry understands the other part.

Senator GERRY. The thing I objected to was bringing up an estate tax matter which I had not seen, and which I knew nothing about. Those are very complicated things, and I would like to see what is in the bill.

Senator KING. Have you any objection to the motion made by Senator Barkley?

Senator GERRY. That relates purely to the agricultural part?

Mr. KENT. Yes. It is a substitute for the 21 (d) of the Agricultural Adjustment Act.

Senator GERRY. That is the processing tax?

Mr. KENT. It deals with the refund of amounts collected under the A. A. A.

Senator GERRY. I have no obbjection to that part of it. The only thing I had in mind was when he brought up the estate tax that I

know nothing about. I may be for it or against it; I don't know anything about it.

Senator BARKLEY. He called attention to the fact that the House bill contained other amendments. I suppose the committee would like to know what those other amendments are before embodying them as a whole. I understand they are mere technical departmental suggestions, and if there is any objection to their going in now, we can let it go over until the members have a chance to look into it.

Mr. PARKER. I have read them, and I think the committee should have read them and considered them before they go in. They are somewhat administrative, it is true, but there are points of policy involved which I think the committee undoubtedly ought to pass on.

Senator GERRY. I think Senator Barkley probably should withhold that motion until we can go into it a little more fully.

Senator BARKLEY. Then we will rescind what we have done until we can look into title II. I do not think anybody will object to title I.

Senator GEORGE. If you are sure that the bill is coming out in the House and will be passed in both Houses, otherwise we could just attach that simplified section 21 (d) pursuant to the bill to make certain that they go through.

Senator KING. In the meantime, Mr. Kent and our experts here will consider it.

Senator BLACK. At our next meeting we can probably take that up.

Senator KING. What is in section 21 (d)? There seems to be some misunderstanding.

Mr. BEAMAN. Do I understand that the wishes of the committee are that that part of the House bill 21 (d) goes into your bill and the rest, nothing has been done about it?

Senator KING. That is correct.

Mr. BEAMAN. The 21 (d) part goes in the bill without further action. Does it go in the bill, or is it an amendment on the floor?

Senator KING. I do not understand you.

Mr. BEAMAN. Is it to go in the bill as you report it, or as an amendment on the floor?

Senator KING. In the bill. That is the understanding.

Mr. BEAMAN. And just take it without looking at it?

Senator LA FOLLETTE. I think it would be very desirable to have Mr. Beaman, Mr. Parker, and Mr. Kent go over title II of that bill.

Mr. BEAMAN. When would you suggest we do it, Senator?

Senator LA FOLLETTE. I assume that this bill is not going to pass in the next 24 hours.

Senator GERRY. Mr. Chairman, if we are going into title II, I have some estate-tax matters that I let go until next January that I would have to take up too, where there are great injustices.

Senator LA FOLLETTE. My point is that there may be amendments in this title II which are very desirable, which everybody will agree to, and I do not see any reason for throwing them all out just because——

Senator GERRY (interposing). If we are going to have a study of it, frankly I would like to look into it first, because I waived my rights on some very desirable things going into this bill.

Senator KING. The matter has been referred to the experts to consider and they will report it back to us for our consideration. I

have in mind the suggestion made by Mr. Kent that we lose 20 millions unless a certain amendment which he has in mind is adopted, and certainly that ought to be brought to our attention in a concrete way. I think at the next meeting it will be ready to report, Mr. Kent.

Is there anything further?

Senator GERRY. There is one question I would like to ask, Mr. Chairman. I introduced an amendment here for Senator Van Ness. The Treasury officials said that they would like to look it up and see if it was covered by Senator George's amendment that he offered——

Senator GEORGE (interposing). No; Senator Barkley and Senator Black.

Senator GERRY. You told me you thought it was covered.

Senator GEORGE. I think it is, but I do not know positively.

Senator KING. Mr. Kent, I handed you an amendment yesterday relating to an amendment that I think Senator Walsh is interested in. Are you ready to report on that?

Mr. KENT. On this matter that Senator Gerry refers to, if the exporters referred to here are not the processors who paid the tax, they are amply covered by the provisions of the present section 601. If they are themselves the processors who paid the processing tax, their cases are covered by title I of this other bill.

Senator GEORGE. I should think they would fall in this classification, because, recollecting Senator Van Ness' amendment, he referred to them as packers who shipped abroad, and they must undoubtedly be the processors.

Senator LA FOLLETTE. Then they will be taken care of in title I of this House bill which has just been voted to be incorporated in this bill?

Mr. KENT. Under section 601 as it stands, the bill dispenses with any proof of payment of the processing tax into export drawbacks. With that provision in the bill, which is very desirable from the point of view of administration, it would be very unsafe to bring processors in under section 601, because if a processor never paid any processing tax, there is no reason apparent why he should get an export drawback on it, and many of the processors never paid processing taxes on their exports. That was particularly true in the case of cotton, where the law itself provided for a rather liberal extension of time for the payment of the processing tax. They filed bonds in such cases to secure the Government its tax in the event that the cotton processed was not exported, but was diverted into the domestic commerce. If they paid the tax and then exported the goods, they will have no difficulty in establishing their claims for refund under title I, of this other bill, and it would complicate section 601 very considerably, I believe, to attempt to bring them in.

Senator GERRY. How does 601 cover that?

Mr. KENT. Section 601 covers the export drawbacks, and the drawbacks on deliveries to charitable and public institutions where the exportation or the delivery was made by the person who was not a processor who paid the tax. It covers all other cases.

Senator GERRY. In this case they are looked after if they are the processors who paid the tax?

Mr. KENT. They will be taken care of.

Senator GERRY. I think that probably answers my question. I will speak to Senator Van Nuys about it.

Senator KING. That matter that Senator Walsh was interested in; are you ready to report on that, Mr. Kent?

Senator COUZENS. Before you go into that, may we take this up? During the discussion we had with respect to the options, those given to the floor taxpayers, of either getting back the August 1, 1932, tax they paid or taking the inventory of January 6, 1936, as I recall it, the draftsmen from the Treasury were to work up some sort of a proposal which would protect the Treasury and the taxpayer from an inordinate amount of work in computing his refund as of January 6, 1936. I have not heard anything about it yet today. I now have a letter which was addressed to Mr. Kent yesterday by these people with reference to the matter, and I do not know now what conclusions the Treasury and the experts reached with respect to the matter.

Mr. KENT. Do you wish a statement on that?

Senator BARKLEY. There is nothing that has been submitted to me as the chairman of the subcommittee on it. The matter is still under consideration, so I do not suppose that anything has been worked out. Mr. Kent can tell more about what the Treasury's attitude is toward it than I can. There has been no suggestion made to the subcommittee so far about it.

Mr. KENT. We are up against this difficulty there, Senator. If the option to pay back the tax collected in 1933 is limited to cases in which a right to a refund under section 602 is established, there really does not seem to be very much practical utility in it, because when they have established their right to a refund under section 602, the refund would automatically be made. If it is the desire of the committee as a matter of policy simply to provide for refund of the floor stock taxes collected in 1933, that of course could be done very expeditiously, but it would cost the Government a good many dollars more.

Senator BARKLEY. We discussed that in detail and decided not to recommend that for the very reason which was explained. What a lot of these people want is to collect back the tax they paid regardless of what happened. They want to collect it back even though they passed it back to the public, and that is why they are demanding the other provision to actually return what they paid in 1933, although they might not now be in business and might not come under section 602 as it is written, and although every dollar of it was passed on, they want it back. That is what they are asking for.

Senator LA FOLLETTE. Is there not also, aside from the Government's interest in this situation, a diversity of interest between various people who paid the floor stock taxes? It is one of those cases where it is very difficult to work it out so that it suits everybody. One group, as I understand it, feel that they would be very greatly penalized if you just went back to 1933, and the other group feel it would be to their advantage. That is the way I have it in mind.

Senator BARKLEY. That is true. Especially the concerns that were not in business in 1933 and who paid no tax and would get no refund under that, but who would be entitled to a refund because they had to reduce the price of their floor stock as a result of the court's decision. They would be deprived of any refund at all. We talked about trying to work out some sort of an option where the concern existed in 1933 and paid the tax and has been a going concern ever since and would be entitled under section 602 to a refund as of January 6, 1936, but even

that offered difficulties because in that case the merchant would take off whichever were the larger amount, and if he paid more tax than he would be entitled to as a refund, although the tax was passed on to the consumer, he would take that because it is a bigger amount. It is an impossibility only to work it out so as not to work hardship on somebody by offering this option. That is the difficulty the Treasury is up against.

Senator COUZENS. Here is a letter they wrote you yesterday. I understand—I assume you have read the letter?

Mr. KENT. Yes, I have.

Senator COUZENS. And it is your conclusion that there is no form of amendment that can be made to take care of these situations?

Mr. KENT. Yes. And I am so advised also by the gentleman in the Bureau in whose domain this probably falls, and who would be charged with administration of any such provision if it were adopted.

Senator LA FOLLETTE. To illustrate the point I have in mind, it is my recollection if it serves me correctly, that one representative of some trade association, in order to take care of the situation of all of his members, wrote a letter recommending that both things be done. In one place he came out for one thing and in another place he came out for another. I suppose that was so that he could say to everybody that he took care of them.

Senator BARKLEY. What they want—what he is lobbying around here for—is to get the tax they paid in 1933, regardless.

Senator GEORGE. Mr. Kent, of course you realize the difficulty in which a retailer finds himself?

Mr. KENT. Yes.

Senator GEORGE. He could hardly claim any. There would be exceptional cases, of course; but it would be very difficult for the average retailer to establish any claim for refund.

Mr. KENT. I think his problem will probably be simpler with respect to the 1933 tax than with respect to the 1936 tax, because I think that he will be able to show in many cases that they did not mark up the prices of their retail stock after the original floor stock tax was put on.

We have tried in section 602 to simplify the requirements of proof as much as possible, and we have authorized the Commissioner to act upon the basis of affidavits filed by the claimant where the Commissioner deems that it is proper to do so.

Senator GEORGE. I was just pointing out their fear.

Mr. KENT. It is a very, very difficult situation. I have talked to representatives of a number of different groups, and almost every one of them tells different stories so it is hard to arrive at any sure conclusion as to what the facts are.

Senator KING. Then the Treasury, as I understand it, does not care to make any further suggestions in regard to this matter. Senator Barkley, is that your view?

Senator BARKLEY. I could not say they do not care to. I would say that they have found it impossible to work it out.

Senator KING. Senator Couzens, have you anything further to say in the matter?

Senator COUZENS. The only thing that I think you are overlooking is the difficulties of computing the taxes as of January 6, 1936, as distinguished between the tax actually paid in 1933. However, if

the Treasury Department does not believe it can be worked out, while I do not agree with them, nevertheless I do not see how I can put it over in opposition to their objection.

Mr. KENT. I may say this also, they will have until January 1 to file their claims, and it is more or less a new situation that we are dealing with. After we have had a little experience with it ourselves, Senator, and can see how it works, we may find that it will be necessary to recommend some other procedure.

Senator COUZENS. All I want to see is that justice is done to these hundreds of thousands of little retailers.

Senator KING. Then we will leave the matter in status quo.

Now, are you ready to report on that trust matter?

Mr. KENT. I have an amendment here, Senator King, that has been submitted, which we add to section 801 (a), a new subsection, reading as follows:

The term "mutual investment corporation" means any corporation engaged exclusively in investing and reinvesting in stocks or securities, all of whose gross income is from dividends, interest on securities, or gains from sales of stocks or securities, provided that it shall apply only to corporations each stockholder of which upon reasonable notice and under reasonable conditions is entitled to withdraw his share of the corporate property or its equivalent in cash, and provided that it shall not apply to any corporation which owns more than 10 per centum of any class of stock or any issue of securities of any other corporation, or to any corporation of whose stock more than 10 per centum of the equitable interest is owned by any one individual, and for those purposes an individual shall be considered as owning stock owned directly or indirectly by his brothers, sisters, spouse, ancestors and lineal descendants, and shall be considered as owning his proportionate share in stock owned by a corporation by a corporation in which he is a stockholder, a partnership of which he is a member, or a trust or estate of which he is a beneficiary.

To section 23, add the following subsection:

(r) Mutual investment corporations. At the option of a mutual investment corporation as defined in section 801, in lieu of the deduction allowed to corporations by subsection (p) of this section—

subsection (p) is the one that allows them to deduct 90 percent of their dividends—

the amount of the prorated dividends paid during the taxable year.

My own present attitude with regard to this amendment is this, that if as a matter of policy it is deemed wise to give any special treatment to this group of mutual investment operations, which would include the investment trust to which I referred yesterday, this amendment probably represents the right angle of approach. There are reasons why it would be rather dangerous without considerable revision in the trust provisions of the statute to classify these institutions as strict trusts rather than as corporations.

Senator WALSH. One outstanding distinction is that anyone who holds stock in the trust can present his stock and receive cash as if he had a savings bank book, at once?

Mr. KENT. Yes.

Senator WALSH. They are peculiar in that respect that they obligate themselves to pay out in cash instantly the amount of the investment at any time.

Mr. KENT. This amendment does contain certain safeguards. I am not prepared, however, to say that it contains every safeguard, Senator, that it ought to contain.

Senator WALSH. It should have all the safeguards.

Mr. KENT. It does contain the safeguard that the trust or the corporation cannot be made the personal instrument of any one individual, because if an attempt to do that is made, it would be excluded by this 10-percent ownership provision.

Senator WALSH. It must pay out all the money it receives from its investments.

Mr. KENT. That is right.

Senator Walsh. And it must hold itself open to pay in cash the same as a savings bank, the amount of the investment at all times.

Mr. KENT. There is another safeguard that the amendment contains, and that is to prevent an investment trust or investment corporation being set up to obtain the control of some corporation and to manipulate its affairs.

Senator WALSH. It would have a right, if it were not for this provision which we propose, to withhold all of the money that it receives from stock dividends?

Mr. KENT. Yes.

Senator WALSH. And reinvest it as it sees fit?

Mr. KENT. That is right.

Senator WALSH. But under this provision, it will obligate itself to distribute them?

Mr. KENT. That is right.

Senator WALSH. So that it will distribute everything. It is only one step removed from a voluntary trust that we incorporated an amendment to the other day.

Mr. KENT. Yes.

Senator WALSH. Mr. Chairman, there are five of these, about, in the country. They are very popular and growing in popularity. There are 70,000 in one investment trust in my State, and the average investment is $3,000. The amount of interest that they pay is only 2.5 percent on the average. It has become a very successful and very popular investment for the average man and woman, and they have expanded considerably in recent years.

Mr. KENT. Such corporations could not afford to retain any of the dividends that they receive under this amendment for the reason that they take up 100 percent of such dividends in their income, and if they did retain any of the dividends, they would be paying the full corporate rate as well as the undistributed profits rate on 100 percent of their dividends.

I would feel, however, Senator, that if this amendment should be acted upon favorably, we should be given the opportunity to continue working on the draft and to submit any further safeguarding provisions that might be deemed desirable.

Senator WALSH. I desire that you do that, because I do not care to offer it until every safeguard is embodied in the amendment.

Senator COUZENS. May I point out, Mr. Chairman, that if this proposal is adopted, it is my judgment that many of these other investment trusts will immediately rush to get under this section and abandon the old form of investment trust that they now have, and you will find a rush of those to get under this section.

Senator WALSH. Of course, these investment trusts now reinvest from their capital gains and from their dividends received and only distribute as they see fit. This kind of a trust is a mutual in that it

distributes every dollar that it receives and is compelled to distribute every dollar it receives in order to have the benefit of this statute.

Senator KING. I would not feel like voting for this, Senator, without further study.

Senator COUZENS. I think it ought to go over this session.

Senator WALSH. I want to ask this question. What is the Treasury's view upon what effect it will have upon the Treasury income?

Mr. KENT. I do not believe it would have a detrimental effect, because the entire income of the corporation would either be distributed and would be taken up in the individual returns of the shareholders, or if it were not, to the extent that it was not distributed, the Government would collect more tax than it would otherwise, because of 100 percent of its dividends being taken up into its income base.

Senator WALSH. I would like the record to show also that under the House bill they are exempted.

Mr. KENT. Under the House bill they were automatically taken care of, because if they distributed all of their earnings in dividends they did not pay any tax.

Senator WALSH. And if the latest proposal of the committee is adopted, the 18 and the 7, they lose the benefits of the House bill?

Mr. KENT. That is right.

Senator BLACK. Mr. Kent, from your statement I do not get what special privilege it is that they get, the special privilege which you stated they get.

Mr. KENT. They get this special privilege, if one may call it that, Senator Black, that if they make full distribution, they pay no tax as a corporation; in other words, it is really an application to this particular group of enterprises, as I see it, of the principle of the House bill. The justification which is urged in support of that is simply this, that these corporations and these trusts and the trusts so far as they are classified under the statute as corporations, and so far as they satisfy other conditions, this amendment says would obtain the benefit of it, are formed for the purpose of enabling persons to invest their income in such a way as to get the benefit of diversification of risk. They invest in a more or less varied and extensive list of securities. In many cases the list of securities which they can invest in is set forth in the trust investment itself. That is true of the so-called fixed type of trust, whereas the individual with $1,000 or $2,000 to invest finds it difficult to diversify the risk through direct investment. By buying the shares or the beneficial certificates of one of these organizations, he does get the benefit of the diversification of investment.

Senator BLACK. The special privilege that you mention and the only one that you have mentioned or had in mind is that that if this little group instead of plowing back what you call their earnings into the trust fund, pay out every dime in dividends, then they do not pay any trust tax similar to a corporation tax.

Mr. KENT. That is right.

Senator COUZENS. In other words, they get a much more preferential treatment than a bank does, because a bank pays a flat tax like any other corporation pays.

Mr. KENT. Yes, sir.

Senator KING. Are there any other matters to be brought before the committee?

Senator WALSH. You agree they should at least be given the same benefit as a bank if they distribute all of their earnings?

Senator COUZENS. Absolutely. I do agree with that, but I do not agree to take away the corporation tax.

Senator KING. Did you have anything, Mr. Beaman?

Mr. BEAMAN. We would like to have you give us authority to work out and put in the bill the effect upon the earnings and profits of a corporation of a distribution of stock in securities either in connection with a reorganization in which, in many cases, such distributions are tax-free or tax postponed, and also in the case of stock dividends, the effect of which under the present law nobody knows exactly what it is.

Obviously, if the distribution is tax exempt, it should not be considered a distribution of earnings and profits of the corporation, therefore we want to write that into the law that the distribution by a corporation of its stock or securities or the stock and securities of another corporation shall not be considered a distribution of earnings and profits in the first place if no gain was realized by the distributee, and secondly if the distribution is of such a character that was tax exempt by reason of some act of Congress, with a safeguard that a distribution out of pre-March 1, 1913, earnings out of profits in the form of stock should be considered a distribution of earnings and profits although tax exempt, unless it was constitutionally exempt or exempt by act of Congress for some reason other than from being out of March 1, 1913, earnings.

Senator LA FOLLETTE. Was not an attempt made in the House bill to do that?

Mr. BEAMAN. No, Senator. This has not anything to do with the taxable of March 1 earnings. That is left in the present law, and the House bill did not change it. It is simply correcting a lot of disputes in the Department and the Board of Tax Appeals as to what the effect of these tax exempt distributions not only out of pre-March 1, 1930, but since that time, where the distribution takes the form of stock and securities other than cash or property.

Senator COUZENS. Have you the exact amendment drawn?

Mr. BEAMAN. I have, Senator.

Senator COUZENS. Will you read it?

Mr. BEAMAN. I will. It is pretty long. That is all it does.

Senator COUZENS. I think we ought to adopt it.

Senator GEORGE. Mr. Beaman, I did not get your statement; I am sorry.

Mr. BEAMAN. The question is this: A corporation distributes stock or securities to its shareholders, and that for some reason is tax-exempt because it is in connection with a reorganization or because it is a stock dividend, and the question immediately arises, to what extent shall that distribution be considered a diminution of its earnings and profits for the purpose of determining future distribution, as to whether or not they had any earnings and profits out of which to make a declaration?

This states that the distribution shall not be considered a distribution of earnings and profits if no gain to the distributee was recognized by the applicable law, either in the future or in the past.

Senator BYRD. That does not change the present principle of a stock dividend where there is no gain, it is nontaxable.

Mr. BEAMAN. Not at all. And secondly, if the distribution is of such a character that it was exempt from tax in the hands of distributees generally because it was a McCumber dividend which came as a dividend to him or because it was exempt by act of Congress if by act of Congress it was exempt, which is a question nobody knows the answer to.

Or take the stock dividend. You have in this bill said that a stock dividend shall be taxable with the stockholder to the extent the Constitution permits, but that rule does not apply to a man whose taxable year begins next July. If you pass this bill today, that rule would not apply to him except in the case of stock that he receives after July 1.

Senator COUZENS. Assume that we are dealing with a trust such as Senator Walsh is talking about, and they distribute stock or securities other than their own stock or securities, this would take care of some such case like that?

Mr. BEAMAN. No, it has nothing to do with that. It would not cover at all the distribution of stock or securities as a distribution in kind; in other words, a corporation has cash and declares it out. This has nothing to do with that. It has cows and horses and pigs. It declares those out as dividends; this has nothing to do with that. If it has, instead of cows and pigs, Liberty bonds and stock in another corporation and declares that out, this has nothing to do with that.

Senator COUZENS. What would happen in the case of those declarations other than cash?

Mr. BEAMAN. They are taxable just like cash at market value at the time of distribution. This amendment has nothing to do with the taxability of the shareholders. All we are seeking to do here is to make the law definite and clear as to the effect of the distribution on the earnings and profits of the corporation for the purpose of future dealings of the corporation. Nothing to do with taxing the stockholders; that is all taken care of.

Senator COUZENS. Can you give us an illustration of the application of this amendment? I do not quite follow it myself.

Mr. BEAMAN. A corporation in pursuance of a plan of reorganization distributes stock to its stockholders, which, under the other provisions of the law, no gain or loss is recognized. That distribution shall not be considered a distribution of the earnings and profits of the corporation because it was exempt to the stockholders.

Senator KING. Where they have accumulated in their operations, stocks of other corporations?

Mr. BEAMAN. No.

Senator KING. Just its own?

Mr. BEAMAN. Its own or securities of another corporation which is a party to the reorganization, but not of its investments. It does not make any difference from that point of view whether it is cash or horses and cows or stocks and bonds.

Senator COUZENS. Would it have any effect upon revenues at all?

Mr. KENT. It will measureably protect the revenues, because if I may attempt to state the principle as simply as possible, if the distribution is nontaxable and if as would be the case under this amendment it does not diminish the earnings and profits of the corporation, then the Government would get its tax if subsequently there were a distribution out of those earnings and profits; but if a nontaxable

distribution can diminish earnings and profits then the Treasury stands to lose not only the tax on the original nontaxable distributions but also any subsequent distributions that may be made; so it seems to me that the two things really go along with each other.

Senator KING. I assume the Treasury favors it?

Mr. KENT. Very strongly.

Senator COUZENS. Let us pass it.

Senator KING. Are there any objections? Without objection it will be adopted. And I suggest that you furnish a number of copies of the amendment so that we may have a chance to examine it before the next meeting of the committee.

Is there any other matter, Mr. Beaman?

Mr. BEAMAN. The committee passed over until today, at the request of Senator Lonergan, Mr. Kent's suggestion of amendments to Senator Lonergan's amendment.

Mr. KENT. I have a suggested draft on that and I would like to talk it over with you.

Mr. BEAMAN. All we want is for the committee to adopt the policy and we can work it out.

Senator COUZENS. What is the policy? Is it a good policy?

Mr. BEAMAN. Here is the situation. The amendment you have already agreed to says that you cannot get a deduction that the amendment gives if the policy is written so that the premium-paying period is less than 10 years; in other words, that, I take it, was put in to guard againt deathbed policies; in other words, a man knowing that he is going to die very quickly, wants to take out a million-dollar policy. He can go to any insurance company and by paying them a million dollars or a little more, he can get a policy without any medical examination or anything else. Thus, it apparently was the policy of the amendment to guard against that thing by saying that the premium-paying period must be at least as much as 10 years.

Mr. Kent pointed out to you yesterday that that is not of any value in accomplishing its purpose of protecting against deathbed policies unless you provide that for at least the first 10 years of the life of the policy, the premiums shall be substantially equal in amount. Otherwise he could take out a policy with a premium the first year of $9,990,000 and the policy provision of a dollar for the next 9 years, thus defeating the purpose of the amendment.

Senator LONERGAN. The insurance men met with Mr. Kent and they have agreed on an amendment.

Mr. BEAMAN. I am not at the moment interested in the language, but whether the committee wants to take care of that loophole.

Senator La FOLLETTE. I move we take care of it, and you confer with Mr. Kent on this draft and satisfy yourself.

Mr. SELTZER. May I say that we are now making an estimate of the probable loss under this amendment? We have not gotten very far, but we find so far that there is a maximum possible loss on the basis of present conditions of $53,000,000 a year.

Senator GERRY. How do you base that?

Mr. SELTZER. We took the amount of insurance policies reported in estates for the last several years in excess of the deductible amounts, and we said that if the face value of all of these policies could be assumed to represent the amounts that the policyholders had esti-

mated their death taxes would be, we might run up to a loss of about $53,000,000. Now, of course, we never give you an estimate the maximum theoretical loss. We arrive at that first where we can, and then we study to find out what the probabilities are. We have not yet completed the study.

Senator GERRY. What you have not taken into account at all is, which is a very possible point, that where a man has a mill and it is a large amount and you try to sell it, under your sale you may not be able to collect anything like your tax. This will give you quick revenue. That is one reason I voted for it.

Senator LA FOLLETTE. You have, though, Mr. Seltzer, some experience upon which to base the amount of loss from liquidations?

Mr. SELTZER. Surely.

Senator LA FOLLETTE. You simply apply this additional loss to that experience when you come to make your final estimate, as I understand?

Mr. SELTZER. Quite correct.

Senator LONERGAN. What is the loss for a year in taxes that the Government is unable to collect on account of defunct corporations or individuals who are insolvent?

Mr. SELTZER. I cannot tell you that offhand.

Senator CLARK. That loss would have to be balanced against the other one, would it not? On the question whether or not this Lonergan amendment would mean a net loss, the loss that the Government now suffers from defunct corporations or insolvent individuals would naturally have to be balanced against the theoretical loss which you have just mentioned, in determining whether from the standpoint of Government revenue, the amendment would be a beneficial one to revenue or not?

Mr. SELTZER. You would not want to balance off against this loss on estate taxes, non-collections for corporation taxes, would you, and individual income tax collections?

Senator CLARK. There are plenty of estates that turn out to be insolvent.

Mr. SELTZER. You would just take the death tax collections of those, would you not? That is what we intend to do.

Senator GERRY. The trouble is that you are not going to be able to realize the tax in a lot of these cases, and you have not got enough statistics since you have put these very high taxes in effect where you go up to 70 percent in your 1934 act yet, because you have not worked out these estates. You have not enough statistics in the Treasury now to tell you how many of those you are going to be able to collect. I have a case here which is before the Treasury, which is a small matter, where an estate is probably going to owe the Government money when it comes in, and you do not get a tax for years. It is just typical. What he is stating is pure theory.

Senator LA FOLLETTE. We have had some experience, and the collections have exceeded the estimates. Whatever experience we have had under this law will be taken into account in balancing against the advantages, if any, in the Lonergan amendment, when the estimate comes in.

Senator GERRY. What I have in mind is that with the 1934 tax you have not had time to know where you are going on this law.

Senator LA FOLLETTE. All I want to point out is that they were very conservative in their estimates of what it would yield, and it is exceeding the estimates.

Senator KING. Your experts have not completed their investigation in regard to this matter?

Mr. SELTZER. No; they have not.

Senator KING. Will you be able to complete your study by tomorrow?

Mr. SELTZER. I think so.

Senator KING. We wish you would push the matter, because it will be brought up again then, with the consent of the Senators.

Mr. BEAMAN. One more point in connection with that same amendment, Senator. I think there is no question about the fact that everybody concerned in the committee is proceeding on the principle that this deduction of the proceeds of the policy is only given on the theory that the amount of the policy is included in the gross estate in the first place. We think it is advisable to put in language to make that perfectly clear.

Senator GERRY. No; it was not in the gross estate. It was not in the tax. It was outside the tax.

Mr. BEAMAN. I understood that the committee proceeded on the theory, because I was asked the question and I stated it myself, that the proceeds of the policy would be put in the gross estate.

Senator GERRY. No; on the contrary.

Mr. BEAMAN. The amount of the policy is put in the gross estate, and this amendment takes it out, but you are not going to take it out if it is never in there in the first place, are you?

Senator GERRY. I see what you mean. In other words, you do not pay the tax on this policy. The idea of this, as I understand it, was to help them liquidate and liquidate quickly and give the Government quick assets.

Mr. BEAMAN. Unless the proceeds of the policy go into the gross estate, you are not going to take it off. We want language to make that plain.

Senator KING. The matter you are referring to is intertwined with the same subject, and I suppose we can treat them in action together.

Mr. BEAMAN. I take it you can pass on this thing. It simply prevents——

Senator WALSH (interposing). Has Senator Lonergan any objection to it?

Senator LONERGAN. Do you mean the amendment of Mr. Kent? Just the mechanics of it, to put it in the gross and then allow the deduction? I see no objection to that.

Senator KING. That will be adopted.

Are there any others?

Mr. KENT. I have already spoken to Senator Barkley about this. This is a very slight amendment to subsection (a) of section 602 of title IV—that is, the refunds provision. The section as it stands at present reads:

> There shall be paid to any person who at the first moment of January 6, 1936, held for sale or other disposition any article processed—

And so forth.

We would simply interpolate after "other disposition" a phrase "including manufacturing and further processing"; in order to make it clear that if a manufacturer of some commodity or some product in which sugar is used, for instance, holds sugar in his floor stocks in direct consumption form on January 6, 1936, he should be entitled to a refund under the section subject to the same conditions as applied to all other claimants. I may say, I think that is the way we would interpret "other disposition" anyway, but in order to calm some fears that have arisen, this clarifies it.

Senator KING. Without objection that will be done.

Is there any other suggestion from the Treasury Department?

Senator GERRY. I would like to ask, Mr. Chairman, if they have nothing else now, what the estimate shows the tax would be on a million dollar corporation under those two plans which I asked Mr. Seltzer for last night.

The CHAIRMAN. If you can give the answer, please do so.

Mr. SELTZER. Do you want this read or merely inserted in the record?

Senator GERRY. I want it read.

Mr. SELTZER. This is the tax liability under each of the two proposals submitted yesterday.

For a corporation with statutory net income of $1,000,000, which retains all of its earnings and which does not receive any dividends under the proposal—that is the first proposal on the left-hand side of that balance sheet of the document that you had yesterday—which repeals the present capital stock and excess profits taxes——

Senator WALSH (interposing). How would you designate that?

Senator LAFOLLETTE. It does not have any designation.

The present capital-stock and excess-profits taxes would be repealed; the present ordinary corporation income taxes would be retained at the present rates, and taxes would be imposed on the undistributed adjusted net income of corporations after a flat exemption of $15,000 for every corporation and a credit for dividends paid. The taxes equal to the sum of the following, 25 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent of the adjusted net income, 35 percent of the amount on the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income, and 45 percent of the amount of the undistributed net income which is in excess of 40 percent of the adjusted net income.

We computed the tax liability as follows if the corporation retained all of its earnings.

Senator GERRY. That was the question I asked.

Mr. SELTZER. Corporation income tax, $149,440; tax on undistributed adjusted net income, $324,968.40; total, $474,408.40.

Senator KING. Out of $1,000,000?

Mr. SELTZER. Yes. Now, under the second proposal, the one on the right-hand side of the sheet which you had yesterday, whereunder you would retain the present corporation income taxes and retain the present capital stock and excess profits taxes and impose somewhat different rates on undistributed adjusted net income after a flat exemption of $15,000 for every corporation, and after the dividend credit, of course, the rates being 15 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent

of the adjusted net income, 25 percent on the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income, and 40 percent of the amount on the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income.

The tax liability under this second proposal for a corporation earning $1,000,000 and retaining all of it after taxes, was as follows:

Ordinary corporaton income tax, $147,340; tax on undistributed adjusted net income, $262,371.20; capital stock tax, $14,000; total, $423,711.20.

I might say that in computing the capital stock tax we had to make an arbitrary assumption, of course, as to the declared value.

Senator BYRD. That is where there is no distribution?

Mr. SELTZER. No distribution. We assumed here that the corporation would earn this $1,000,000 and represented 10 percent on its capital, and would declare a value accurately so that it would escape excess profits taxes.

Senator WALSH. Senator Gerry, have you any figures showing what a corporation with the same net income, namely $1,000,000, would pay under the plan adopted by the Senate, namely, 18 percent flat tax and 7 percent upon undistributed profits?

Senator GERRY. I have not any figures.

Senator WALSH. Why don't you ask for them? This second plan is a substitute for the Senate plan. There is the way to make the comparison.

Mr. PARKER. The tax on that is $237,400.

Senator WALSH. And the substitute which has been presented to us in place of the Senate plan, there is a tax of $423,000 plus.

Mr. SELTZER. I should like to point out in connection with this second example, that while we included the capital-stock tax, it does not logically belong there because that is deducted before arriving at the statutory net income, but I assume that you wanted the total corporation taxes to be paid.

Senator GERRY. I wanted it the way you arranged the amendment, and this is the way you arranged it, and I wanted the items, and this is all right.

Mr. SELTZER. Perhaps I have not made myself clear.

Senator GERRY. You have made yourself perfectly clear.

Senator BLACK. Have you the other figures that I asked for yesterday afternoon?

Mr. SELTZER. I have some of them.

Senator KING. Senator Gerry, are you through with Mr. Seltzer?

Senator GERRY. I am all through; that is all I wanted. That is all I asked for.

Senator BLACK. But I asked for some figures yesterday afternoon and I want to get those that he has.

Senator KING. Proceed, Mr. Seltzer.

Mr. SELTZER. I am sorry that these estimates which were overnight estimates were completed so late that I was not able to get copies of them, in fact the figures are still being checked. These are preliminary estimates.

Senator LA FOLLETTE. Will you be able to give more considered estimates by tomorrow?

Mr. SELTZER. They may be unchanged, of course.

Senator LA FOLLETTE. I understand that, but do you think you will be able to give more considered estimates by tomorrow?

Mr. SELTZER. Yes.

Senator LA FOLLETTE. Very well.

Mr. SELTZER. Senator Black, you will recall, wanted an estimate on a proposal that ran pretty much as follows: Retain the present taxes on statutory net income as now defined; retain the present capital stock and excess-profits taxes; repeal the exemption of dividends from the normal tax of individuals; tax undistributed adjusted net income as follows—I take it you do not want me to define the thing all over again?

Senator GEORGE. No.

Mr. SELTZER. Nothing on the first 20 percent of the undistributed adjusted net income; that is, you would have an exemption there of the first 20 percent. Then a tax of 20 percent of the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income and a tax of 30 percent on the balance of the undistributed adjusted net income; in other words, you would have zero, 20 and 30 as the rates.

We estimated gross increase in revenue over the present law under this proposal would approximate $680,000,000 before allowing for a loss on small corporations, which has been running in the neighborhood in all these plans between—well, in one case it ran up as high as $57,000,000. Probably in this plan, somewhere around $30,000,000. So that you get under this proposal, our preliminary estimate shows, approximately $650,000,000 additional revenues.

Senator WALSH. The record would show that there are no cushions in that proposal.

Mr. SELTZER. There are no cushions here other than a $1,000 exemption.

Senator BLACK. And 20 percent untaxed in the beginning.

Senator WALSH. Of the undistributed profits?

Senator BLACK. Yes.

Mr. SELTZER. Those are two cushions. Senator Black asked for a similar proposal whereunder, however, you exempted the first 30 percent instead of the first 20 percent of the undistributed adjusted net income, if you applied the same rates of tax as in the preceding proposal, that is, 20 percent and 30 percent after the 30-percent exemption. Under this proposal, we got an estimated increase in revenue over the present law of $515,000,000 before a deduction for the special credit for small corporations, which therefore would be reduced by approximately $30,000,000 to perhaps $485,000,000.

Senator GEORGE. I lodged a motion which of course would not be in order to press now. I suggest the motion stand.

Mr. SELTZER. Senator Barkley, you will recall, had requested an estimate whereunder we would take the schedules presented to you yesterday and insert a normal tax on dividends, and add the revenues from that normal tax on dividends to reduce the rates on undistributed income. I have such an estimate here.

(And the same is as follows:)

Preliminary estimate

SENATE FINANCE COMMITTEE PROPOSAL A-13	*Additional revenue (million dollars)*
1. Repeal capital stock and excess-profits tax	(−)168
2. Impose present corporate tax rate (12½ percent to 15 percent) on statutory net income as defined in present law, which includes 10 percent of inter-corporate dividends received	
3. Define adjusted net income as the statutory net income less corporate income taxes plus 90 percent of dividends received. Define undistributed adjusted net income as adjusted net income less the dividend credit, less a special exemption of $15,000 to all corporations. Impose a tax on undistributed adjusted net income equal to the sum of the following:	
13 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent of the adjusted net income; 25 percent on the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income; and 40 percent of the amount of the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income	
Yield of such tax on undistributed adjusted net income and of surtax on dividends to individuals	649
4. Remove exemption of dividends from individual normal tax	144
Total additional revenue	625

SENATE FINANCE COMMITTEE PROPOSAL A-14	*Additional revenue (million dollars)*
1. Retain capital stock and excess-profits tax	
2. Impose present corporate tax rate (12½ percent to 15 percent) on statutory net income as defined in present law, which includes 10 percent of inter-corporate dividends received	
3. Define adjusted net income as the statutory net income less corporation income taxes plus 90 percent of dividends received. Define undistributed adjusted net income as adjusted net income less the dividend credit, less a special exemption of $15,000 to all corporations. Impose a tax on undistributed adjusted net income equal to the sum of the following:	
8 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent of the adjusted net income; 22 percent on the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income; and 40 percent of the amount of the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income	
Yield of such tax on undistributed adjusted net income and of surtax on dividends to individuals	494
4. Remove exemption of dividends from individual normal tax	123
Total additional revenue	617

If the percentage of intercorporate dividends now subject to corporate income tax be increased from 10 percent to 13⅓ percent, the additional yield would be $5,000,000. If from 10 percent to 10⅔ percent, the additional yield would be $10,000,000.

Those estimates assume no changes in existing law other than those cited above and that the new bill will contain provisions which will prevent any avoidance of the above taxes.

Senator LA FOLLETTE. These are without cushions?

Mr. SELTZER. It contains the same cushions, if you want to call them such, as the original proposals contained, namely, a $15,000 flat exemption.

Senator LA FOLLETTE. But they do not contain any of the House cushions?

Mr. SELTZER. No. I might say, of course, if they contained only the House cushions, the estimate would remain substantially unchanged. There would be relatively little change.

Senator BLACK. Would that be true in the estimates you gave to me awhile ago?

Mr. SELTZER. Well, yes. If you provide cushions of the same effective character as the House cushions——

Senator WALSH (interposing). What do you mean by those cushions?

Senator BYRD. You would have to have a tax on corporations that pay their debts in excess of the 15 percent.

Mr. SELTZER. You mean in excess of their normal corporation income tax? Yes; surely. I am speaking now of the cushions strictly comparable to those provided in the House bill.

Senator WALSH. You mean the 22.5-percent rate that is in the House bill in the case of debts?

Mr. SELTZER. You see, you would have to have a different set of rates here for the same provisions that you have in the House bill, because the House bill system of corporation taxes is quite different from this.

Senator BYRD. Would it have to be higher or lower than 22.5 per cent?

Mr. SELTZER. They could be lower.

Senator LA FOLLETTE. In other words, all you would have to have is the comparable rate and not necessarily the same rate?

Mr. SELTZER. That is right.

Senator GERRY. How much do those cushions take off?

Mr. SELTZER. In the House bill?

Senator GERRY. Yes.

Mr. SELTZER. I believe only $5,000,000. That is my recollection.

Senator GERRY. It cannot do much good then. Those cushions only apply to corporations up to 1936, do they not? They are not intended prior to 1936?

Mr. KENT. If I may interject a remark there, I think the major purpose of the cushions in the House bill was to protect corporations from a 42.5 percent tax by reason of the situation in which they found themselves, rather than to give any very large measure of actual tax relief.

Senator WALSH. Have you included the same treatment for banks and insurance companies?

Mr. SELTZER. As I said several times, that would make very little difference.

Senator KING. Are those the only estimates you have to present?

Mr. SELTZER. Yes. These are the changes. When we remove the exemption of dividends from the individual normal tax, we add $144,000,000 of revenue to this measure. I am reading now the left hand side. That enabled us to reduce the rates of tax on undistributed adjusted net income as follows: Whereas the first rate in the sheet that you had yesterday was 25 percent on the amount of the undistributed adjusted net income not in excess of 20 percent, that was reduced to 13. From 25 to 13.

The second step was reduced from 35 to 25; and the third step from 45 to 40. We wound up with an estimated net additional revenue of $625,000,000, the increased revenues resulting from the subjection of dividends to normal tax being substantially counterbalanced by the reduction in the rates on undistributed earnings.

On the right hand side, we were able to get an additional $123,000,000 of revenue by subjecting dividends to the normal tax on individuals. That enabled us to reduce the rates on undistributed corporate earnings from 15 to 8 percent in the first bracket, and from 25 to 22 percent in the second bracket.

Senator KING. Are there any questions?

Senator BYRD. Has Mr. Seltzer gotten my request for cushions on debts? Have you made that up?

Mr. SELTZER. Not overnight.

Senator BYRD. Do you think you will have it tomorrow?

Mr. SELTZER. I doubt it; we might.

Senator KING. Thank you very much, Mr. Seltzer. Let me ask the Treasury Department again and the experts who are advising us, if they have any procedural recommendations or suggestions to make?

(Discussion off the record.)

Senator KING. We will recess until 10:30 o'clock tomorrow morning.

(Whereupon, at 12:15 o'clock p. m., a recess was taken until tomorrow, Friday, May 29, 1936, at 10:30 a. m.)

REVENUE ACT, 1936

FRIDAY, MAY 29, 1936

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

The committee met in executive session, pursuant to adjournment, at 10:30 a. m., in the committee room, Senate Office Building, Senator William H. King presiding.

Present: Senators King (acting chairman), George, Walsh, Barkley, Connally, Bailey, Clark, Byrd, Lonergan, Black, Gerry, Guffey, Couzens, Keyes, La Follette, Metcalf, Hastings, and Capper.

Also present: L. H. Parker, chief of staff, Joint Committee on Internal Revenue Taxation, and members of his staff; C. F. Stam, counsel, Joint Committee on Internal Revenue Taxation; Middleton Beaman, legislative counsel, House of Representative; John O'Brien, assistant legislative counsel, House of Representatives; Arthur H. Kent, acting chief counsel, Bureau of Internal Revenue; C. E. Turney, assistant general counsel for the Treasury Department; L. H. Seltzer, Assistant Director of Research and Statistics, Treasury Department.

Senator KING. The committee will be in order. Mr. Kent, you have the liquidation matter and several other matters that were undisposed of. Please present them as soon as you can.

And, Mr. Parker and Mr. Beaman, whatever suggestions you have, precedual and otherwise, which are ready, you will be able to present them too?

Mr. PARKER. The liquidation proposition, I am sorry to report, is not yet finished. We have made very substantial progress in it. But there are one or two knotty questions in there that we have not completed.

Senator KING. That does not include investment trusts? That is a different problem?

Mr. PARKER. Yes.

Senator KING. Then take what you are ready to report. I think the committee is very anxious to get this bill out today.

Mr. BEAMAN. Our feeling about that liquidation was that if you want to get the bill out today, or very quickly, that that matter I believe we have reasonable assurance, unless some unexpected angle of it turns up, that we do not know about, that we can probably get it in shape so that you can offer it on the floor as an amendment. If you wish, the committee can meet and discuss it then, because I do not think there is any possibility of getting it done right off. We worked 4 days on it and we are beginning now, for the first time, to see a little light.

Senator KING. Is that agreeable to you, Senator George?

Senator GEORGE. I was going to make that suggestion. I wanted to have the benefit of the committee approval on it.

Senator LA FOLLETTE. May I suggest that I am in sympathy with this idea if it can be worked out thoroughly, but would it not be well for the committee to act in principle, and then with the understanding that there would be a meeting of the committee while the bill was in progress, to pass on the details.

Senator GEORGE. I think so; that was going to be my suggestion—that we undertake not to pass upon it now further than to ask that the committee be allowed during the consideration of the bill after it is reported, to come back to consider this matter.

Mr. BEAMAN. I will say this, gentlemen, that the thing could be considerably simplified if you are willing to make a determination of policy, in which a considerable group could be said that the provision would not be fair to them.

There are two classes of people involved on the matter of principle; those who would like to have the new rule that you are proposing, at least the one that all of the experts seem to think is the correct rule, and write into this bill for the future; but a great many people in the past would have liked to have had the benefit of the past. There are a few people that would prefer the 1935 rule. If you are willing to face the problem of simply cutting this thing right off and dealing with it as if you never did anything in 1935 and this is the first time it was ever heard of, it would considerably simplify it.

Senator KING. Can you not present it in the alternative?

Mr. BEAMAN. No. But that would shorten the time considerably for doing it.

Senator KING. I am not sufficiently familiar with all of the angles of it to determine what course should be pursued.

Mr. PARKER. Of course, we are proceeding on the theory that the main policy here was on this liquidation, to make the parent pick up the base of the assets that existed in the hands of the subsidiary. The committee understands that, as the principle, because that is the fundamental thing.

Senator GEORGE. Yes; that is the amendment.

Mr. PARKER. My understanding is that that is what the committee wants.

Senator KING. Can you not proceed along that line and work out your plan?

Senator GEORGE. What Mr. Beaman means to say, I think is that the approach would be much easier and simpler if we would not be embarrassed by the fact that some corporations that have come under the 1935 act and have liquidated under it, naturally will turn back to us and say that this is a much fairer program of proposal and we ought to have the benefit of the advantage on it.

Personally, I would be willing to treat it de novo and dispose of it on that base, on a fair equitable basis.

You want to take as far as you can of course, and as well as you can, the Treasury's interest, and give to the corporation as much latitude as you can to get the subs out of the picture where they went to get them out.

Senator KING. I think you understand the situation, gentlemen.

Senator GEORGE. And if that can be done without embarrassing the Treasury.

Mr. KENT. I would like to inquire if the committee would be willing, since the exact content of the amendment we are preparing will be considered later, to have us make a recommendation with respect to a change in section 113 (a) (7), which would eliminate one class from that section.

The section now reads:

"If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization"—and this is the clause to which I refer—"and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them"—it is that particular clause.

It has been in the act for a long time. At one time it was 80 percent. No one knows just what it means. It results in a very serious loss of revenue to the Treasury over the years. It is unsound in principle.

Our feeling about it is this, that if a transfer qualifies as a nontaxable reorganization where there is no gain or loss recognized at the time of the reorganization, there ought not to be any stepping up of bases in any case. If there is a stepping up of bases allowed, the Government not only gets no revenue at the time of the reorganization, but it loses the opportunity of relizing any revenue subsequently by reason of the stepping up of that basis.

The justification for the treatment of reorganizations since 1924 has been not that the gain should be permanently exempted from taxation, but rather that because reorganization is oftentimes a business or economic convenience or even necessity, business should not be handicapped in making proper reorganizations by the immediate assessment and collection of large taxes; that is, that there should be a proper postponement of taxes until gains are actually realized upon the subsequent disposition of securities rather than that there should be a permanent exemption on such gain from taxation.

There are cases coming under this 50-percent rule as it stands where there is substantial stepping up of the basis, and we simply lose that revenue for all time. There is nothing we can do about it. It is a provision in the law that has lent itself to all kinds of fake reorganizations and to a lot of improper manipulation.

I think that all of us are in substantial agreement that the reorganization sections would be much sounder in their operation if that provision were eliminated from the law.

I simply wish to know whether in considering this whole problem, the committee would wish us to present a draft which would present that question also for its consideration.

Mr. PARKER. That is, that could be presented along with this liquidation proposition?

Mr. KENT. Exactly.

Senator KING. I think you should cooperate with Mr. Beaman and Mr. Parker and work together and submit a plan as soon as you can, for the consideration of the committee.

Is there anything else, Mr. Parker?

Mr. PARKER. Section 351.

Senator KING. Have you anything else, Mr. Kent?

Mr. KENT. Yes; I have, but I would rather have Mr. Parker go ahead.

Mr. PARKER. Section 351, page 224 of the bill.

This is the surtax on personal holding companies and it is the stricken-through type that I am referring to, because the House bill struck out section 351, and the committee has acted to restore that section.

In the first place, this is a surtax. It is tax paid by personal holding companies which is in addition to the taxes of title I except section 102. Therefore, under the proposed plan, a personal holding company is going to be subject to the 18-percent tax and the 7-percent undistributed-profits tax of title I, and then they are going to be subject on the retained amounts of income to these rates: 20 percent on the first $2,000; 30 percent between $2,000 and $100,000; 40 percent between $100,000 and $500,000; 50 percent between $500,000 and $1,000,000; and 60 percent on amounts over $1,000,000.

Senator COUZENS. May I ask in that connection, would it not be better to have that on a percentage of the retained rather than on a fixed amount like that? I think that is rather a ridiculous schedule, if you are fixing the others on a percentage basis, which I understand is to be the substitute.

Mr. PARKER. The reasons for the amounts here, Senator, are because you are dealing with a personal holding company and have a relation to the personal surtax rates. I would want to think for a few minutes on your suggestion. I am unable to answer it without further thought. There may be much to it, but I know why we fixed them, and I am uncertain whether the percentage would be better or not.

Senator COUZENS. All right, go ahead.

Mr. PARKER. I would like to look into that. In any event I think as they have got to pay 7 percent on these amounts retained anyway, that these rates should all be reduced 7 percent. The first rate should be 13; the next 23; et cetera. Of course, there are not so many companies that pay tax under this plan. Most of them pay out all in dividends.

Senator BARKLEY. How much revenue does this section produce?

Mr. PARKER. The direct revenue is around $5,000,000; the indirect is far in excess of that amount. In fact, I think something could be added in section 351 which we have thought, in comparison with the House plan—you see, the House plan did away with this section except that they put it in in a limited extent in section 102.

Senator KING. What is your concrete suggestion then for amendment?

Mr. PARKER. My concrete suggestion for the amendment is first to reduce these rates by 7 percent.

Senator BLACK. Why? What administrative feature of the bill does that affect? I thought the committee had already voted on this amendment. That is simply a difference in policy.

Senator GEORGE. Because the 7 percent is already imposed on undistributed earnings.

Senator BARKLEY. The rates as they are now will require them to begin paying at 27 percent if you include the 20. And it would run above 67.

Mr. PARKER. 67 plus 18, which is 85 percent. It seems to me they are getting a little high.

Senator GEORGE. I think undoubtedly that should be done.

Senator BLACK. I object to it.

Senator COUZENS. I move that that proposal be accepted.

Senator BLACK. As I understand it, the object in taxing these personal holding companies was to make it impracticable and practically impossible to let them have them for the purpose of evading taxes, and I do not see any reason why we should reduce this now 7 percent.

Mr. PARKER. Let me say one word in explanation, Senator Black. Under the existing law, we have our 15 percent; that has to be paid. Then we have, if they retain, in the large companies, they pay 60 percent, and that makes 75 percent. That is comparable with our surtax rate. Now, we have changed the other part of the bill, and under the new plan they pay 18 percent and 7 percent, which is 25 percent, and if you keep the 60, that is 85.

Mr. BEAMAN. Not quite.

Mr. PARKER. Not quite, that is true. They will pay on the balance of course. But that is in excess of your highest surtax rate, and it did not seem necessary to go above what they would have to pay if they distributed to the individual.

Senator BARKLEY. Aside from this section, the personal holding company will pay the same that any other corporation would pay?

Mr. PARKER. Oh, yes.

Senator BARKLEY. Under the 18 and the 7 provisions?

Mr. PARKER. Exactly.

Senator BARKLEY. This is an additional tax?

Mr. PARKER. An additional tax.

Senator BARKLEY. Whatever the rate here is will be added on to 25—18 plus 7—because this only applies to the undistributed?

Mr. PARKER. That is right.

Senator HASTINGS. As a matter of fact, the effect of this section 351 is to compel them to distribute, is it not, and these penalties really are rarely ever applied?

Mr. PARKER. There are very few that keep a little and pay the tax. The first information that has come in on the first year is approximately this: $4,000,000 tax, and $155,000,000 distributed in dividends, so that it is perfectly obvious that this section was very effective in forcing the distribution of dividends. All that is necessary is to keep these rates sufficiently high, and if we can keep them even after the reduction of these rates of 7 percent, it will still be higher by 3 percent than existing law, because we have increased the normal rate from 15 to 18.

Senator BLACK. All that being true, Mr. Chairman, I don't think anyone has ever offered any legitimate excuse for a personal holding company. It is simply a method of a man putting his money in corporations instead of taking it directly and I would favor raising them still higher, because I am opposed to the personal holding companies. I think it is a plan and a scheme to evade taxes.

Senator HASTINGS. How high would you make it?

Senator BLACK. I am perfectly willing to make it high enough so that they could not do business at all.

Senator HASTINGS. How high would you make it?

Senator BLACK. As high as possible.

Senator HASTINGS. One hundred percent?

Senator BLACK. If they still leave some in, it is an indication that it is advantageous to them to leave that much in still. This is

nothing in favor of the Government, and it is only to the advantage of individuals.

Mr. PARKER. That is probably true in the great majority of cases, but we had a case here, just by way of example, that was fully explained before the committee. Here was a company formed some time ago before we had income taxes, that owns the stock of these two clock companies. It is really an operating company. It had to be incorporated under the laws of different States, and they are going on and operating those two companies. There was no bad purpose so far as I can see when that corporation was formed, and it appears difficult for them to get out.

Senator BLACK. They could merge without any difficulty.

Mr. PARKER. They claim that there would be legal difficulties in the State of Illinois to merging. They have some rule about domestic corporations.

Senator KING. In some of the States they prevent the merger of corporations that are rather distinctive in their character, such as for instance a mining company and the other a real-estate company; they prevent mergers.

Mr. PARKER. You see, you have to prove no intent to avoid surtaxes here, Senator. If you come within the definition, the tax falls, and there is no way out.

Senator KING. Are you ready for the question?

Senator BAILEY. What is the question?

Senator BARKLEY. To reduce all of these brackets on personal holding companies 7 percent.

Senator GEORGE. Just getting this down by the same amount which has already been added.

Senator KING. Those in favor will say "aye"; contrary, "no".

(The amendment was agreed to.)

Senator CONNALLY. Mr. Chairman, I am going away tonight, and I have a matter which I would like to bring up before the committee. I want to present it to the committee some time this morning.

Senator GEORGE. We will get through today.

Senator KING. Let us get rid of these procedural matters.

Senator CONNALLY. Very well, so long as it can be taken up before I have to go.

Mr. PARKER. Senator Harrison asked me to bring this up. It has been brought before the committee, but no formal action has been taken—and that is, whether these small-loan companies that loan less than $300 should be exempt from section 351.

Senator COUZENS. They charge outrageous interest, don't they?

Mr. PARKER. The matter has been fully explained a number of times.

Senator KING. The chair will entertain a motion.

Senator GEORGE. What was the request?

Mr. PARKER. That these small-loan companies that loan $300 to individuals be taken out.

Senator COUZENS. Only out of section 351?

Mr. PARKER. They would have to pay the 7 percent.

Senator COUZENS. In other words, we would just take them out of the penalty clause of section 351?

Mr. PARKER. Yes.

Senator KING. Mr. Kent, have you any recommendation, speaking for the Treasury?

Mr. Parker. They ought to be left under section 102. They have to pay the 7 percent and the 18 percent, and they would be subject to section 102, so that the Treasury could come in and examine and see if their accumulation was unreasonable, and then they could apply the surtax in section 102.

Senator COUZENS. Well, I make a motion that they be exempted from section 351.

Senator KING. You have heard the motion. Are you ready for the question? Those in favor say "aye"; contrary, "no."

(The motion is agreed to.)

Senator KING. Have you the amendment there?

Mr. PARKER. In rough form subject to correction.

Senator KING. Is there any other matter?

Mr. PARKER. Before you finish section 351, Mr. Beaman has some minor amendments, I think.

Mr. BEAMAN. They are only technical amendments.

Mr. PARKER. There are a few technical amendments which we would like permission to make in section 351 that would not change the policy, but due to the structure of the act and the definitions.

Senator KING. Invite the attention of the committee later to those technical amendments.

Mr. PARKER. Mr. Kent has another matter now.

Senator KING. Is that all you have for the moment, Mr. Parker?

Mr. PARKER. I think I have one or two additional small things.

Mr. BEAMAN. Mr. Chairman, yesterday I brought up a question in regard to the effect of the earnings and profits of a corporation, not to the tax on the stockholders but merely on the effect of the earnings and profits of the corporation that distributes stock by the corporation in connection with a reorganization or with the issuance of a stock dividend, and I have a draft here to pass around if you want to see it. It is very long and technical and I can explain it again.

Senator KING. I think you had better do it, because there are some Senators here who were not present when you explained it the other day.

Mr. BEAMAN. The question arises when the corporation pays out some money or some property, is it out of earnings or profits, or not? If it is out of earnings or profits, the dividend is taxable to the stockholder. Therefore, whenever distribution is made, you have to find out what is earnings and profits.

Now, in determining that question, of course you take off the earnings and profits all the distributions which are made which are taxable to stockholders. Equally you ought not to take off from earnings and profits the distributions that are taxable.

All that this amendment says is that if a corporation makes a distribution of stock to stockholders and no gain is recognized to the stockholders who receive it, that distribution does not diminish the earnings and profits; they are still there, and if they are later distributed, it is a taxable dividend.

Secondly, it says that if a corporation makes a stock dividend, if that stock dividend is a nontaxable stock dividend under the Constitution or under the act of Congress in either case, that distribution shall not reduce earnings and profits, but if the stock dividend is a taxable dividend because taxable under the Constitution and

because Congress has taxed it, then it shall reduce earnings and profits. With the proper safeguard that in no case shall a distribution of stock out of earnings made before March 1, 1913, be considered as not producing earnings and profits unless the distribution is exempt for some other reason other than because it is out of earnings and profits before March 3; in other words, if it is exempt because it is an *Eisner* v. *McCumber* dividend, or if it is exempt because Congress has exempted it as a stock dividend, regardless of what it is out of; in either of those two cases, of course, the corporation has still got the earnings and profits. That is all that this amendment says. It takes a great many words to say it, because the concatenations of circumstances are large.

Senator COUZENS. Is it a wise amendment, in your opinion, Mr. Beaman?

Mr. BEAMAN. It seems to me it is almost a self-evident proposition. The policy is that when a corporation has made a distribution which is not taxable and a dividend out of earnings and profits, then quite obviously the earnings and profits ought to be still there for the purpose of determining whether a future distribution is out of earnings and profits or not.

Senator BLACK. What stock dividends are not taxable now under the law that we would have a right to tax under the Constitution?

Mr. BEAMAN. We do not know. That is one of the reasons this amendment is so long.

Senator BLACK. Is that complicated any by the recent opinion of the Supreme Court?

Mr. BEAMAN. It is not helped any by the recent opinion. You see, what happened was, when *Eisner* v. *McCumber* came down, that said that dividends of common-stock holders were not income within the Constitution wherein Congress in 1921 put in the law that stock dividends shall not be subject to tax. There is not much in inquiring what they meant when they did it. I have an idea, but that is neither here nor there. That is what they said. The Treasury immediately put out a regulation that that meant exactly what it seems to say on its face, namely, that dividends paid on stock of a corporation was not taxable. Whether or not the Constitution permitted the taxation or not, the Treasury took that view of the law and so interpreted it, and nobody knows whether the Supreme Court is going to follow the Treasury on that point. Everybody hopes that this decision handed down a week ago Monday, I think it was, in the *Koswood case* would settle that question, but it does not do it, so we do not know any more than we did before whether Congress, when it said in 1921, that Congress said that stock dividends shall not be taxed, whether they said that stock dividends which cannot be taxed under the Constitution should not be taxed, or whether they will be taxed.

This House bill in which you gentlemen have concurred had settled the doubt for the future to this extent, that the bill says that stock dividends shall be taxable just as far as the Supreme Court will let them be taxed. Just how far that is, still nobody knows, and it is impossible to write a rule into the statute now which would attempt to specify the various ones because nobody has had time to go into it, and we did not try to attempt any enumeration. It is safer to leave it that way.

Senator BLACK. Under the bill as we have it drawn now, whether there is a computation made of the 7-percent tax on undistributed dividends, does the corporation receive credit for distributed stock dividends that are taxable?

Mr. BEAMAN. It does; but not for those that are not taxable.

Senator BLACK. So that if a corporation desired to do so under this bill as we have it, it could distribute its dividend either in money or in stocks which would be taxable on the individuals and receive credit for either type of dividends?

Mr. BEAMAN. That is right.

Senator BLACK. There is no doubt about that being absolutely provided for in the bill?

Mr. BEAMAN. Not at all.

Mr. KENT. If I may so say, the decision of the Supreme Court in the *Koswood case* clarified the situation only to this extent, that it gives support to the conviction that many of us have had that there are forms of stock dividend differing from those involved in *Eisner* v. *McCumber*, which are taxable so far as the Constitution is concerned. The Court's opinion definitely recognizes that, although it does not attempt to make any exhaustive enumeration of such dividends, but so far as the interpretation of the statute is concerned, the Court said that the result which it was reaching would be reached whether Congress had exempted, because of *Eisner* v. *McCumber*, stock dividends from taxation or not; that it did not make any difference in the decision of the case and therefore it was not necessary for the Court to decide. Further, the Bureau's regulations were a proper interpretation of the statute.

Senator CONNALLY. Did not the Court in this last opinion hold that stock dividends were taxable?

Mr. BEAMAN. Ir will take but a minute to describe that case if you are interested. The corporation had outstanding some preferred stock and had some earnings and profits. Instead of distributing them in cash, it gave the preferred stockholders common stock. Now, it is quite apparent, I think, that if there were a taxable dividend, the question could never have confronted the Court which did confront it; namely, what happened was that the man sold not his stock dividend but his old stock for which, we will say, he paid $100. He paid $100 for this old stock, and now he takes the stock dividend. If that were a taxable dividend, of course he has his $100 basis for the sale of his old stock.

The Department, however, had made a ruling long ago that if a fellow gets a stock dividend, whenever he gets a stock dividend the basis of his $100 shall be allocated and spread over the two. If what he got was a taxable dividend, nobody could possibly claim that he had any reduction in his $100 basis. Therefore, if that was true, and the court should say it was a taxable dividend, that would dispose of the case right then and there and, of course, the Government would lose the case and the man would have his basis for $100; but the court did not do that. They went ahead and examined into the question whether this ruling of the Department was valid, and yet they say in another part of the opinion that whether or not this is a taxable dividend is unimportant in this case, and nobody can make head or tail out of it.

Senator CONNALLY. But in one place that opinion went on to say that Congress in interpreting the *Eisner* v. *McCumber* case had stated—I am not talking about the rule of the Department and the Bureau of Internal Revenue—had indicated that Congress thought that the ruling was that the stock dividends were not taxable.

Mr. KENT. I do not think it was so much that they thought Congress had done that, but the Bureau's regulation, which had been in effect for a great many years, had placed that interpretation on the action of Congress.

Senator CONNALLY. I read that portion of the opinion, and it occurred to me that that interpretation was that the rule is too broad, and they still had the power to tax in some of these cases.

Senator KING. Are there any objections to the amendment that has just been presented by Mr. Beaman? The Chair hears none, and it is accepted.

Have you any others, Mr. Kent?

Mr. KENT. This is an amendment to the Lonergan amendment. While this is being distributed, may I bring up again a matter which I discussed before the committee yesterday, for the purpose of obtaining, if possible, a decision on the question of policy involved with respect to mutual benefit corporations, and which would include investment trusts which are taxable under the statute as corporations where they comply with the conditions of the proposed amendment.

The effect of the proposed amendment, if adopted in principle, would be to enable such institutions, if they took up 100 percent of their dividends along with their other investment income and capital gains income into their statutory income, to obtain credit for the amount of pro rata dividends paid by them during the taxable year; in other words, if they paid out all of their net income, they would escape any corporate tax.

Senator CONNALLY. Any corporate tax?

Mr. KENT. They would escape payment of any corporate tax.

Senator CONNALLY. Flat or graduated?

Mr. KENT. Flat or graduated. The reasons which are urged in support of such special treatment for this group of enterprises is that they provide a method by which investors may, through buying the shares or the beneficial certificates of such corporations or trusts, obtain the benefits of diversification of risk in the investment of their funds. Each one of these institutions invests in a more or less varied list of securities. In some cases the trusts of the fixed type, the trust instrument in itself, will specify the securities in which the trustees may invest the funds of the certificate holders. That is, they have discretion within the limits of that list, but they cannot go outside of that list in making their investments.

It is urged that the imposition of the flat corporate rate—and the complaint has existed under the present law, it is not by reason of anything in the new bill except to the extent that the flat rate may be increased—that the payment of the flat rate in such cases reduces so seriously the yield to the certificate holders upon their investments that it will be difficult or impossible for them to continue unless such a special treatment is provided.

I merely wish to point out that in order to take advantage of this amendment, they must take up 100 percent of their corporate dividends instead of 10 percent, which other corporations are compelled to

do, into their adjusted net income, and that they could scarcely afford not to distribute any of the income received from dividends, because the effect of doing so would be that they would be subjecting themselves thereby to an 18-percent rate plus a 7-percent rate, the undivided profits rate, on 100 percent of their dividend income.

If the committee is favorable to the amendment in principle, then I should like to have permission to present a perfected draft at the same time that the draft on the corporate liquidation and the reorganization problem is presented. If the committee is not favorable to the amendment in principle, there is not much in going ahead and undertaking the very considerable labor that would be involved in perfecting the draft so as to provide safeguard against the abuse of the amendment.

Senator KING. Do you believe it is so important to the Treasury that this amendment should be perfected and offered as part of the bill?

Mr. KENT. So far as the Treasury is concerned, I cannot see that there is any real prejudice in it from a revenue point of view. The President did indicate in a message which he sent to the Congress, I believe prior to the revenue act of a year ago, an interest in bona-fide investment trusts. He stated the view that they were performing a socially valuable function, and that probably that the method in which they should be taxed was one which he thought was worthy of serious consideration.

Senator WALSH. Without this amendment, they could distribute all of their income except 90 percent that they received from dividends?

Mr. KENT. Yes.

Senator WALSH. This amendment, in order to get that benefit, would compel them to include that 90 percent?

Mr. KENT. That is right.

Senator WALSH. I think the amendment should be adopted.

Senator LA FOLLETTE. Well, Mr. Kent, can you tell me whether these investment trusts that Senator Walsh and Senator Metcalf have been discussing, how they differ from other investment trusts?

Mr. KENT. This amendment, Senator La Follette, would apply to all investment trusts which satisfies the conditions. Let me point out what some of the conditions are. We might think in a perfected draft that there would be others which would improve it.

One of the conditions is that a trust must not own more than 10 percent of any class of stock or any issue of securities of any other corporation. That is to prevent an investment trust or corporation being set up for the purpose of obtaining a controlling interest in some other corporation and manipulating its affairs.

Senator LA FOLLETTE. Now, for example, let me see if I understand that. Let us say that this investment trust has $1,000,000 to invest. It could invest that $1,000,000 in the stock of any one company, providing the $1,000,000 did not exceed 10 percent of the total stock of the company they were investing in.

Mr. KENT. Yes, that is true; and provided that in the process they did not acquire more than 10 percent of any particular class of stock. It is not limited to the investment in the voting stock of the corporation.

Senator LA FOLLETTE. What else?

Mr. KENT. Another provision in the proposed amendment is that not more than 10 percent ownership of the securities of the corporation or trust must be held by any one individual, and one individual is defined in substantially the same manner as in section 351. The purpose of that is to prevent one of these companies being set up in a form to make it practically a personal holding company.

Senator WALSH. There are these two distinctions, also. Most of these trusts are at liberty to distribute as little or as much of the income as they see fit to their stockholders. This particular type of trust must distribute all of its net gains and profits that it makes from the transferring of stocks or securities. Secondly, this particular type of trust holds itself open, like a savings bank, to pay in cash the certificate at any time that anyone demands it. No other trust can do that.

Senator LA FOLLETTE. Senator, I hope you will understand. I am not positive about this thing and I do not know enough about it really to discuss it, but I did take the time to go back to the reports of the stock-exchange practices made by the subcommittee of the Committee on Banking and Currency, and I would like, if the committee will bear with me, to read briefly from their report, just to indicate that there are certain types of trusts which it seems to me should not be given any particular advantages, and that is the question that I raised, whether the conditions set down here could not be used by these people to bring themselves under the privileges of the act.

It won't take me but a minute. I am not going to burden the committee. This report starts out with the first heading of "Abuses." [Reading:]

> The investment trust has become an important component of the investment system of our Nation. Availing themselves of the successful record of English and Scottish investment trusts as a potent sales argument to inveigle the participation of the public, American financiers, devoid of the tradition, training, viewpoint, and competency of the British investment trustees, employed the investment trust to indulge in venturesome transactions in securities with the "public's money", and as vehicles for personal profit.
>
> A veritable epidemic of investment trusts afflicted the Nation. The conception of function of these professed skillful investing managers of the function of an investment trust was diametrically opposed to the British viewpoint. Our investment trusts, lacking the essential characteristics of the British companies, were founded in speculative desire and dedicated to capital appreciation rather than investment return. The investment trusts of this country, from their inception, degenerated into a convenient medium of the dominant persons to consummate transactions permeated with ulterior motives; served to facilitate the concentration of control of the public's money; enabled the organizers to realize incredible profits; camouflaged their real purpose to acquire control of equities in other companies; and became the receptacles into which the executive heads unloaded securities which they, or corporations in which they were interested, owned.

I shall not read any further out of that, but just to give a little idea. Under the heading "Concentral of control of public's money" the report states:

> Through the medium of the investment trust, the organizers were enabled to acquire control of an amount of the public's money grossly out of proportion to their own original investment.
>
> In the instance of the United States & Foreign Securities Corporation, Dillon, Read & Co. and its associates, in consideration of the investment of $5,100,000, procured 50,000 shares of the second-preferred stock and obtained absolute control of that corporation through the ownership of 750,000 shares of common stock,

which had the exclusive voting power of the $25,000,000 invested by the American public.

I am not going to bore the committee with reading any more of that.

The next heading here is "Excessive profits to organizers", and there it is stated:

The organizers of investment trusts always succeeded in devising a financial set-up which allocated to them a most substantial equity in the company with a minimum of cash investment.

Under the heading "Failure to diversify holdings", one of the arguments of these organizations was that they could diversify for the smaller investor which he could not do for himself.

The report states:

The organizers of investment trusts in this country merely paid lip service to this expressed purpose. The record before the subcommittee demonstrates that the proclaimed intent of diversification was merely a cloak to conceal the real purpose—to acquire concentrated holdings in particular industries, thereby subjecting the investor to the very risk he was seeking to avoid.

And there are examples given of that.

Under the heading "'Unloading' of securities on investment trusts", the next heading, it states:

Investment trusts possess the functional indicia and connotations of banks. These investment companies are entrusted with funds by the public with intent to effectuate investments which assure the investor of a fair return upon his money without subjection to undue risk. As was stated by Clarence Dillon referring to the United States & Foreign Securities Corporation, "I am a large holder of what you call the 'public's money.'"

This guardianship is burdened with the elemental fiduciary duty of fair dealing at arm's length with the public. The realization of secretary profits of pecuniary advantage by the dominant personalities of these investment trusts, from the transactions consummated through the medium of these trusts, is repellant to the concept of true function of these investment companies.

The limited inquiry which this committee has been able to make into investment trusts exposed a predominance of conflict of interest and duty of investment managers and their cestui qui trust, the investment public. The record indicates that the losses sustained are attributable to the fact that these investment managers resolved those conflicts in their own favor to the pecuniary disadvantage of the investor. Executive authorities employed the investment trusts as convenient receptacles into which to unload securities which they personally, or corporations, or copartnerships in which they were interested, owned.

And then a lot of examples of how the public was skinned.

I am not saying that these companies that you are suggesting need help are——

Senator WALSH (interposing). There are only five in the country of this type.

Senator LA FOLLETTE. I am trying to point out for my own point of view for Mr. Kent that there is a problem here which must be considered by the committee in connection with this. That is all I have to say about it.

Senator WALSH. If the Treasury would not lose any money, would it not be in the public interest, decidedly in the interest of these poor who go into these investment trusts, to require them to distribute every dollar that they take in, and furthermore to be in a position to give them the cash when they want to get it? That is the position of that particular trust, and there are only five, and they have grown with great rapidity because of these features.

Senator LA FOLLETTE. I confess that at this stage of the proceedings I am unable to pass any intelligent judgment upon this amend-

ment and the problems that are involved in it, but I do say that if the committee adopts the policy, that what little I have said here will put Mr. Kent and the other draftsmen on notice that we want this amendment drawn in such a way that it is not going to offer advantages to trusts that are operated, or were operated at least prior to 1929—maybe they have all reformed—I do not know enough about it, but they certainly were indulging in practices in 1929 and before, that received the condemnation of the investing public as well as the general public, and they were a part and parcel of the mechanism for manipulating stock prices not only to the disadvantage of the investors in the so-called investment trusts, but to the disadvantage of individual investors who were going into the market that was rigged against them before they ever put a dollar on the line.

Mr. KENT. It is because of my awareness of some of those problems, Senator, that I am quite unwilling to say to the committee that the amendment as now drawn contains adequate safeguards against such abuses, and it may well be that in the time available it will prove quite impossible to submit a form of amendment which I can with confidence assure the committee will contain adequate safeguards.

There have been bad investment trusts and good investment trusts. The bad ones were what you call of the management type, where the discretion of the trustees is almost unlimited. The good ones have been more often, although not exclusively, of the fixed type, where the trustees are limited by the terms of the instrument itself.

Senator WALSH. I do not want to prolong this, Mr. Kent. Is it a fact that there is a group of these trusts that are apart and distinct and have a high rating, as high a rating as any bank in the country?

Mr. KENT. I think that is probably true.

Senator WALSH. And they should at least have the rights of a bank.

Senator LA FOLLETTE. In opening the door to obtain that assistance, I do not want the public policy or the tax policy of this Government to be used by the type of trust which, if they are still indulging in the practices that they were before 1929, they ought not to be given any particular inducement to go on.

Senator KING. I understand Mr. Kent is to further consider this matter and perfect the amendment. There is no need for further discussion of it at this time.

Is there anything else?

Mr. KENT. I have now the suggested amendment to the Lonergan amendment. It has been passed around.

Senator CONNALLY. I do not want to interrupt, but I am going to be away after today, and I would like to present a matter. If I can be sure that we will meet this afternoon——

Senator KING (interposing). Perhaps we had better consider your amendment now, Senator Connally.

Senator CONNALLY. Mr. Chairman, I brought this up the other day and the chairman assured me that we would have a reconsideration of it. The committee one day, during a hectic session, voted me down. I know that the Senator from Michigan is not in sympathy with this, but I want to bring up again, for revision, the matter of capital gains in the case of mines, oil wells, and oil leases. The case of mines does not make so much difference, because a mine is a permanent thing and you can work it or not as you like, but in the case of oil wells and gas leases, it is fugitive, and unless the dealer can sell it promptly, his

property is gone, or else he has to spend more money to dig offset wells and things of that kind. In the old law, we only charged people 16 percent of their actual capital gain and loss. It is not like an income from property, because when you have an income from property you still have your property left, but when you sell an oil well or a gas well, your capital is gone.

Under the present law a man will go out and discover an oil lease, and it is worth $1,000,000. He sells it and he has to pay $770,000.

Senator WALSH. Within what period of the sale?

Senator CONNALLY. Any time within a year, he has to pay $770,000. He has got to spend a lot of money to invest and discover it and drill wells, and all of that, and it is prohibitive. They cannot sell it.

A little later on, we raised the tax to not exceeding 20 percent. I want to ask Mr. Parker here—he tells me that his view is that if we will loosen this up, we will make revenue and we will get money. There are no dealings in these things now. If a corporation does the same thing, the Gulf Oil Co., or the Standard Oil Co., or the Texas Co., if they do the same thing, they pay 15 percent and no more, because it is a corporation; but if it is an individual, he has got to pay out all he makes in order to make a sale and try to make a profit. That is not fair nor just. You are turning over the entire oil business to a few great and powerful corporations.

Senator WALSH. Are you going to confine yourself to oil?

Senator CONNALLY. Oil and gas; fugitive properties.

Senator COUZENS. I want to add patents and royalties to it, because you have exactly the same thing there.

Senator CONNALLY. I have no objection to adding that, but I am confining this to the old law. If patents are entitled to be put in, put them in; but this is a matter that we dealt with, and I want Mr. Parker to quickly and sharply tell this committee what he thinks about whether we will get some revenue or not.

Mr. PARKER. Is it true that if a man makes one of these discoveries you talked about and there is $1,000,000 over there, he is going to hesitate before selling it; there is no doubt about that. What he can do if he can will be today with the present tax, he won't sell, but he will lease it. When he leases it, his tax will be very much smaller than if he sold it. If he sold it, we would get more money if the transaction takes place. If the transactions do not take place, we won't get as much out of the annual income from the operation of that lease on account of the fact that depletion is given to the lessor and the lessee, as we would if he sold it, and then the company won't go on with the proposition. It is purely a practical matter of whether or not the rate is so high as to prevent wildcatting in oil fileds.

Senator CONNALLY. It is prohibitive.

Senator HASTINGS. If it were incorporated, it would not sell either, would it?

Mr. PARKER. There would be no need of this—at first sight you would say "Why doesn't the man incorporate and pay the 15 percent tax?" The trouble is with the incorporation proposition and the wildcatter, if he incorporates, of course he comes under the personal holding company, and if the company sells it, that capital gains will go into a personal holding company, so we have him through the same tax as if he sold an individual.

Senator CONNALLY. Suppose I already have a lease? If I incorporate I have to turn my lease into the corporation and that is a sale. That is a sale from the individual to the corporation.

Senator HASTINGS. But, Senator, the stockholder of that corporation when he gets the money and his $1,000,000, he reaches into the surtax brackets, and he is in the same position as individuals.

Senator CONNALLY. What I mean is, he cannot incorporate because if he already has his well incorporated, he has got to transfer his lease over the corporation, and when he does that, that is just the same as if he sold it to Bill Smith or John Jones.

Senator COUZENS. Not if he took stock of the percentage in the ownership.

Senator CONNALLY. I do not see why not under our laws. You have to make affidavit of the value of the property. Suppose it is a tract of land and does not have any oil. We provide for that if he holds that for 5 years, he gets a reduced rate; if he holds it 2 years he gets a reduced rate, because he has spread it out over the period. If he holds it 5 years he gets a reduced rate, if he holds it 10 years, he gets a very greatly reduced rate. That is just the same as an oil well, except with an oil well, he cannot hold it; he has either got to sell it or it is gone. Somebody else gets his oil and somebody else gets his gas, and this differentiates.

I would like very much if the committee will put this in and let it go to conference. I am willing to raise the rate. I am not going to quibble about that, but we are going to get some revenue here.

Senator WALSH. It is quite evident that this committee will have to have another session and report amendments through the committee to the floor, and I hope the Senator from Texas will allow this to be done, because I do not think the committee is in any temper or mood to discuss amendments, because most of the members want this bill reported today, and we want to get to the major question and decide that so that we can report the bill.

Senator CONNALLY. I am going to leave town, and I should like to have this considered before I go.

Senator COUZENS. You can have somebody else put it on the floor.

Senator WALSH. I move we consider the matter of rates.

Senator KING. I think the Senator is entitled to have the matter voted upon.

Senator GUFFEY. What the Senator from Texas has said is right along the lines of the problem which arose during the war days, and we had to get an amendment to help out the same situation in order to get oil enough to run the war. I am in sympathy with what Senator Connally is trying to do as an oil man.

Senator CONNALLY. We have never until the last revenue bill departed from the principle I am urging now, and the tax heretofore has never exceeded 24 percent until the last revenue bill. Simply in the hope of grasping a lot of money, we enacted the present law which makes them turn it all in, and Mr. Parker knows that the revenue has not come in under that. It did come in before the rate was made prohibitive.

Senator CAPPER. Mr. Chairman, I come from an oil State, and there is merit in the proposal made by the Senator from Texas. I think it is a fair proposition and it will be to the interests of the Government

if the proposal submitted by the Senator from Texas were incorporated in the law.

Senator BARKLEY. Let us put it in and it goes to conference anyhow.

Senator LA FOLLETTE. What rate do you suggest?

Senator CONNALLY. Not exceeding 30 percent.

Senator LA FOLLETTE. What do you think of that, Mr. Parker?

Mr. PARKER. Let me understand this. It is the same as the old law, and the old law was not on the gain. The old law was that the tax shall not exceed 30 percent of the selling price. That is a bigger base, and that is more protection to the Government. If it is on 30 percent of the selling price, the same as the old law and not on the gain, that is a considerably bigger amount.

Senator CONNALLY. This is on selling price. It may be more than the gain.

Mr. PARKER. If $1,000,000 is the selling price, his gain might have been only $900,000.

Senator CONNALLY. Or $500,000 or $600,000.

Mr. PARKER. In which case, 30 percent, his tax, would only be $150,000. So you are putting this on a selling price, the same as the old law, and that makes quite a lot of difference.

Senator CONNALLY. In favor of the Government.

Mr. PARKER. I think if you put it there, we would be around the place where we would get the most revenue without freezing the transactions.

Senator KING. Is the committee ready to vote upon the matter?

Senator CONNALLY. I should like it voted upon.

Senator COUZENS. I understand the last time you wanted to vote on this, you wanted to claim it to be retroactive?

Senator CONNALLY. No.

Senator KING. If there is no objection, it will be incorporated and go to the conference.

Senator LONERGAN. May we pass on the insurance amendment?

Senator KING. Mr. Kent, have you anything on that?

Mr. KENT. The committee yesterday adopted one amendment to the Lonergan amendment to make it clear that the proceeds of the policy were included in the gross estate, and then the proceeds as far as used to pay the tax, is allowed as a deduction. We suggest this further amendment:

> Page 2, strike out all after the comma in line 10 through line 13, and insert: "That the proceeds of policies on which the premium-paying period is less than ten years, or on which the premiums are not substantially equal in amount for each of the first ten years of the life of the policy, or on which more than one year's premium has been paid in advance, shall not be deductible: *Provided further*, That the amount deductible as aforesaid shall not include premiums paid in advance, and shall not exceed $1,000,000."

There is just one item in there, the phrase "on which more than 1 year's premium has been paid in advance."

We have been talking over the matter and believe that that is necessary to close a possibly serious loophole if some fly-by-night company wishes to make a collusive arrangement with a policy holder. I do not anticipate any such difficulty with reputable companies, but one never can be sure, and I cannot see that it would measurably affect the general purpose of the amendment.

Senator LONERGAN. Mr. Kent, I would like to have inserted, if you will, please, in your copy——

Senator KING (interposing). Before you withdraw, Mr. Kent, I understood from some source that I regard as authentic, that Senator Lonergan's amendment, if we adopt it, would cost the Government $40,000,000.

Senator LA FOLLETTE. Mr. Seltzer, have you your final estimate on that?

Senator KING. I was wondering what the facts are.

Senator LONERGAN. Can we not dispose of this and then go into the figures?

Senator KING. Very well.

Senator LONERGAN. Mr. Kent, will you please take your copy and if you will follow me (reading):

That the proceeds of policies on which the premium-paying period.

I want to have inserted after that word "period", "as provided in the policy."

Senator COUZENS. I think that leaves it open to all kinds of a policy.

Senator LONERGAN. I beg your pardon. It was ambiguous. "That the proceeds of policies on which the premium-paying period is less than 10 years"—the words "premium-paying period." Supposing John Jones has his life insured and he pays one premium or he pays two premiums. This is ambiguous. In that case that policyholder's estate would not have the advantage of this. We are talking now of term insurance, a 10-year policy, and therefore we should incorporate the words "as provided in the policy."

Senator WALSH. What difference does it make whether it provides payments every 3 months or every year? It is the same thing.

Senator KING. What do you think of that, Mr. Kent?

Mr. KENT. What we had in mind was to exclude any policies which could become paid up in less than the 10-year period.

Senator LONERGAN. You accept that amendment, do you not? It makes it clear.

Mr. BEAMAN. I do not think you need the word "as."

Senator LONERGAN. Well, that is all right.

Senator BARKLEY. It would have to be provided in the policy or there would not be any premium-paying period.

Senator KING. Is there any objection?

Senator LONERGAN. That is on this amendment that I offered?

Senator LA FOLLETTE. Have you an estimate now?

Mr. SELTZER. We have not completed——

Senator LONERGAN. I beg your pardon. Do I understand that has been adopted?

Senator KING. That is adopted, yes. Now, Mr. Seltzer.

Mr. SELTZER. We have not completed a final estimate of the probable loss resulting from this amendment for the calendar year 1936 or for the fiscal year period. For one thing, it depends upon whether the period allowed for returns remains at 15 months from the time of death, or whether it is made for a year from the time of death.

Also we want to play with the figures a little bit more, but I do not think that there is any doubt that over a period of years, this amendment is capable of reducing the revenues of the Government by something in the neighborhood of $50,000,000, and for this reason: The

exemption of the insurance policy comes off in effect from the top bracket of an estate. In the second place, it is the larger estates, usually, that get the best legal advice, and the large estates can be expected to be protected in this respect. We found, for example, we estimate that during the fiscal year of 1936, our estate tax levies will aggregate about $191,000,000, the Federal Government's share of it. In the fiscal year 1937, $268,000,000. For the calendar year 1936, we expect the tax liability accuring to be in the neighborhood of $300,000,000.

I would want to check a little more carefully than I have had time to, but I would say offhand that this $301,000,000 tax represents something between 18 percent and 19 percent of the net value of the estate; or, let me put it this way, that on an over-all basis, the totality effective rate of tax on estates would average somewhere between 18 percent and 19 percent. I make that statement subject to correction.

What you in effect do is to make it possible to reduce your revenues from the estate taxes by that percentage of 18 or 19 percent; that is to say, if all decedents subject to estate taxes took out policies payable to the Government in the amount, or roughly in the amount, of the tax that would be borne by their estates, the revenues would be reduced by about 19 percent.

Senator HASTINGS. Have you taken into consideration the fact that the chances are that these kinds of policies will increase estates over what they would normally be; for instance, if there is an estate worth $10,000,000, and the person took out a $1,000,000 policy, are not the chances that that will be $1,000,000 more than he otherwise would have had except the amount that he pays in premiums?

Mr. SELTZER. Where would he get the money to pay his premiums?

Senator HASTINGS. I say, it takes off something for that.

Mr. SELTZER. Is it not really just a transformation of the character of the composition of the estate? More consists of insurance and consists to a lesser extent of something else.

Senator HASTINGS. It depends on how long he lives.

Mr. SELTZER. Unless the insurance companies lose money.

Senator GERRY. Mr. Chairman, I would like to ask a question on this. I think the Treasury has absolutely misconceived the whole theory of it. What has really happened, and the Senator from Delaware brought it out, is where a man has a big estate, we will say 8 or 9 or 10 millions, what he does in this is he saves a certain amount of money that he would not otherwise save to put into an insurance policy, making the Government the beneficiary. That is the first thing he does. If there is not this clause in the bill, he won't put it into that insurance policy; he probably would not put it into anything. There are other ways of taking out insurance, and he can probably get around it very much more easily. For instance, a man can take out an insurance policy on his death, and the Government cannot collect a cent.

Another thing which the Treasury is entirely overlooking is the question of what we brought out last year, of where a man is on in years and one or two in the family own a mill, and they feel that they will not be able to realize because that is not liquidate assets and they will not be able to realize on the estate so they are probably going to liquidate, they are not going to borrow money, they are not going to

make anything like the money which the Government will get the taxes on unless they feel they have some security. On top of that, you had the cases in 1929 where the thing was at the top of the market. You have got a provision which we helped a little bit in this bill of where you can put it over a year, but even then you may not be able to realize, and you have many estates—I have a case I brought up—you may not be able to realize on the estate when the man dies because they do not keep the money in going concerns, and the result is going to be, if you got this insurance policy with the Government as the beneficiary of it, you are going to get cash right away and you are going to get the advantage of that cash.

Personally, I think your figures are based absolutely on a theoretical actuary basis, and that you are going to make money and not lose it. It is not just sitting down and taking figures on what you will get, and a lot of people will get around to taking insurance on another person's life and they getting the benefit of it.

Senator COUZENS. I would like to have an amendment drafted—I am not going to ask the committee to do it now—that this would not apply to estates exceeding $1,000,000. The application of this provision would not apply to estates with a net value of more than $1,000,000.

I think this provision is not defensible for big estates. I see no reason why big estates should have the provisions of this amendment. I do see some advantage and some desirability if the amendment is applied to the small estates which the Senator from Connecticut has been referring to, and others where they might break up a big business, but in the big estates, I see no reason for this application, and I would like to have such an amendment prepared to limit it to estates of a million dollars net or less, and then we will take it up later.

Senator GERRY. Of course I disagree with the Senator from Michigan. What they can always do is to insure outside, and I think the Treasury will lose money on the big estates. I think you are going to need it.

Senator LONERGAN. I think this, Mr. Chairman. I think in most cases that the policies will be in amounts far in excess of the sum found due the Government, and that excess of course will be taxable; there is not any question about that. I also believe that most of the policies that will be issued will be issued for comparatively small sums, say $25,000 to $50,000.

Senator COUZENS. My amendment probably would not affect that.

Senator LONERGAN. That is my judgment from my knowledge of my own section of the country. You must bear this in mind, that the United States Government loses a great deal of money where the estates are unable to pay, estates of individuals and of corporations. Let us make the test. If we find we are losing money, we can deal with it in a year or two from now, but let us make the test.

Senator COUZENS. But then the policies are all in effect.

Senator LA FOLLETTE. Then they are a vested interest.

Senator GERRY. The Senator from Michigan was not here when we had this question of estate inheritance taxes up.

Senator COUZENS. You can inform me outside of the committee room. Let us get down to the next thing.

Senator GERRY. I think I have a right to be heard.

Senator COUZENS. There is no objection to your being heard, but you are going to inform, and I say that you can inform me outside of the committee room.

Senator GERRY. I do not think it is necessary to inform the Senator if he does not wish to be. But I do think there is this proposition that the testimony showed last year very clearly, that the tax would be 100 percent and over. They admitted that, because they cannot realize.

I frankly think that the Government will make money on it, and if you are going to confine it to the taxes that you have in the 1934 act, you are going to get into the difficulties of raising money. I have a case now which I put up to the Treasury, where a small estate, or a large trust, where a man died in 1900, where the beneficiary is probably going to owe the Government money, and there is no way she can get out of it.

Senator LA FOLLETTE. Mr. Seltzer, just briefly once more, I want to ask you for the record: Did you take into account in making this estimate for this committee and will you take into account when you furnish it finally, your final estimate, the experience of the Government so far as it has had experience in regard to losses due to the insolvency of estates?

Senator GERRY. And will you take ito account how many of those have been decided since the act of 1934 has gone into effect, and the act of 1935, because you have not had any settled in that time.

Mr. SELTZER. We shall of course take those facts into account.

Senator GERRY. Will you give me the numbers?

Mr. SELTZER. As far as I understand the situation, there is no prohibition today against individuals taking out life-insurance policies to provide their estates with the liquid funds necessary to pay estate taxes. The only change that this law makes is to provide a special extra inducement in the form of a tax saving.

Senator GERRY. Why in the high brackets would any individual take out life-estate insurance when the Government will collect 70 percent of it? Of course what will happen is not that. The heirs will take out the insurance on the decedent's life, and they won't pay any tax.

Senator KING. Is there anything further?

Mr. KENT. I merely want to ask one further question: Does the committee wish this amendment to apply to decedents dying before the enactment of the act?

Senator GERRY. Personally, as a member of the subcommittee, I think that is absolutely wrong.

Mr. KENT. That it should not apply retroactively?

Senator GERRY. Retroactively? No.

Mr. KENT. That should be added on then.

Senator GERRY. What do you mean by that?

Mr. KENT. Suppose that someone dying before the effective date of this act has taken out an insurance policy the proceeds of which are to be used for the payment of taxes?

Senator WALSH. Should they have the past premiums paid deducted? Of course not.

Senator LONERGAN. My judgment would be it should be effective as of the date of the passage.

The CHAIRMAN. I understand Senator Couzens has offered an amendment.

Senator COUZENS. I want it prepared. I will offer it at some other time. I do not want to take up the time of the committee.

Mr. KENT. I hesitate to take up any more of the time of the committee. But I have one other matter and then I am through.

In section 211 (b) which contains the phrase "engaged in trade or business in the United States" this is not an exclusive definition. It simply includes one thing and does not include another thing. There are two problems that are likely to be troublesome. The phrase "engaged in trade or business in the United States" includes any personal service profit within the United States during the taxable year of a professional character or otherwise, that is, other than services rendered for a nonresident alien employer by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000.

The purpose of that is to take care of these commercial traveler cases and business executives coming over here for a short period of time to negotiate business contracts.

Such phrase does not, however, include the effecting of transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian.

Senator WALSH. I move that it be adopted.

Senator KING. Without objection, it will be adopted. Are there any other amendments?

Senator COUZENS. I hesitate to do this, but there has been a long controversy about taxing these apostolic organizations who have a community interest, such as the House of David, the Shakers, and so on, the Holy Rollers, and all of those. They are not permitted to deduct the married man's or single man's allowance, and they are taxed as a corporation. When they enter these organizations, they put in all of their property, I understand, and do a community business, run community farms, and all of the revenue is put in one pot and they are taxed as a corporation, and the married people in these organizations are not permitted to deduct anything for being married, or the single men for being single. So they have been imposed on for a number of years by that application of the law to them.

I would like, if there is not too much objection, to have an amendment drawn and later submitted to the committee covering that question. There are a number of organizations throughout the Nation who are very adversely affected, and it does seem to me an antireligious procedure to follow in the tax law.

Senator WALSH. Of course, there is no objection.

Senator KING. Mr. Beaman, I talked this over with you and some of the other experts the other evening down in your rendezvous. Did you prepare something?

Mr. PARKER. This is a rather difficult proposition.

Senator LA FOLLETTE. It seems to me this is something that could be handled by the Bureau.

Senator COUZENS. I do not want to take up the committee's time, but I have here a memorandum of a memorandum of law, opinion 550,

which was issued in 1916, and a memorandum signed by Mr. Ballantine, June 1918, in which they took no cognizance of it.

Senator LA FOLLETTE. The trouble is they held that these people are not religious organizations because they do not belong to an accepted religion, but to them it is just as much a religion as any other kind of a religion.

Senator COUZENS. It does not seem to me that there is any justification for it at all.

Senator LA FOLLETTE. If you would hold that they are a religion, they would get out under section 101.

Mr. KENT. I do not think so——

Senator WALSH (interposing). Can we agree that the amendment can be ordered and submitted to the committee later?

Mr. KENT. I do not believe that section 101 is broad enough to cover them, because that provides that no part of the earnings shall inure to any individuals. These people are getting individually the benefits of community earnings even though the funds as such are not divided between them.

Senator COUZENS. Yes; but they are not getting the benefit of the earnings to the extent that the married man gets an exemption of $2,500. They probably make $500 or $600, and an ordinary person would be exempt and they are not exempt.

Senator LA FOLLETTE. If you just decide they were a religious organization, then you would be confronted with the decision on section 101, and you could have taken care of it that way, and it is a lot easier than trying to put something in the law, because it is going to look very funny when you get through with it, I do not care how long you and Mr. Beaman and Mr. O'Brien work on it.

Senator KING. Prepare an amendment covering that.

Senator COUZENS. And you can submit it to me.

Senator KING. Mr. Seltzer has just advised the Chair that Senator Harrison prior to his unfortunate departure from the committee because of illness, asked him to prepare estimates on estate taxes.

Mr. SELTZER. On certain revisions of exemptions from estate taxes. I do not know whether you gentlemen are interested in getting these estimates or not.

Senator WALSH. Was it to raise revenue?

Mr. SELTZER. Yes.

Senator WALSH. How much were you able to raise by the tax?

Mr. SELTZER. There are several varieties of these changes that were suggested. When one of them got into full operation, it would raise $53,000,000 a year on the basis of the 1936 conditions. Another would raise $47,000,000 a year. A third would raise $44,000,000, and a fourth would raise $40,000,000 a year.

Senator BARKLEY. How long does it take them to get into full operation?

Mr. SELTZER. That depends on your dating, you see. When you make returns filed 15 months after death, that is one story.

Senator BARKLEY. How much would it increase revenue for 1936?

Mr. SELTZER. It depends on how you make the dates in the law.

Senator GERRY. But you cannot change the date in the law on that. That is one thing we went over last year in 1935.

Mr. PARKER. It would have to affect decedents dying after passage of the act.

Senator BARKLEY. You would have to know how many people died and how much they are worth.

Senator LA FOLLETTE. And that would be a year after that, because you have a year to file.

Senator WALSH. I move the estimates be put in the record for the benefit of the committee.

Senator BARKLEY. It would not appreciably increase the revenue for this year.

Senator LA FOLLETTE. It would not increase it for 1936.

Senator KING. It has been moved that they be put in the record for the benefit of the committee for future uses. If there is no objection, Mr. Seltzer's estimates will be included in the record.

(The estimates referred to are as follows:)

ESTIMATED ADDITIONAL REVENUE UNDER VARIOUS ESTATE TAX PROPOSALS

Proposal I: In place of the present specific exemption of $40,000 in computing the net estate subject to the additional estate tax, a specific exemption of $40,000 would be allowed in full on net estates (before deducting a specific exemption) of $40,000 or less, would be reduced gradually on net estates between $40,000 and $80,000, and would be eliminated entirely in the case of net estates of $80,000 and over.

Estimated additional revenue, calendar year 1937

	In millions of dollars
If made retroactive to Jan. 1, 1936, and returns filed 1 year after death	53
If made retroactive to Jan. 1, 1936, and returns filed 15 months after death as provided by the Revenue Act of 1935	40
If made effective June 15, 1936, and returns filed 1 year after death	29
If made effective June 15, 1936, and returns filed 15 months after death as provided by the Revenue Act of 1935	15

Proposal II: Same as proposal I except that the specific exemption for computing the net estate subject to the additional estate tax would be reduced gradually on net estates between $40,000 and $100,000 and would be eliminated entirely in the case of estates of $100,000 and over.

Estimated additional revenue, calendar year 1937

	In millions of dollars
If made retroactive to Jan. 1, 1936, and returns filed 1 year after death	47
If made retroactive to Jan. 1, 1936, and returns filed 15 months after death as provided by the Revenue Act of 1935	35
If made effective June 15, 1936, and returns filed 1 year after death	25
If made effective June 15, 1936, and returns filed 15 months after death	14

Proposal III: Same as proposal I except that the specific exemption for computing the net estate subject to the additional estate tax would be reduced gradually for net estates between $40,000 and $120,000 and would be eliminated entirely in the case of net estates of $120,000 and over.

Estimated additional revenue, calendar year 1937

	In millions of dollars
If made retroactive to Jan. 1, 1936, and returns filed 1 year after death	44
If made retroactive to Jan. 1, 1936, and returns filed 15 months after death as provided by the Revenue Act of 1935	33
If made effective June 15, 1936, and returns filed 1 year after death	24
If made effective June 15, 1936, and returns filed 15 months after death	13

Proposal IV: The present specific exemption of $40,000, in computing the net estate, would be repealed, but a credit against the additional estate tax equal to the estate tax on $40,000 would be allowed.

Estimated additional revenue, calendar year 1937

	In millions of dollars
If made retroactive to Jan. 1, 1936, and returns filed 1 year after death	40
If made retroactive to Jan. 1, 1936, and returns filed 15 months after death as provided by the Revenue Act of 1935	30
If made effective June 15, 1936, and returns filed 1 year after death	22
If made effective June 15, 1936, and returns filed 15 months after death	12

This proposal would have the effect of making the $40,000 exemption of equal value in tax reduction to all sizes of estates.

Senator KING. Is there anything else?

Seantor LA FOLLETTE. I would like to ascertain whether this committee would entertain a consideration of an amendment looking to get some additional revenue from the surtax brackets which were not touched in the 1935 act. I am not talking about $100,000 brackets or reducing the brackets or anything of that kind, but whether they would be willing to consider getting additional revenue from those surtax payers who were not required to increase their contribution to the Federal Government in this emergency by any of the tax legislation we have passed heretofore.

Senator WALSH. And regardless of whatever rates we decided upon to go upon corporate income?

Senator LA FOLLETTE. Precisely.

Senator WALSH. Why can we not get the corporate rates finished once and for all?

Senator LA FOLLETTE. There is a motion pending to report the bill, and the only way I could get any committee consideration of this principle is in that way. There is a motion pending by Senator George moving to report the bill as it was agreed upon some days ago, namely, a flat 18 percent on corporations and a 7-percent tax on undistributed profits.

Senator WALSH. There was some taik about changing that 18 percent to a graduated rate. Has that been abandoned?

Senator KING. There has been no concrete suggestion.

Senator BARKLEY. It is perfectly evident, it seems to me, that this bill as worked out up to date does not raise the required revenue. I think everybody admits that.

Senator LA FOLLETTE. That is my point.

Senator BARKLEY. I have stated frequently that I was willing to increase the normal rate up to 5 percent, but I would rather get it somewhere else. Informally there has been worked out some slight increase on the rate on surtaxes that will raise anywhere from $60,000,000 to $100,000,000, which I think ought to go into this bill.

Senator LA FOLLETTE. I do think, Senator Barkley, that that is so. I do not see how this committee can defend its position by going on the floor with a bill that on its face does not raise as much money as the President has requested and does not raise within $150,000,000 of what the House has raised in its bill, and I am willing to vote for almost any sort of an increase that is reasonable on any of these brackets that will get that money.

My position is, Senator Barkley, that we are much more justified in asking for an increase in the surtax brackets that have not yet been increased than we are, for instance, in increasing the normal, because that applies to everybody without regard to ability to pay.

Senator KING. May I say that I asked Mr. Parker last evening——

Senator BARKLEY (interposing). What are those brackets that have not been raised?

Senator LA FOLLETTE. From $4,000 to $50,000.

Senator BARKLEY. I think we should start——

Senator LA FOLLETTE (interposing). I do not care where we start. But, in principle, would not the committee be willing to get from $50,000,000 to $100,000,000 by a reasonable increase in those surtax brackets that have not yet been touched?

Senator KING. I asked Mr. Parker last evening to present the figures here on surtaxes where there is a sort of a lag, as there is from about $4,000 to $10,000 up to $50,000 or $60,000, to raise about $50,000,000 or $60,000,000, and I think he has done so. Have you that here?

Mr. PARKER. I can go through all of the figures——

Senator GERRY (interposing). Mr. Parker, will you give us the page of the bill?

Senator BARKLEY. Page 8.

Mr. PARKER. We had an estimate for Senator King where he proposed to raise the surtaxes between $4,000 and $62,000 by 1 percent in some cases, 2 percent in other cases and 3 percent in others.

Senator KING. Those are estimates that I submitted to the committee almost the first day we met.

Mr. PARKER. That estimate was $154,000,000.

The rates I am going to give you now are approximately one-third of that amount, and should therefore yield between $50,000,000 and $60,000,000. That estimate, though, is not a Treasury estimate, but it will be in that neighborhood.

On page 8, at the bottom of the page, line 23, upon net incomes in excess of $6,000 and not in excess of $8,000, instead of 5 percent, 6 percent.

Line 24, $200 upon surtax to $8,000. That is $20 increase there.

Senator KING. That is just 1 percent, is it not?

Mr. PARKER. That is 1 percent in the $6,000 to $8,000 bracket, so that a man who has a surtax net income of $8,000 will pay $20 more tax than he does now.

Page 9, on line 1, strike "6" and put in "7". That will make $340 upon surtax on incomes of $10,000, an increase of $40.

Line 5, strike out "7" and put in "8".

Line 7, strike "$440" and put in "$500".

Line 9, strike "8" and put in "9".

Line 11, strike "$600" and put in "$680". In other words, on a $14,000 surtax the surtax will be increased $80.

Without reading all of these, each one of these rates in each one of the brackets will be increased 1 percent; that is, 11 is increased to 12; 13 is increased to 14.

Senator HASTINGS. How far do you know? What is line 15?

Mr. PARKER. Line 13, change "9" to "10".

Line 15, strike out "$780" and put in "$880".

Line 17, strike out "11" and put in "12".

Line 19, strike out "$1,000" and put in "$1,120".

Senator BYRD. It is just 1 percent straight through, is it not?

Mr. PARKER. Yes; but they wanted them read.

Line 21, strike out "13" and put in "14".

Line 23, strike out "$1,260" and put in "$1,400".

Senator KING. It is the equivalent of 1 percent right straight through.

Mr. PARKER. Page 10, line 1, strike "15" and put in "16".

Line 3, strike out "$1,560" and put in "$1,720".

Line 5, strike out "17" and insert "18".

Line 7, strike out "$2,240" and insert "$2,440".

Line 9, strike out "19" and insert "20".

Line 11, strike out "$3,380" and insert "$3,640".

Line 13, strike out "21" and insert "22".

Line 15, strike out "$4,640" and insert "$4,960".

Line 17, strike out "24" and insert "25".

Line 19, strike out "$6,080" and insert "$6,460".

Line 21, strike out "27" and insert "28".

Line 23, strike out "$7,700" and insert "$8,140."

At that point there is $440 increase in the surtax. There is no more change in the rates. That $440 increase will continue throughout now. For instance, on page 11, line 3, strike out "$9,650" and put in "$10,000."

Senator COUZENS. In other words, you add $440 all the way down the line?

Senator GEORGE. A straight addition without any increase?

Mr. PARKER. Yes.

Senator GEORGE. You started to increase at $6,000?

Mr. PARKER. Yes.

Senator GEORGE. And the increase ends at what?

Mr. PARKER. At $50,000, except that that $440 keeps right on.

Senator KING. And the 1 percent is the basis of the increase?

Mr. PARKER. Yes; 1 percent in those brackets.

Senator KING. And that will give how much additional revenue?

Mr. PARKER. Around $50,000,000.

Senator BARKLEY. I move that this amendment be agreed to.

Senator COUZENS. I support it.

Senator KING. As many as are in favor will say "aye"; contrary "no."

(The amendment is agreed to.)

Senator GERRY. Senator Clark asked me to vote him against it.

Senator GEORGE. Mr. Chairman, I suggest one change in the flat tax. We have heretofore imposed fixed or agreed upon, and the committee has adopted a flat 18 percent on corporate profits, net taxable income, but we gave a deduction of $1,000 for corporations up to $15,000. I am advised that we will get the same result if we omit that deduction of $1,000 up to $15,000 and impose the graduated scale of 15.5 percent on the first $2,000; 16 percent on the next $13,000; 17 percent on the next $25,000, and 18 percent on the balance over $40,000.

Mr. PARKER. That was my estimate. I would like to have Mr. Seltzer say something on that.

Mr. SELTZER. I cannot give you an offhand answer.

Mr. PARKER. Do you think it makes much difference? You deal with those things.

Senator GEORGE. Do you think it would make much difference? You have the schedules there.

Mr. PARKER. From your estimates, I would not think that it makes much difference.

Senator COUZENS. While your are considering that, I want to say this, that I do not think the committee is in a humor now to put in cushions, but I want to make it plain that I am going to try as well as I can on the floor of the Senate to try to get cushions on this tax on undistributed earnings. If the committee were in a humor to consider it now, I would bring it up. But I think this tax of 7 percent on indistributed earnings is an unwise thing without any cushions. I do not want to impose on the committee by taking the time now.

Senator BARKLEY. I understood that the fixing of cushions was contingent upon a high graduated rate on undistributed earnings and the 7 percent was agreed upon as the simplest manner to get away from cushions. The Senator from Michigan does not agree on that, but I think that was the feeling of the committee.

Senator COUZENS. I think that was, and that is the reason I brought it up now. I do not know whether anybody has changed his mind since then. That is quite a substantial tax on a person who is in debt and obligated not to pay any dividends, and if the committee is not in any humor to consider cushions with respect to that 7 percent, I will just say that I will try to put it on on the floor of the Senate.

Senator HASTINGS. It seems to me that everybody agrees on the subject of cushions here that ——I got the impression that everybody agreed that it should apply to corporations that had a contract which prevented them from paying out their dividends. I understood that was a simple proposition to put in, which everybody was agreeable to. I do not mean that any formal action was taken on it, but the various members expressed themselves.

Senator WALSH. I think the subject matter of that that Senator Couzens mentions is very proper to discuss tomorrow morning or Monday morning after the bill is reported.

Mr. SELTZER. With regard to the graduated rates, we find on the first test that the thing would be about the same.

Senator GEORGE. That is approximate, of course. I understand it is just an estimate. I move that the flat rate heretofore agreed upon by the committee, and I ask unanimous consent that we reconsider that, and that these graduated rates be inserted in lieu thereof: 15.5 percent on the first $2,000, 16 percent on the next $13,000, 17 percent on the next $25,000, 18 percent on the balance over $40,000.

Senator BYRD. That takes the same rates as now existing and simply adds 3 percent straight through.

Mr. PARKER. That 3 percent is added to all existing rates in the present act.

Senator BLACK. I do not suppose it would be worth while to offer an amendment, but I would personally like to see that the rates start at 12.5 percent as they did before, and make an equal distribution between there and the higher figures that Senator George has suggested. I do not believe it would change the revenue very much.

Senator KING. We have just cut out the $1,000 credit.

Senator BLACK. That is one of the reasons that I would like to keep the smaller rates down.

Senator KING. If there is no objection to the amendment just offered by Senator George it will be adopted.

Mr. BEAMAN. Does that apply to insurance companies?

Senator KING. Mr. Beaman has asked a pertinent question. Does it apply to insurance companies?

Mr. PARKER. We always have given them the same basic rate.

Mr. BEAMAN. Do you want to leave the $1,000 credit to them?

Senator GEORGE. No. Take away the $1,000 credit.

Mr. PARKER. I should think after all, perhaps the same argument would hold. You have a small bank that makes $1,000; 18 percent is a pretty heavy rate. You have a small insurance company that makes $1,000, therefore I should think offhand that the graduated rates should apply to them.

Senator BYRD. Does it apply to them now?

Mr. PARKER. Yes.

Senator BYRD. My understanding is we are just continuing the same rates with 3 percent added.

Senator KING. Yes. Any other questions?

Mr. BEAMAN. How about foreign corporations?

Mr. KENT. The committee has imposed on them a flat rate of 22 percent without specific credit. Under the present law they get the benefit of the graduation.

Senator KING. Leave it the same way.

Mr. PARKER. I do not see why we should give them the benefit of graduation.

Mr. KENT. I simply raised the question.

Mr. PARKER. We do not know how much outside income they have got.

Senator KING. The motion is adopted as amended.

Senator BLACK. Is it proper to offer an amendment——

Senator COUZENS (interposing). If the committee will look at page 25 of the bill, I would like to have them if you will, adopt this section 15 which contracts not to pay dividends, only that portion of it which applies to dividends. I think that perhaps is the only cushion they need, and it would save a lot of discussion on the floor of the Senate.

Senator WALSH. Mr. Seltzer has just stated to me that if we adopt the House cushions, it would only take about $10,000,000 away on this bill. But it would be very hard to work it out.

Senator COUZENS. I am not proposing to adopt them all. In section 15, contracts not to pay dividends. As I understand it, that first provision ends on line 3 of page 26?

Mr. PARKER. That is right. That is the least objectionable cushion, because it does not have any reference to earnings and profits, the thing that we were worried about in respect to litigation.

I would like to say that, in respect to that cushion, it is very restrictive in the way it is drawn, because the contract has to specifically mention dividends. The committee might want to consider whether they want to change that word slightly; that it would have to do with contracts the effect of which was to prevent the payment of dividends.

Senator COUZENS. If we will adopt the principle, we can get the exact language right, between now and the next meeting.

Senator GERRY. Where is that?

Senator COUZENS. On page 26 it just deals with the question of contracts and does not go into this rate of 22.5 percent or any other.

Mr. BEAMAN. Do I understand that this is for the purpose of offering a committee amendment on the floor?

Senator COUZENS. No. If we agree on a principle, we can draft this so that when we have another meeting we can cover the ground.

Senator BARKLEY. What is the principle?

Senator COUZENS. Just to deduct contracts and not impose the 7 percent penalty on those that are covered by contract.

Senator BARKLEY. What about the question that Mr. Parker raised?

Senator HASTINGS. Where they are in a position where they cannot pay.

Senator BARKLEY. If by contract they cannot pay dividends——

Mr. PARKER (interposing). Not of a debt.

Mr. BEAMAN. You are getting into some deep water if you go abroad on this thing. If you want something done quick.

Senator COUZENS. What is the difficulty of excepting it?

Mr. BEAMAN. You talked about broadening it.

Senator COUZENS. I am not talking about broadening it.

Mr. BEAMAN. Mr. Parker was.

Senator COUZENS. You are not talking about broadening it, are you?

Mr. PARKER. Yes, I did. Because I want the committee to know that that is very restricted. One company may have a contract with the R. F. C. that has loaned them money and that contract says that "You cannot pay out dividends until you pay us." They are protected; they will be in under the amendment as drawn. All right.

Supposing a company has this kind of a contract, that they agree with the R. F. C. to set aside 50 percent of their earnings each year until they pay this debt, but it does not say anything about dividends. They are not in. They would not be protected by a contract.

Senator KING. Amortization then under the contract.

Senator HASTINGS. It ought to be protected.

Senator COUZENS. Could you not put in amortization under a contract such as you have just suggested?

Senator LA FOLLETTE. What Mr. Beaman is pointing out is that this is a pretty delicate proposition and when you go out with a crowbar you do not know just what the results would be that you would get.

Mr. PARKER. I would suggest if the committee wants to put that in as is, and later if we can suggest something, we can bring in something as an amendment on that on the floor.

Senator COUZENS. That is all right.

Senator BARKLEY. Let it go in just as written in the House bill so as to get rid of it for today.

Senator COUZENS. And we can change it later on if it can be worked out.

Senator KING. This is quite unimportant. Inadvertently a confidential letter written to Senator Harrison appears in the confidential print. I suggest that before the record is put up, it be eliminated.

Senator BARKLEY. I move it be reported.

Senator BLACK. I should like to offer a substitute. The substitute I offer for the 7 percent is that we retain the capital stock and excess-profits taxes, repeal the normal tax exemption and tax undistributed net as follows: Nothing on the first 20 percent; tax 20 percent on the

next 20 percent to 40 percent, and tax 30 percent on the balance. That means a gross increase in taxes which would increase the taxes $650,000,000, as shown by the Treasury estimates. Under this estimate you have the first 20 percent exempt from excess tax, and I would want to include a clause which permits the company to take advantage not only on the distribution of money dividends, but the distribution of different stocks such as described in the Supreme Court opinion, and on that I would like to have a record vote of the committee.

Senator WALSH. Any cushions?

Senator BLACK. The cushion is the 20 percent, and the fact that they can issue stock dividends which would permit them to keep every dollar they have.

Senator LA FOLLETTE. You would except the cushion that the committee has just adopted?

Senator BLACK. Yes.

Senator KING. Senator Black asks for a record vote on his substitute.

(A record vote is taken, after which Senator King announced 12 against and 6 in favor of the substitute.)

Senator WALSH. I move to report the bill with the amendments.

Senator BLACK. I vote "aye" with liberty to file a minority report.

Senator LA FOLLETTE. I join Senator Black in that. I want it clearly understood that I am only voting for this bill to get it out of committee. I do not take any responsibility for it at all.

Senator KING. The motion is carried. The committee will recess subject to the call of the Chair.

(Whereupon, at 12:45 p. m., adjournment was taken subject to the call of the Chair.)