REVENUE ACT OF 1928

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTIETH CONGRESS

FIRST SESSION

ON

H. R. 1

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

APRIL 9, 10, 11, 12, AND 13, 1928

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REVENUE ACT OF 1928

MONDAY, APRIL 9, 1928

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

The committee met, pursuant to call, at 10 o'clock a. m., in the committee room, Senate Office Building, Senator Reed Smoot presiding.

Present: Senators Smoot (chairman), Reed of Pennsylvania, McLean, Curtis, George, and Harrison.

The CHAIRMAN. If the committee will come to order I think we might as well proceed.

Mr. William C. Roberts, of the legislative committee of the American Federation of Labor, has prepared a statement in opposition to the estate tax. He requests that this statement be placed in the record, as he has nothing to say in addition to the contents thereof. Therefore, I will ask the reporter to incorporate this statement in the record at this point.

STATEMENT OF WILLIAM C. ROBERTS, ESQ., LEGISLATIVE COMMITTEE OF THE AMERICAN FEDERATION OF LABOR, WASHINGTON, D. C.

It is the belief of the American Federation of Labor that the only just form of taxing great wealth is through the estate tax, as there is no question of the ability to pay. And it can not be denied that in many cases the owners of great fortunes fail during their lifetime to pay their fair proportion of taxes. Because of that it makes the estate tax a fair tax. Besides, it is a direct tax.

In 1906 the American Federation of Labor unanimously declared for "an inheritance tax that would increase with the inheritance." In 1918 it approved the levying of taxes on "war profits and swollen incomes." In 1919 it declared that there should be provided a "progressive increase in taxes upon incomes and inheritances," and in 1921 it demanded "that the Government promptly levy a rapidly progressive tax upon large estates." This was reiterated in 1922.

You have been told by Mr. Mellon that 97.8 per cent of the population pay no Federal income taxes whatever. Nevertheless, the 2.2 per cent who pay Federal taxes had previously passed them on to the 97.8 per cent in whole or in great part. But the estate tax can not be passed on.

During the war the American Federation of Labor approved of all taxation laws enacted, as the only thought was to win the war no matter what the sacrifice. It has not asked for any reduction of taxes that bear upon those least able to bear them. In fact, the American Federation of Labor contended during the war and since that all the war taxes should be retained until the cost of the war had been paid.

Those who favor the repeal of the Federal estate tax insist on the retention of what are termed "nuisance" taxes, otherwise sales or buyers' taxes. The argument is that the estate tax was a war-emergency tax. The "nuisance" taxes also were war-emergency taxes. The estate tax is more easily paid by the few than is the "nuisance" taxes by the many.

Those who accumulate fortunes great enough that their estates pay the Federal tax obtain their wealth through the good will of the whole American

public. And good will has been declared by the Supreme Court to be property. If the accumulators of great fortunes have a property right in the patronage of the people it is no more than right that they pay for that good will in an estate tax. Besides, all the forces of government are freely given to the protection of these fortunes both before the death of the owners and after they have been passed on to the heirs.

There is nothing more dangerous to our country than the accumulation of enormous wealth in the hands of a few. The estate tax results in i s distribution for the benefit of the whole people.

Legacies received by the heirs of great estates have been justly called unearned income, for few of the heirs had anything to do with their accumulation.

Andrew Carnegie became one of the richest men of his time in the United States. He knew where his fortune came from and the reasons for its growth, as is evidenced by the following statement made by him:

"Now, who made that growth? The American public—that is where that wealth came from, and that is the partner in every large enterprise where money is made honorably; it is the people of the United States."

He reasoned undoubtedly that the good will of the American public made the people a partner. Why then should not the people demand through an estate tax a squaring of accounts?

Mr. Carnegie also said:

"The growing disposition to tax more and more heavily large estates left at death is a cheering indication of the growth of a salutary change in public opinion. Of all forms of taxation this seems the wisest. By taxing estates heavily at death the State marks its condemnation of the selfish millionaire's unworthy life. It is desirable that nations should go much further in this direction. Indeed, it is difficult to set bounds to the share of a rich man's estate which should go at his death to the public through the agency of the State, and by all means such taxes should be graduated, beginning at nothing upon moderate sums to dependents, and increasing rapidly as the amounts swell."

Who is more entitled to a share of such fortunes than the people who made them possible? Few, if any, of the heirs of these estates had anything to do with their accumulation. It is what might be called a "windfall" for them. Although these legacies came without any effort on their part they are among the persons who are crying for a repeal of the estate tax law as well as the State inheritance taxes.

Dr. Thomas S. Adams, the famous authority on taxation and formerly financial adviser for the United States Government, declared "that if we must tax it is better to tax him who merely receives than him who earns."

It should be the American policy to demand that this tax be levied to prevent in the future the perpetuation and further accumulation of immense fortunes in the hands of those who did little, if anything, to create them.

Theodore Roosevelt in a message to Congress in December, 1907, said:

"A heavy progressive tax upon a very large fortune is in no way such a tax upon thrift and industry as a like tax would be on a small fortune. No advantage comes either to the country as a whole or to the individuals inheriting the money by permitting the transmission in their entirety of the enormous fortunes that would be affected by such a tax."

In his inaugural address in 1909 President Taft declared:

"Should it be impossible to do so by import duties, new kinds of taxation must be adopted, and among these I recommend a graduated inheritance tax as correct in principle and as certain and easy of collection."

On March 23, 1909, Chairman Payne, of the Ways and Means Committee, made this statement on the floor of the House:

"What easier tax to pay than this? A man gets a legacy, a stranger perhaps, to the testator, a clear gain to him; why should not he pay a part of that to the support of the Government? * * * It is a fair tax; it is a tax easily collected; and it is a tax that this class of people ought not to hesitate to contribute for the support of the Government and the protection of the law."

One of the most conservative of Republicans was Senator Cullom of Illinois. In his Fifty Years of Public Service he said:

"An income tax is the fairest of all taxes. It is resorted to by every other nation. It falls most heavily on those who can best afford it. The sentiment in the Republican Party has changed, and I believe that at no far distant day Congress will pass an income tax, as well as an inheritance tax, law."

In 1914 the American Federation of Labor presented to both political party conventions a demand for the inclusion of the following plank in their platforms:

"Labor favors graduated income and inheritance taxes and opposes the sales tax as well as all other attempts to place excessive burdens on those least able to bear them."

In a letter to the Iowa Legislature in February, 1927, William Green, who was then chairman of the Ways and Means Committee of the House, stated that the estate tax is a just tax. He added:

"It is a reasonable tax. The exemption is $100,000, and it is very light up to $500,000, and then moderately increasing.

"It is a fair tax, because the great fortunes upon which it is levied have not paid their fair proportion during the lifetime of the owners."

Mr. Green also said:

"It is a tax that is not easily evaded and is the only tax which everybody agrees can not be passed on to those who ought not to bear this burden."

He also referred to the aggressive campaign of various persons to repeal the estate tax by saying:

"The purpose of those who have raised an enormous fund which has been and is now being spent for the repeal of the Federal estate tax, is to repeal all State inheritance taxes, and they admit it."

Organized labor has no quarrel with those who honestly accumulate great wealth, but it does insist by all that is fair and right that at death a just portion of those fortunes should go to the people who helped to accumulate them and to the States to prevent them from growing larger and larger and becoming too dangerous to the welfare of our Republic. The power that could be exercised by their owners might be disastrous.

If the Federal estate tax is abolished it would create extensive competition between the States that do not collect an inheritance tax to induce rich men to locate in them. It would encourage States with inheritance tax laws to repeal them for the same purpose for self protection.

Organizations have been formed by professional lobbyists to fight all inheritance taxes, and there is no doubt that if the Federal estate tax is repealed their efforts will be continued to repeal all State inheritance taxes, and there is no doubt that if the Federal estate tax is repealed their efforts will be continued to repeal all State inheritance tax laws. On the payment of $10 or more an expectant heir of an estate can be made a member of some of these self-constituted organizations whose organizers make a living on the cupidity of the selfish overly rich. Through misrepresentation they have sought to induce the State legislatures to pass resolutions calling upon Congress to eliminate the estate tax. Some have done so while others have refused.

I heard an insurance actuary one day say that more than 80 per cent of the people who died did not leave a dime. Nevertheless, everything they bought while alive went to pay some of the taxes of those who accumulated great fortunes in financial or commercial life. What labor fears is that taxes will be gradually taken off of the well to do and finally placed through a consumption tax upon those least able to bear them. The sales tax—or, rather, the buyers' tax—on the necessaries of life is the most vicious of all methods of taxation.

In 1922 there was quite a campaign to establish the sales tax. At that time Senator Smoot publicly declared:

"While the manufacturers' or sales' tax is not embodied in the revenue laws of our country at this session of Congress it will be in the very near future just as sure as God lives."

The argument in favor of the sales tax that was passed about among Members of Congress at that time was this:

"If you tax the people so they do not know it they can not object, but if they know they are being taxed they will object."

At that time the owner of a large department store in Washington in a newspaper interview said:

"I am not only in favor of the sales-tax plan for raising funds for the soldiers' bonus, but I would like to see it adopted as a permanent plan of raising Government revenues to replace the present taxation system.

We believe that this plan is being followed: First, stock dividends were declared nontaxable; then excess profits were abolished; and now there is an attack on the estate tax.

We believe that the proposal to retain the "nuisance" taxes is part of the program to eventually bring about the desire of those who advocate the consumption tax on the necessities of life. The effort to repeal the estate tax, a direct tax, and continue the "nuisance" tax, an indirect tax, seems to us to be sufficient proof of this.

Estate taxes should not be considered war measures. They are becoming a permanent tax in many countries and should be continued permanently in the United States. There is no other tax that is more directly levied or is easier to pay.

The statement of the Secretary of the Treasury that less than three-tenths of 1 per cent of our population paid 95.5 per cent of our total income tax should warn us that wealth is getting into fewer and fewer hands. It is also an argument that a portion of those great fortunes should be given back to the people who helped to accumulate them to conduct the affairs of government, which did so much to protect the interest of the owners.

We hear much of prosperity, but apparently this applies only to the 2.2 per cent who pay income taxes. The more than 111,000,000 other people in the United States must have accumulated very little money to be absolved from paying any income taxes at all.

It might be well to quote another economist of great renown, Dr. Edwin Robert Anderson Seligman, of New York. In a hearing held in 1925 before the Ways and Means Committee of the House, he said:

"If the States keep for themselves the inheritance tax, they can not and will not * * * ever succeed where they have a situation like the one in Florida. You will never succeed, no matter how model a tax law you have; no matter how many hundreds or thousands of reciprocal laws you pass among the States, because unless you get every single one of the States to come in and agree you will not have solved the problem, because you will always have a Botany Bay to which the rich man will of course repair, if he is at all a wise man. Therefore, I say the States themselves can not, will not, and never have in any country abolished those evils of multiple taxation. Secondly, as Congressman Green and others have pointed out, they will not be able to tap to the full the rightful revenues which ought to come in a country like this from inheritance taxation."

The American Federation of Labor insists that the welfare of our Government demands that the estate tax be made a permanent feature of our taxation system.

The CHAIRMAN. Senator Simmons has handed me a letter from Black Bros. Furniture Co., of Houston, Tex., addressed to Hon. Daniel E. Garrett. Senator Simmons desires that this letter be placed in the record.

Senator HARRISON. What is it about?

The CHAIRMAN. Installment payments. The reporter may incorporate this letter in the record at this point.

(The letter referred to is as follows:)

HOUSTON, TEX., *March 30, 1928.*

Hon. DANIEL E. GARRETT,
Washington, D. C.

DEAR SIR: The proposed revenue act of 1928 in section 44 contains several details—provisions relating to the much-discussed installment method. Subsection (c) provides:

"If a taxpayer elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales made in any prior year, shall not be excluded."

In this brief and apparently innocent provision, there is contained a great deal of very serious inequity and hardship upon numerous taxpayers and its enactment into law might mark the culmination of a long controversy which has turned around this point by the decision of it in a way most unfair to the citizens who have relied on the long-established rule of the Treasury Department to the contrary. In order to fully understand the issues involved in this controversy, the history of the ruling involved and consideration of the principles underlying it, are necessary.

The early acts (acts of 1909, act of 1913) providing for taxation of income permitted only the use of a cash receipts and disbursements basis. Taxable income consisted of the difference between cash or other property having a cash value received during the year, after deducting payments in cash, or property made during the year. This was not in accord with the best theoretical accounting principles, and the idea gradually obtained recognition that as income was essentially an economic and accounting conception, income should be determined with reference to the established conceptions of economics and accounting regarding it. This led gradually to the adoption of the so-called accrual method, which treats income not from the standpoint of cash received, minus cash paid out, but which requires maintenance of records on which are set up the income accrued whether actually received or not, and the expenses incurred whether actually paid or not, during a given period of time. This method was only permissive under the provisions of the revenue act of 1916 (sec. 13–B), but later was required in most cases (revenue act of 1918).

Early in the administration of the law, there arose the question of the proper treatment of installment sales, or other contracts, under the terms of which property was sold with a small initial payment, the balance to be paid in small periodical payments over the succeeding year or years.

It will be evident that under the cash receipts and disbursements basis only the cash received would be subject to tax, and the problem would not become acute. Under the accrual basis, however, under which it is required that obligations be accrued on the books in accordance with the terms of the obligations, irrespective of whether the amounts due have been received or not, a peculiar problem regarding installment sales arises.

For example: The profit on a contract of sale which is payable on delivery of the property on the cash receipts and disbursements basis, is accounted for only when it is actually received in cash, even though it may be overdue. On the accrual basis, it is set up on the books as income as it accrues, that is, when by the terms of the contract the seller is entitled to receive it even though not actually paid. But the usual installment sales contracts expressly provide that the payments are not due until some time in the future. It is possible to treat the entire sale as completed when the initial payment is made, and the entire profit which it is expected will be realized as accrued thereby at the date of sale, but it is evident that this conflicts with the accrual principle in some degree, and also that it taxes the one selling under such a contract on a profit which he has not received and is not entitled under the terms of the contract to receive, for a considerable time in the future, and which, indeed, he may never actually collect. The first complete regulations promulgated by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, viz, regulations 33, revised, provided for this situation in article 120. This applied to the revenue acts of 1916 and 1917.

This provided for a method of determining the income from this class of transactions, which was obviously fair both to the Government and the taxpayer and in accordance with sound economic principles. It was silent on the double taxation feature, making no special provision for the change from one basis to another, as accrual methods were in a stage of transition then and many taxpayers used a combination cash and accrual method. It provided, in substance, that the proportion of the entire price to be received which represented profit should be determined, and that as each particular payment was actually received in cash that same proportion of that particular payment should be returned as income in the year in which the payment was received. In principle this is the method which has been continuously followed by the Treasury Department from that time—1917—to the present, and is now embodied in section 212 (d) of the revenue act of 1926.

That this method is a fair one and in accordance with common sense has been recognized by everyone concerned. It is not a special concession to one class of taxpayers, but only recognizes and gives effect for tax purposes to the express terms of the agreement of sale.

There are several details of the practical application of these principles, however, which have led to some uncertainty and confusion. That which gives rise to the particular controversy under consideration is the treatment accorded profits taxed as income in the year the sale is made on the accrual basis in cases where the taxpayer changes to the installment basis later and then collects part of this same profit in cash. The following table shows the dates, regulations, article numbers, and substance of the various Treasury

Department regulations which since 1917 have reiterated and reaffirmed the principles above mentioned:

Date of adoption	Regulations No.	Article No. or Treasury Decisions	Substance of provisions
Jan. 2, 1918	33 Rev.	120	Installment method recognized where title passed.
Apr. 25, 1918		T. D. 2707	Extended to all installments agreements.
Dec. 29, 1919	45 (reprint of preliminary editions).	42	Continued same principles under 1918 act, apparently required double taxation.
Oct. 20, 1920		T. D. 3082	Amended article 42, Regulations 45, from date of 1918 act, eliminated double taxation, required allocation of payments.
Jan. 28, 1921	45 (1920 ed.)	42	Included T. D. 3082 in Regulations as article 42.
Feb. 15, 1921	62	42	Same for act of 1921.
Oct. 6, 1924	65	42	Same for act of 1924.
Aug. 27, 1926	62	T. D. 3921	Required double taxation under all acts.
Sept. 1, 1926	69	42	Same for act of 1926.

It will be observed from the foregoing that with the exception of a brief period from December 29, 1919, to October 20, 1920, up until T. D. 3921 in August, 1926, the regulations have taken uniformly the view that in changing from the usual accrual basis to the installment method the profit which had been taxed once on the accrual basis need not be taxed again on the instalment basis when collected, and that such profits should be excluded in computing the income on the installment basis. It is also important that while during the period mentioned the regulation was outstanding, it was subsequently amended by T. D. 3082, which had retroactive effect. So that in legal effect, there has been such a regulation from 1918 to August, 1926.

After enactment of the revenue act of 1926, T. D. 3921 was promulgated, which laid down the entirely new rule contradicting the long-established practice of the department that such profit should be taxed twice and should not be excluded from income in the year in which received. The validity of this requirement was considered by the Board of Tax Appeals in the case of Blum (Inc.), 7 B. T. A. 737, and for the reasons which we shall be glad to discuss more at length, was sustained and is now proposed to be embodied in the statute law in section 44 (c) of the pending measure.

The striking fact about this history is that the practice initiated under article 42 (1920 ed.) of Regulations 45, effective from January 1, 1918, for avoiding double taxation, which seemed so obviously fair, has been continued without interruption and has been approved by the successive restatements in the regulations of the Commissioner of Internal Revenue for more than eight years, and that finally and within the course of less than one year, this long-established practice, in reliance upon which hundreds of thousands of returns have been made, and closed by the Treasury Department, is suddenly reverted, and a new principle introduced which calls for the double taxation of the same item of income. Before such a result is definitely enacted into law, the entire situation, not merely as it is viewed by certain representatives of the Treasury Department who are already committed to a position, but as viewed by those who have to pay the tax, should be most earnestly and carefully considered by the Congress.

In order to remedy the situation, our National Retail Furniture Association has presented to the Senate Committee on Finance, a proposed new section 44 (c) as follows:

"In any case where the gross profit to be realized on a sale or contract for sale of personal property has under the provisions of the revenue acts of 1916, 1917, 1918, 1921, 1924, and 1926 or this act been reported as income for the year in which the transaction occurred, and a change is made to the installment plan of computing net income, no part of any installment payment received subsequently to the change, representing income previously reported on account of such transaction, should be reported as income for the year in which the installment payment is received; the intent and purpose of this provision is that where the entire profit from installment sales has been included in gross income for the year in which the sale was made, no part of the installment payments received subsequently on account of such previous sales shall again be subject to tax for the year or years in which received."

Regardless of whether or not the proposed revenue act of 1928 is before your branch of Congress, may we respectfully suggest that you present the viewpoint contained in this letter to members of the committee immediately charged with study of the revenue act, with hopes that double taxation will be wiped off the statute books once and for all?

It is our sincere desire, therefore, that you as representing our interests in the Nation's Capital will give your personal consideration to this matter which is of concern to so many in our trade and write us your views.

Cordially yours,

BLACK BROS. FURNITURE CO.,
A. B. HEROD, *Treasurer.*

(Whereupon the committee proceeded to the transaction of other business.)

REVENUE ACT OF 1928

TUESDAY, APRIL 10, 1928

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

The committee met, pursuant to adjournment, at 10 o'clock a. m., in the committee room, Senate Office Building, Senator Reed Smoot presiding.

Present: Senators Smoot (Chairman), McLean, Curtis, Reed, Shortridge, Simmons, Couzens, Gerry, Harrison, Bayard, Walsh, and Barkley.

The CHAIRMAN. If the committee will come to order, we will proceed with the hearing this morning. Is Mr. Brady present? Is Mr. Mann here?

STATEMENT OF JOSEPH F. MANN, ESQ., REPRESENTING THE BUILDING MANAGERS AND OWNERS ASSOCIATION OF NEW YORK, THE NATIONAL ASSOCIATION, AND ASSOCIATIONS IN 37 CITIES

The CHAIRMAN. Mr. Mann, you may give the reporter your name and address.

Mr. MANN. My name is Joseph F. Mann. I represent the Building Managers and Owners Association of New York, the National Association with headquarters in Chicago, and associations in 37 cities of the United States.

I have sent in a brief, and I will file copies of it with the committee. The cities which have joined with us in opposition to section 104 are Birmingham (Ala.), Los Angeles, San Francisco, Denver, Atlanta, Chicago, Peoria, Indianapolis, New Orleans, Boston, Detroit, Duluth, St. Louis, Omaha, Buffalo, Cincinnati, Cleveland, Dayton, Tulsa, Portland (Oreg.), Philadelphia, Pittsburgh, San Antonio, Seattle, Spokane, Kansas City, Minneapolis, and Washington (D. C.), these cities joining us through the association in the various cities.

The CHAIRMAN. Mr. Mann, may I call attention to the fact that we would like to have the statements as brief as possible.

Mr. MANN. Yes, sir.

The CHAIRMAN. If there is any real suggestion that you have to make we would like to have you make it, because I am quite sure there will be a change in this section.

Mr. MANN. I have filed a brief which covers these matters. I want to call attention to the fact that I think your purpose in sec-

tion 104 is to make the nonoperating companies which have accumulated profits disgorge them, so the surtax would be taxed on the individual stockholder. Unfortunately, in including the word "rents" in that section you have included not only the nonoperating companies, but the operating real estate companies. In New York City our association represents about $3,000,000,000 worth of improved real estate. We represent practically every modern building in the city of New York, and of those almost one-half would go down under that section. In other words, probably one-half of the modern buildings in the United States are owned in corporate form. Probably half the apartment houses, office buildings, and loft buildings are owned in corporate form in the United States, and many of those have less than 10 stockholders.

The CHAIRMAN. Is Section 220 satisfactory to you?

Mr. MANN. Yes, sir; section 220 is perfectly satisfactory.

The CHAIRMAN. You have no suggestion to make as to an amendment to section 220?

Mr. MANN. That is correct. Mr. Smith, of our association, is also here.

The CHAIRMAN. On the same subject?

Mr. MANN. On the same subject.

The CHAIRMAN. Unless there is something special or something in addition, I do not know that Mr. Smith could aid the committee.

Mr. SMITH. No; I just want to register the appearance here of the ex-president of the national association.

The CHAIRMAN. And you take the same position as Mr. Mann?

Mr. SMITH. Yes, sir.

Mr. MANN. I would like to submit this brief for your record.

(The document referred to is as follows:)

BRIEF OF JOSEPH F. MANN, GENERAL COUNSEL OF THE BUILDING MANAGERS AND OWNERS ASSOCIATION OF NEW YORK (INC.)

The following associations join the Building Managers and Owners Association of New York (Inc.) in protesting against section 104 of the revenue of 1928:

National Association of Building Owners and Managers.
Birmingham Building Owners and Managers Association.
Los Angeles Association of Building Owners and Managers.
San Francisco Association of Building Owners and Managers.
Denver Building Owners and Managers Association.
Atlanta Association of Building Owners and Managers.
Building Managers Association, Chicago, Ill.
Peoria Association of Building Owners and Managers.
Indianapolis Association of Building Owners and Managers.
Building Owners and Managers Association, New Orleans, La.
Boston Real Estate Exchange, Boston, Mass.
Building Managers Association of Detroit.
Building Owners and Managers Association, Duluth, Minn.
Building Owners and Managers Association, St. Louis, Mo.
Building Owners and Managers Association, Omaha, Neb.
Building Managers Association, Buffalo, N. Y.
Building Owners and Managers Association, Cincinnati, Ohio.
Cleveland Association of Building Owners and Managers.
Dayton Owners and Managers Association.
Tulsa Association of Building Owners and Managers.
Portland Association of Building Owners and Managers (Oregon).

Building Owners and Managers Association, Philadelphia, Pa.
Pittsburgh Building Owners and Managers Association.
Building Owners and Managers Association, San Antonio, Tex.
Building Owners and Managers Association, Seattle, Wash.
Spokane Building Owners and Managers Association.
Kansas City Association of Building Owners and Managers.

The Building Managers and Owners Association of New York (Inc.), protests against section 104 of the revenue act of 1928. Our opposition to this section is both to the section as a whole, as well as to the inclusion in its effects of corporations engaged in the real-estate business.

This section 104, as it appears in the bill which has passed the House of Representatives and has been referred to the Finance Committee of the Senate, reads as follows:

"SEC. 104. Accumulation of surplus to evade surtaxes—1928 or subsequent taxable years—

"(a) *Tax on personal holding company.*—If any personal holding company permits its undistributed profits for the taxable year 1928 or any succeeding taxable year to exceed 30 per centum of the sum of its net income for such year plus the amount of the dividend deduction and interest upon obligations of the United States, there shall be levied, collected, and paid for such taxable year, in addition to the tax on corporations imposed by section 13 (a), a tax equal to 25 per centum of such undistributed profits.

"(b) *Definitions.*—As used in this section—

"(1) The term 'personal holding company' means any corporation if (A) at least 80 per centum of its gross income for the taxable year is derived from rents, royalties, dividends, interest (whether or not tax exempt), annuities, and (except in the case of regular dealers in securities) gains from the sale of securities, and (B) either 80 per centum or more of its voting stock (exclusive of stock limited as to dividends and exclusive of stock redeemable upon less than thirty days' notice) is owned or controlled, directly or indirectly, through affiliation, stock ownership, voting trust agreements, or otherwise, by or for not more than ten individuals, or the right to receive 80 per centum or more of the dividends distributed by the corporation is vested, directly or indirectly, through affiliation, stock ownership, voting trust agreements, or otherwise, in not more than ten individuals; but such terms shall not include any banking or insurance corporation.

"(2) The term 'dividend deduction' means the deduction specified in section 23 (p).

"(3) The term 'interest upon obligations of the United States' means interest upon obligations of the United States issued after September 1, 1917, which would be subject to tax in whole or in part in the hands of an individual owner.

"(4) The term 'undistributed profits' means the net income for the taxable year increased by the amount of the dividend deduction and interest upon obligations of the United States, but diminished by—

"(A) the amount of tax under section 13 (a) for the taxable year.

"(B) the amount of dividends declared out of earnings or profits for the taxable year, not later than the fifteenth day of the third month following the close of such taxable year and payable prior to the fifteenth day of the sixth month following the close of such taxable year. If dividends so declared are not actually paid prior to such date, then the amount not so paid shall be included in the undistributed profits and the tax imposed by subsection (a) shall be redetermined in accordance therewith.

"(c) *Tax on corporation formed or availed of to evade surtax.*—If any corporation, however created or organized, other than a personal holding company, is formed or availed of for the purpose of preventing the imposition of the surtax upon any of its shareholders through the medium of permitting its gains and profits to remain accumulated, instead of being divided or distributed among its shareholders, there shall be levied, collected, and paid for the taxable year 1928 and succeeding taxable years, in addition to the tax on corporations imposed by section 13 (a), a tax of 25 per centum of the net income of the corporation increased by the amount of the dividend deduction and interest upon obligations of the United States. Such tax shall be computed, levied, collected, and paid upon the same basis and in the same manner and subject to the same provisions of law, including penalties, as that tax. The following shall be prima facie evidence that a corporation, other than a 'personal holding company' as

hereinbefore defined, is formed or availed of for the purpose of preventing the imposition of surtax upon any of its shareholders:

"(1) That the corporation is a mere holding or investment company; or

"(2) That the gains or profits are permitted to remain accumulated beyond the reasonable needs of the business. In determining whether gains or profits are permitted to remain accumulated beyond the reasonable needs of the business there shall not be included gains or profits remaining accumulated during a prior taxable year for which the corporation has paid a tax imposed by this section.

"(d) *Information statements.*—A corporation which in the taxable year 1928 or any succeeding taxable year permits the accumulation of more than 60 per centum of its net income increased by the amount of the dividend deduction and interest upon obligations of the United States, under regulations to be prescribed by the commission with the approval of the Secretary, shall (1) file as a part of its return a statement giving in detail the reasons for the accumulation and the purposes to which the amounts accumulated are to be devoted, and (2) from time to time thereafter, file reports under oath giving the disposition of the amounts so accumulated until all such amounts have been accounted for.

"(e) *Optional tax on shareholders.*—The tax imposed by subsection (a) shall not apply in respect of any taxable year if all the shareholders of the corporation include in their gross income, at the time of filing their returns, the amount of their entire distributive shares of the undistributed profits of the corporation for each taxable year. The tax imposed by subsection (c) shall not apply in respect of any taxable year if all the shareholders of the corporation include in their gross income at the time of filing their returns, the amount of their entire distributive shares of the gains and profits remaining accumulated beyond the reasonable needs of the business as determined by the commissioner. Any amount so included in the gross income of the shareholder shall be treated as a dividend received by the shareholder. A shareholder who has so included in his gross income his distributive share shall be entitled to receive exempt from tax subsequent distributions made by the corporation out of earnings or profits until such taxpayer has received exempt distributions in the amount of such share."

It is to be noted that subdivision C of this section is a revision of section 220 of the revenue act of 1926, but that the other subdivisions are new and are not at all in consonance with the recommendations of the Joint Committee on Internal Revenue Taxation.

The report of the Ways and Means Committee of the House of Representatives states as to sections 104 and 105 (section 105 being also derived from section 220 of the revenue act of 1926 and being applicable only to the years 1927), as follows:

"SECS. 104–105. Accumulation of surplus to avoid surtaxes: The bill provides in section 105 for the continuation, in substance, of section 220 of the revenue act of 1926 for the taxable year 1927 except section 220 (c), which is covered by section 148 (c) of the bill.

"For the taxable year 1928 and succeeding taxable years, a distinction is made in section 104 between personal holding companies, as defined in that section, and other corporations. A personal holding company is defined to mean any corporation (except a banking or insurance corporation) if 80 per centum or more of its gross income is derived from rents, royalties, dividends, interest, annuities, and gains from the sale of securities, and if either 80 per centum or more of its voting stock, as defined, is owned or controlled directly or indirectly by not more than ten individuals, or the right to receive 80 per centum of its dividends is vested in such individuals directly or indirectly. It is believed that corporations falling within the class thus described are more likely to accumulate their surplus to evade surtaxes than other corporations. Provision is made in section 104 that if such a company permits its undistributed profits, as defined in the section, to exceed 30 per centum of the sum of its net income plus dividends and tax-free interest received, an additional tax shall be imposed on such net income so increased, equal to 25 per centum of the undistributed profits.

"Section 104 (c) is substantially the same as section 220 of the 1926 act in its application to corporations which are not within the definition of a 'personal holding company,' and provides that if any corporation, other than a personal holding company, is formed or availed of to permit its profits to remain accumulated, in order to evade surtaxes, a tax of 25 per centum of the

net income, increased by dividends and tax-free interest received, shall be imposed. The tax under section 220 of the revenue act of 1926 was 50 per centum. It is believed that this reduction will eliminate unnecessary harsh features of the former provision and will contribute to its practical effectiveness. Section 104 (c) further provides, in accordance with existing law, that if a corporation is a mere holding or investment company or if the gains or profits are permitted to accumulate beyond the reasonable needs of the business, either fact shall be prima facie evidence of the purpose to evade the surtax.

"Section 104 (d) contains a new provision that if any corporation, in the taxable year 1928 or in any succeeding taxable year, permits more than 60 per centum of its net income, increased by dividends and tax-free interest received, to accumulate, it must file as part of its return a statement giving in detail the reasons for the accumulation and the purposes to which the amounts accumulated are to be devoted. It must file subsequent reports under oath, giving the disposition of the amounts so accumulated until all such amounts have been accounted for."

Most improved properties are owned in corporate form, and the ownership has taken this form because it is obviously proper that structures with a life of 25 to 100 years, depending upon both physical and economic factors, be owned by a corporation than by an individual, or individuals, whose expectancy of life was in most cases much less. It is only through corporate form that there can be both a continuity of ownership and management.

During the last 50 years there has come first in the big cities of the United States, and now throughout the entire United States, a change both in the type of development of real estate and the manner of its management. With the improvement in steel processes and the other allied arts of the building trade there has come the modern fireproof structure, and with this structure the problems of renting and management have become magnified. The mere ownership of property no longer carries with it an ability successfully to compete in the new field of "building ownership and management." As in every other business or profession, the successful building owner and manager has become a specialist. The renting and management of the great office buildings, loft buildings, and apartment houses of this country require skilled organizations. Owner-managed buildings are no exception to the rule, which is so obviously demonstrated in the large management organizations of the big cities.

The renting of the new and bigger buildings which are constantly being built requires an art of salesmanship which is of no less an order than that developed for the sale of property itself. But even when the building is fully rented (or rented to a satisfactory point, for vacancies are normal), the work of the building owner and manager is not done.

Modern buildings must compete in service. Public space and offices must be kept clean; employees must be courteous and well-groomed; windows must be kept clean; all parts of the structure and its equipment must be kept at all times in repair. In most cases the owner must supply heat, light, power, elevator service, cleaning and porter service.

Statistics compiled from 207 office buildings of various cities in the United States show that the operating costs are made up as follows:

	Per cent		Per cent
Taxes	27	Elevators	8
Depreciation	17	Heat	6
Cleaning	15½	Electric light	3
Office expenses	11	Power	2
Alterations	8½	Insurance	2

There can be no question but that the ownership and management of such a building is a business and that the corporation engaged in it is active. Such a corporation merely because it has less than 10 stockholders is no more a "personal holding company" than a closely held corporation engaged in the cloak and suit or any other legitimate business.

When it is realized that building-owning companies, in many instances, use all of their available earnings toward the amortization of mortgages, or toward providing sinking funds to meet mortgage maturities, and for reconditioning, replacement, and other unusual but essential purposes, it is to be

seen that the inflexible provisions of section 104 are singularly harsh in their application to corporations owning and operating buildings.

In this connection, this association calls the attention of the Senate Finance Committee to the failure of the income tax department to grant modern fireproof buildings the relief which Congress intended in its provisions in allowing to the taxpayer as a deduction a reasonable allowance for the excessive wear and tear of property used in a trade or business, including a reasonable allowance for obsolescence. In view of the fact that the skyscraper structure is comparatively modern, there are no statistics to show what the physical life of such buildings are, nor are there statistics to show what the economic life of such buildings are, but building managers do know that the older of such buildings are suffering a handicap in competition with the newer buildings. Improvements and style changes in windows, elevators, plumbing and lighting fixtures, and other equipment have made the newer buildings more habitable and more serviceable to the tenant, and have reduced the operating expenses, and have correspondingly made the older buildings less rentable and less profitable. For instance, new apartment houses install some type of electric refrigerant and some improved method of garbage disposal. Such improvements as these tend to render old buildings obsolete in whole or in part. Owners, in order to keep old buildings fully rented, must make replacements of equipment and install new devices from time to time.

The Income Tax Department takes little or no recognizance of this factor of obsolescence. Its official position is that there can be no obsolescence until there has been some development, such as an improvement in the art which has fixed the economic life as less than the physical life. The department does not recognize the fact that the art of housing the family and the business is so continuously developing that the owner must be prepared annually to spend large sums in replacing obsolete equipment and installing devices which have come upon the market, in order to keep pace with the competition.

The prudent owner must, therefore, retain part of his income for replacements and new installations, a reserve which is not deductible from income under the rules of the department. No owner could exist long in the face of the competition which he must meet if he were content to reserve merely the factor of depreciation which the department is willing to allow him in its estimate of the physical life of his property.

The Building Managers and Owners Association of New York (Inc.), whose membership represents over $3,000,000,000 worth of improved property in New York, including practically every important modern building in Manhattan, estimates that most of these buildings are owned in corporate form; that of such corporaions practically all of them receive at least 80 per cent of their gross income from rents; that the majority of such corporations have less than 10 stockholders or are otherwise brought within the definition of a "personal holding company" through their capital structure. Very few of such corporations distribute more than 70 per cent of their net income. In fact, most of them distribute less than 50 per cent of their net income. The improvident corporation which distributes more than 70 per cent of its net income and is therefore in no position to amortize the mortgages which made its construction possible, to cope with the factors of obsolescence or to meet the competition, or to withstand the unexpected contingency, is the only corporation which is not affected by section 104 as proposed. The conservative corporation which maintains the proper and necessary factor of safety is penalized.

In the case of the building-owning corporation, there is evident an aggravated evample of the objection which has well been made to this type of taxation in the report of the Joint Committee on Internal Revenue Taxation of the present Congress (p. 54):

"The most obvious objection to such a tax is the burden which it places on legitimate and proper business expansion. As a business expands not only does its plant and property increase, but a larger working capital is required and it is desirable that reasonable accumulations of profits necessary for the expansion and stability of corporations should not be unduly burdened. A tax placed only upon the unnecessary accumulation of capital instead of upon the total accumulation involves many of the difficulties inherent in section 220, and is certainly an impracticable solution of the problem. It is believed that a tax on the total accumulation of profits by corporations is not desirable, because in many cases it might cause the making of unwise distributions and prevent the accumulation of a reasonable and proper surplus."

The reasoning advanced by Mr. Green of Iowa in the House on December 12, 1927 (Cong. Rec., p. 507), is equally applicable to the recommendation of the joint committee and to the present wording of section 104. This is, in part, as follows:

"* * * the proposition * * * to put a differentiated tax on profits distributed from the rate on profits which are not distributed hits the honest man who has the necessity for keeping a surplus in his corporation just as hard as the dishonest man who is trying to avoid taxes. If there is anything men do not like to be penalized for, it is when they have not done anything wrong."

Surely Congress never intended to pick out of many legitimate businesses the one business of "building ownership and management" for these special penalties, and never intended to classify an active business such as ours, which has peculiar needs for conservative management, with the type of personal holding corporation at which section 104 was aimed.

Such a classification so as to penalize the conservative and reward the improvident is unfair, and will have a dampening effect upon the business and profession responsible for the structural greatness of American cities.

Section 104 is contrary to the sound public policy which Congress has heretofore declared with regard to encouragement of private building enterprises, affording better and more modern housing facilities throughout the country. Building and loan associations have been encouraged and fostered through exemption from Federal taxation. Insurance companies are favored by the tax laws of the United States. These insurance companies engage in the business of making real estate mortgage loans on apartment buildings, and like building and loan associations, which lend to the individual home builder and owner, the result is the increase of modern and greater housing facilities throughout the Nation. The pending revenue bill recognizes a new deduction (in section 23-q) of taxes and interest paid by the owner or long-term lessee or other occupant of a cooperative apartment, when such payments are made through the medium of a corporation holding title to or a long-term lease on the entire building. The purpose of this is to place the owner or long-term lessee of a cooperative apartment in the same position as the owner of a dwelling house so far as deductions for interest and taxes are concerned.

Of course, this is a wise and sound public policy on the part of the Federal Government. But why should any departure be made simply because the owner of the apartment building is a corporation falling within the definition of a "personal holding company" as contained in section 104? It has been shown that because of modern business requirements, an individual owner of an apartment or other building may find it highly advisable to incorporate his holding or ownership. Under this scheme of things, his profits, if any, from the operation of the property will come to him in the form of dividends, subject to surtaxes. The corporation receives the rentals from the building and is liable for and is required to pay a Federal income tax (under the present law) of 13½ per cent. Therefore, the income from the property does not escape taxation merely because the ownership is in the hands of a corporation, or a so-called "personal holding company" within the definition contained in section 104 of the pending bill. Certainly it is not the part of wisdom for Congress to destroy the corporate form of doing business in such a case, or to so interfere with the conduct of the business of operating an apartment house or office building as to dictate whether the title or ownership must be in the name of individuals rather than in the names of a corporation.

The history of section 220, and the purpose of section 104 of the pending bill, is quite well understood to be the prevention of evasion of taxation by the use of the corporate form of organization in order to allow the profits to accumulate beyond the reasonable needs of the business. In the case of the ownership of office buildings, loft buildings, and apartment houses, it is quite generally true that the corporate form of organization is not availed of for the purpose of preventing the imposition of surtaxes upon the stockholders. The corporate form is necessary for particular business reasons. The operation of such enterprises, in modern times, is a business of considerable proportion. It is, by reason of this fact, that organizations have been formed throughout the country similar to the Building Managers and Owners Association of New York (Inc.). There are 37 such local organizations throughout the United States, all of which are affiliated with the national association.

It can be confidently stated that no real-estate corporation has ever, in fact, been found within the purview of section 220 of the present tax law. Although the attempts made by the House bill to supplement the provisions of section 220, in an endeavor to make the section workable and effective, might be considered altogether laudable and praiseworthy, it is nevertheless a harsh and unjust discrimination to include corporations engaged in the real estate business whose sole activities are the ownership and management of office, loft, and apartment-house buildings and which in reality have never been formed or availed of for the purpose of preventing the imposition of surtaxes upon their shareholders. We submit that the definition of the term "personal holding company" is altogether too broad and inclusive. If the Finance Committee does not eliminate this entire provision of the pending bill, as we think it should, then at least, in fairness and justice to the corporate form of ownership and management of buildings, an amendment to section 104–b should be made either by striking out the word "rents" from paragraph (1) of said section or by including therein a specific paragraph which will clearly disclose that there is no intention on the part of Congress that such corporation should, under any circumstances, be taxed under section 104 or 105, unless formed or availed of for the purpose of preventing the imposition of surtaxes upon its shareholders through the medium of permitting its gains and profits to accumulate beyond the needs of the business.

Respectfully submitted.

JOSEPH F. MANN, *General Counsel.*

STATEMENT OF HUGH SATTERLEE, ESQ., CHAIRMAN OF COMMITTEE ON FEDERAL TAXATION OF THE AMERICAN BAR ASSOCIATION

The CHAIRMAN. State your name and occupation to the committee.

Mr. SATTERLEE. My name is Hugh Satterlee. I appear here as chairman of the committee on Federal taxation of the American Bar Association.

The CHAIRMAN. Proceed with your abatement.

Mr. SATTERLEE. Mr. Chairman and gentlemen of the committee, this committee of which I happen to be chairman is the committee on Federal taxation of the American Bar Association, and is supposed therefore to act for it informally between meetings of the association, and to present its recommendations to the association at its annual meetings. At the last meeting of the association, held in August of 1927, we presented recommendations which were adopted, and since that time, of course, in view of the pendency of the present bill, we have made further recommendations which have not yet had an opportunity to be presented to the association. As to these further recommendations, we represent only the view of the committee at the present time, although we try to sound the opinion of the lawyers who are members of the association throughout the country.

I think perhaps the simplest way to proceed and the one that will save the time of the committee as much as possible is to run over the report in the order in which we have it.

The first specific recommendation we have is that the bill, so far as the administrative provisions are concerned, be not made retroactive to January 1, 1927, or even to January 1, 1928, but not to take effect until January 1, 1929. In this recommendation, of course, we want it understood clearly that we are not referring to any question such as rate of taxes, which is entirely outside our province, and can be made effective at any date on which the committee wants them to be made effective. But so far as the administrative provisions are

concerned, and other provisions affecting the mode of determining a net income, for example, we can see no possible justification or reason for making such provisions retroactive to a time prior to the enactment of the act itself. During the war there may have been some reason for retroactivity in tax statutes, but certainly at the present time there is no possible excuse for it, and I doubt if anyone can think of a good reason why they should be retroactive. So our first suggestion in respect to that section is that it should start out by saying:

The provisions of this title shall apply only to the taxable year 1929 and succeeding taxable years.

That would give the taxpayer an opportunity to become familiar with the new statute, and taxpayers would not be obliged, as they would, for example, if the other provisions are made retroactive to January 1, 1927, to file entirely new returns and compute their tax liability on an entirely different method.

The next suggestion is with reference to section 44, which provides a new basis for determining gain or loss in the disposition of installment obligations—obligations taken by installment dealers. We think that provision should not be retroactive; that a man who is engaged in a transaction in the face of the existing law should not be compelled to compute his tax liability on a basis of which he had no conception when he engaged in the transaction. Of course, that would be automatically taken care of if section 1 is amended as I have just suggested.

Then, again, section 45 is another section which in its present form is retroactive. In the report of the Ways and Means Committee it is stated that it is simply a broadening of section 240–F of the 1926 act, which is one of the consolidated return provisions, which provides for the commissioner allocating income and deductions in any way he thinks will most clearly reflect that income.

The CHAIRMAN. In respect to these amendments that relate to a subject matter, such as this, I wish you would confine yourself to the subject matter itself. All those amendments would be necessary and the committee would see they were made, providing the principle is adopted.

Mr. SATTERLEE. All right, Senator, I will try to do that.

Now, section 45, therefore, simply relates to the provision I just referred to, which we think should not be retroactive, but should take effect at a later date.

The next sections we come to in the report are sections 104 and 105, which grow out of the present section 220, with respect to the unlawful accumulation of corporate surplus. Of course, from a lawyer's standpoint the provisions in section 220, that have been in force for so many years, can scarcely be defended, but there are practical considerations which more or less support it, perhaps.

But our present notion about it is that, so far as the general provision applying to all business is concerned, there is less and less need for it, or perhaps there may be greater need than ever before for a special section applying to what are called in the bill "personal holding companies," which are designed almost exclusively for the purpose of preventing the accumulation of the surtax. So far as the members of our committee are concerned I think we should have

no possible objection if the section were limited in some such way that it would simply apply to that class of corporations, almost the exclusive purpose of which is to evade the surtax.

So far as general business is concerned all of us in active practice, and no doubt some of you, have seen the hardships resulting from the present section 220. For example, a client of mine, a corporation, which is very conscientious, whose officers are very conscientious, from year to year, has asked me whether they ought to distribute more of their surplus, and knowing their business has had considerable ups and down I told them from year to year I thought they needed to distribute only so much. Last summer, because they disregarded my advice and distributed more than I had told them I thought was necessary under section 220, a change in market conditions came on which nearly wiped them out because they had no available surplus.

Senator BAYARD. Do you suggest in your brief, sir, a form of law or a change in the bill as it comes from the House?

Mr. SATTERLEE. No, Senator, we do not.

The CHAIRMAN. Your objection to sections 104 and 105 are simply that they go back to section 220, with whatever modifications may be made?

Mr. SATTERLEE. No, Senator. We should like to see section 220 as it was eliminated and in substitution therefor some section more or less along the lines of the present section 104, with that part relating to personal holding companies.

The CHAIRMAN. Which affects holding companies?

Mr. SATTERLEE. Yes. I can see, as the last gentleman who addressed you said, that real-estate companies which are formed for the legitimate purpose of holding real estate should be excluded in some way from the operation of this provision, but a securities holding company is a different proposition.

The next is section 113, dealing with the basis for determining gain or loss, which in both the 1924 and 1926 acts contained a parenthetical clause, which looks small but really has considerable effect. In other words, it leaves it possible if a corporation acquired all the stock of another corporation by the issue of its own stock, the corporation acquiring the stock of the other corporation, taking it at its then value, was not relegated to the cost of the original owner of that stock. These reorganization provisions are so complicated and to a large extent so technical and so much a matter of form rather than of substance than any change in language raises hob with the situation of a lot of people who have relied on the provisions of the act. Perhaps I have an unusual interest in the reorganization provision, because when I was in the solicitor's office during the war, during 1918 and 1919, I spent a month or so doing nothing but trying to work out some proper basis for these reorganizations, and at the time I thought myself unusually stupid because I could not arrive at a result that was satisfactory to myself; but in view of the little progress that has been made since then in the treatment of reorganization I do not feel that I was such an awful fool as I thought myself at the time.

But it is true, as every lawyer knows, that the present provisions which have been retained, I think, without change in the 1924 and 1926 acts, were by no means perfect, but they have provided a basis

for procedure, a guide for people who wanted to get their corporations reorganized. If this change is made in the 1928 act, just this one change, it is going to affect a lot of people who I think had a right to rely on the provisions of the 1924 and 1926 acts. Our very strong feeling is that if you are going to revise the reorganization provisions, they should be thoroughly revised to the extent that they will more thoroughly reflect the substance of the matter than to simply provide rules of the game, so to speak, where if you adhere to them you are all right, and if you do not adhere to them you are all wrong, irrespective of whether the substance of the transaction is one way or another.

The CHAIRMAN. In speaking for the American Bar Association, as I understand you do, could you express the opinion of the association as to the advisability or otherwise of taking the administrative features of the 1926 act, leaving the sections just as they are, making whatever amendments to those sections are necessary, and not trying to change the sections as is done in the bill? Have you discussed that question?

Mr. SATTERLEE. We have in our committee, and also individually with lawyers who are members of the association, but we can not bind the association, as they have not had a meeting this year. The feeling of the committee and such lawyers as I have talked with is that although considerable progress has been made in the present bill from the last bill, the time devoted to the consideration of it has really been too short and we should much prefer to see such changes by way of amendments made in the 1926 act, such as modification of rates, and let the 1926 act go over for another year or two and allow people time for real consideration of a new revenue bill which should be an improvement over any we have had in the past.

The CHAIRMAN. That will not include any amendments that experience has demonstrated should be made to the administrative sections of the 1926 act, would it?

Mr. SATTERLEE. No, sir.

The CHAIRMAN. Some changes in those sections that we all agree should be made?

Mr. SATTERLEE. Yes, sir.

The CHAIRMAN. I have in mind the taking of the administrative features provided in the 1926 act and only making changes where experience has demonstrated that they must be made.

Mr. SATTERLEE. I am inclined to think we should agree to that, that we should favor that, of course, subject to our view that whatever changes are made, except where they are for the benefit of the taxpayer, should not be made retroactive.

Senator REED. You see no objection to putting the sections in ordinary sequence, as has been tried to be done here, do you?

Mr. SATTERLEE. No; Senator, except that I do not think the present bill has gone far enough in that respect. My own view about a revenue act, it being such a highly important matter, is that everything that affects the rates of tax, the administration of the law, the collection of the tax, should be complete in one act, which is not done in the present bill. We still have to refer to other acts. Before any very radical change is made in the present law, I should prefer to see the whole job done at once, rather than done piecemeal,

as it is now. But I do think the arrangement of the present bill is a considerable improvement over the arrangement of the previous act.

Senator REED. It might not be so apparent to a man who is familiar with the act.

Mr. SATTERLEE. That is true.

Senator REED. But a new man who studied it would benefit from the improvement.

Mr. SATTERLEE. I think so, but I do not think it goes far enough to accomplish its real object. For that reason our feeling is that before any radical change is made it might be well to allow another year or so to consider and study an ideal bill, as near as may be possible.

The next section we touch on is section 115, distributions by corporations, in which the House bill omits the former provision excluding from taxation dividend surplus accumulated before March 1 in 1913. That, I have no doubt, enough people have already talked to you about. We object especially to the retroactive feature.

Senator REED. I would like to ask you something about that. Suppose you had stock that was worth $100 a share on March 1, 1913. If you sell it now for more than that you have to pay a tax on the difference, that being your profit?

Mr. SATTERLEE. Yes, Senator.

Senator REED. Suppose, instead of selling it, your corporation goes into liquidation and declares a liquidated dividend of $150. You have realized the same profit?

Mr. SATTERLEE. Yes, Senator.

Senator REED. Why ought not the excess to be taxed as a profit, just as if you had sold the stock and realized the same profit?

Mr. SATTERLEE. Do you mean in a case where the whole $150 represents accumulation before March 1, 1913?

Senator REED. Yes.

Mr. SATTERLEE. Well, as to the original proposition, there is a good deal to be said for it. For instance, to take the opposite situation, if you buy stock at $150 a share and the company has accumulated quite a surplus after March 1, 1913, and you sell it at $150, you make no gain or loss; but if the corporation distributes $50 of that surplus you are taxed on it, though the value of your stock is reduced by that $50. I think it is impossible to work out exact equity in those situations involving corporate distributions, but our chief feeling about this particular section is that it should not be retroactive, because of the general rule that retroactivity is bad, and also if we should go further, although we have not attempted to, that in view of that provision as to March 1, 1913, being in all previous revenue acts beginning with the 1916, it is rather unfair to the stockholders of corporations who have not yet taken advantage of that provision.

The CHAIRMAN. The 1916 act did not go as far as that. The 1921 act is the act that really made the change in the law.

Mr. SATTERLEE. Was it? It was my impression that it was the 1916 act, but I would not be positive about that.

Senator SHORTRIDGE. You think there is a considerable number of corporations that have not taken advantage of that section?

Mr. SATTERLEE. I have no means of arriving at statistics, but I think, particularly in the case of timber and mining companies, there are corporations of that character that had millions and millions of dollars before March 1, 1913, that have not yet been distributed.

Senator HARRISON. There is no doubt but that is the case with the timber people, and I suppose it also applies to mining.

The CHAIRMAN. Mostly timber, however.

Senator WALSH. What do you think about making that provision operative in two or three years.

Mr. SATTERLEE. Our committee considered it a matter of policy, but in legal procedure or in respect to legal rights I can see no objection.

Senator WALSH. There ought to be notice given.

Mr. SATTERLEE. Yes. It is the feature of not giving them a chance to rectify the situation that we object to.

Senator WALSH. When others have had it for so many years.

Mr. SATTERLEE. Yes; that is very true, Senator.

The next provision is the matter of consolidated returns, and while that is largely a matter of policy, still we think we may be justified in saying that our experience in tax matters is such that we feel that something almost approaching chaos will result if the provisions are left out of the present law, and we are inclined to favor their restoration to the bill; that is, not limiting consolidated returns to the next two years, but putting in a general provision which would permit corporations to file consolidated returns subject to regulations promulgated by the Commissioner of Internal Revenue. We would not feel very badly if what are now called class B affiliations; that is, affiliations which depend upon the ownership of stock by individuals, were eliminated; but we do think that from a practical standpoint, entirely aside from the original question of policy, to make it convenient for the Treasury Department and taxpayer and save money for the Government a broad provision should be left in the law permitting consolidated returns in any proper case, subject to regulations provided by the Commissioner of Internal Revenue.

Senator COUZENS. May I ask why you desire it to be optional instead of mandatory?

Mr. SATTERLEE. That goes back, I believe, to the feeling a good many people have had that perhaps the only provision which forced consolidated returns is unconstitutional; that you could not by force disregard the corporate entity, and therefore, the law might be upset if not made optional; but at the present time the right to make consolidated returns is optional, except that when an election is made you have to follow the same course you have followed in previous years. That would work out very well in the future, because corporations that have elected to file separate returns could continue to do so, and the great majority of corporations which have filed consolidated returns would still be able to do so.

Section 271 has a minor change in it.

The CHAIRMAN. I think that is very thoroughly covered in your brief.

Mr. SATTERLEE. You think I need not mention that?

The CHAIRMAN. Yes.

Mr. SATTERLEE. Section 273 is something we embodied in our report to the association last year, in which our recommendation was adopted by the association. In section 273 there is, of course, the very necessary provision for jeopardy assessments. We admit that as a practical matter the Commissioner of Internal Revenue must have the right to make jeopardy assessments; but I think we are all agreed that jeopardy does not simply involve the idea of the running of the statute of limitations. Yet we all know that in times past the Commissioner of Internal Revenue has made jeopardy assessments simply to avoid the running of the statute where, for one reason or another, he had failed to audit the taxpayer's case before that time. That has resulted in considerable hardship, and we recommended in our report of last year and still feel that there should be a provision in section 273 providing for a summary review by some court or by the Board of Tax Appeals as to whether there was real jeopardy, and if that right of review is given we think the taxpayer would be protected. Of course, we realize that the Treasury Department now takes the position that it is not making jeopardy assessments any more for the purpose of avoiding a running of the statute of limitations, but while we know the responsible heads of the Treasury Department feel that way, still the subordinates of the Internal Revenue Bureau may feel they would be caught in a jam if they did not make jeopardy assessments and might go ahead and make them.

The CHAIRMAN. The necessity for it has passed?

Mr. SATTERLEE. It has been very much decreased. We still think that in order to avoid the occasional case of hardship the Treasury Department should have no objection to a provision which would give the taxpayer a right of review to determine whether or not there was real jeopardy.

Senator BAYARD. When you give that right of review you also provide in italics on page 11:

> The decision by such tribunal as to the existence of jeopardy shall not be subject to review.

Why do you limit that in that way?

Mr. SATTERLEE. We put that in because we thought it might be helpful in case that any court to which the matter was brought would feel outraged or would feel right away there was jeopardy.

Senator BAYARD. Might not the decisions involving this question in the several district courts throughout the country be conflicting? Should there not be some form of appeal to a superior court whose decision would be final and cover all these matters?

Mr. SATTERLEE. That might arise with reference to a construction of the law. Usually it is a question of fact, and the decisions would not be conflicting. We have no objection to the elimination of that clause. We put it in simply to help the taxpayer to a limited extent.

Senator BAYARD. I have in mind the equity rules of 1912, in respect to which, as you know as a member of the bar, we had a series of decisions by the district courts and the several circuit courts of appeals, and there was a final decision by the United States Supreme Court. It seems to me, this being an equitable proposition to determine jeapordy, if there be jeopardy, that you would have a series of decisions, and you would need a provision for a final appeal to some superior court which might settle the whole matter.

Mr. SATTERLEE. Yes. I think that last sentence should be eliminated, as you suggest.

Passing on to the next section we touch on, sections 276 and 506 involve the same point, which is with respect to waivers after the expiration of the period of limitation. As yet no court has authoritatively settled the question as to whether a waiver of the statute of limitations given after the statute has run is valid, given without consideration. These sections would make such a waiver valid to reopen the case where the statute has already run, although under section 1106–A of the 1926 act you can scarcely do that. We have no possible objection to a taxpayer against whom the statute has run, if he still feels he is morally bound to pay the tax, paying the tax; but what these sections might result in would be an abuse of such a statute, which we have all noticed in our own experience. That is that a revenue agent or some local collector would ask for a waiver from a taxpayer who does not realize that the statute of limitations has run against the assessment or collection, whereas, if he had been advised of his rights he very probably would not have given it. We do not think, on that account, that waivers should be by statute made effective where they are given after the statute of limitation has run, where the taxpayer's right has accrued, and where under section 1106–A of the 1926 act the liability against him is extinguished.

Sections 311, 602, 604, and 605 of the new bill all grow out of section 280 of the present bill, which provides for the collection by some summary proceeding, such as distraint, assessment, or distraint, against the alleged transferee of the assets of the taxpayer. In our report to the association last year we recommended the elimination of section 280 on not only constitutional grounds but on the ground that it was a radically new departure in tax administration; that it is unfair and not an ordinary procedure or usual method of tax collection against a person who was not a taxpayer, but who was simply claimed to have received assets of a taxpayer. Our view has not changed at all in that respect, and we still think the section should be eliminated and that the Treasury Department should be left to the ordinary procedure of pursuing the transferee by ordinary court action.

But section 604 of the proposed bill goes even further than section 280 by specifically providing that no suit shall be maintained for the purpose of restraining the assessment of collection of the amount of the liability of a transferee of property of a taxpayer. That is designed to avoid the effect of the decision of the United States District Court of the Western District of Kentucky, in the case of the Owensboro Ditcher & Grader Co. *v.* Lucas (18 Fed. 798), which held section 280 unconstitutional, and which would very likely hold section 311 of the present bill unconstitutional if the point came before it. It seems to us certainly a curious policy and an unwise policy to attempt to enforce an unconstitutional provision by simply making it impossible for a taxpayer to raise the point in the proceeding for an injunction.

The CHAIRMAN. Was that case appealed?

Mr. SATTERLEE. The Government took an appeal, and at the request of the Government the appeal was dismissed, because apparently they felt they could not sustain the appeal. Of course, if it

were a case on appeal, and there was a real difference of opinion as to the constitutionality of section 280, our view about it would not be so strong; but where apparently the Government admits that section 280 is unconstitutional we do feel that there should not be an attempt to accomplish by indirection what could not be obtained by direction.

The CHAIRMAN. I understand there is another case going up on appeal. My attention was called to the fact that in that case there was no liability, but it is being tested in another case.

Senator REED. How can that case be carried on under the language of this section. It says no suit shall be maintained. We passed similar language in another act, and the Supreme Court held that no suit of any kind could be maintained.

The CHAIRMAN. Yes. I just wanted to call attention to it.

Mr. SATTERLEE. Section 601, which deals with the Board of Tax Appeals, is something our committee is primarily concerned with. In our report of last year, after consulting with members of the Board of Tax Appeals as to their own views in respect to the matter of procedure, because we have always tried to work harmoniously with them, it was suggested that the work might be facilitated in technical cases involving long accounting if they had the right to appoint special masters. We have suggested an amendment to section 601 to the effect that the board might from time to time, with the consent of the parties, which we thought would protect both the Government and the taxpayers, provide for the appintment of special masters to hear accounting and similar technical and involved proceedings. I think that speaks for itself.

The CHAIRMAN. Would it not be better to increase the members of the board?

Mr. SATTERLEE. We considered that, Senator, but we felt if the board were very much increased it would really be too cumbersome. We feel it is better to have a small board, with assistants in special cases in the nature of special masters. We did not want to go to the extent of recommending that they be allowed to use special masters in all cases, because we thought they should hear most of the cases themselves, but we felt that in long cases involving accountings they might be heard by a special master who would report to the board.

Senator REED. When you get to the proposed amendment to section 907, do not pass it over.

Mr. SATTERLEE. No, Senator. I am just going to speak of it.

In respect to section 907, as proposed to be amended in the present bill, we recommended last year, and it was adopted by the association, that in the case of a return alleged by the commissioner to be false or fraudulent with intent to evade tax, or of a deficiency alleged by the commissioner to be due to fraud with intent to evade tax, the burden of proof upon the issue of falsity or fraud with intent to evade tax shall be upon the commissioner. In other words, that in fraud cases or on the issue of fraud the burden should be upon the commissioner and not upon the taxpayer. We do not question the fundamental proposition that in tax administration the burden of proof shall be upon the taxpayer; in other words, that an assessment once made is prima facie correct and it is up to the taxpayer to dis-

prove it. We have no objection to such a provision being put in the statute, although I do not think anyone has ever seriously questioned it. But fraud is a different matter. It is rather an anomaly to have jurisdiction of fraud in the Commissioner of Internal Revenue. It properly belongs in the Department of Justice. But if the commissioner has the right a impose a penalty for fraud, on a summary decision that there was fraud in the case, it seems to us thoroughly contrary to the ordinary principles of Anglo-Saxon and American jurisprudence that the taxpayer should have the burden of proof in negativing the fact that there was fraud.

Senator REED. If fraud exists the statute of limitation does not run in favor of the taxpayer?

Mr. SATTERLEE. That is correct.

Senator REED. So that a claim by the Government, no matter how old, can be asserted, provided the commissioner makes a finding of fraud?

Mr. SATTERLEE. That is true.

Senator REED. Then, on appeal to the Board of Tax Appeals, the burden is on the taxpayer to disprove fraud, without a syllable of evidence from the commissioner to prove it?

Mr. SATTERLEE. If the taxpayer does nothing the fraud stands against him.

Senaor REED. They have not made any affirmative ruling to that effect?

Mr. SATTERLEE. No; except there have been a number of cases of fraud, and I have read them pretty carefully with the idea of getting some language to indicate just what position the board took. It is obvious from a review of the decisions that they have felt that the burden of proof was on the taxpayer. They have not only asserted that, but on page 16 of my brief I quote from the case of E. G. Humphreys *v.* Commissioner (9 B. T. A. 656), decided as recently as December 19, 1927, where the board said in dismissing a charge of fraud:

> The usual presumption of correctness attached to the finding of the commissioner is fully overcome by the uncontradicted testimony of petitioner.

In other words, there was a case where the petitioner did come in, and his testimony was such that the board believed it, but if it had not done that the presumption would have been that he was guilty of fraud.

Senator SHORTRIDGE. The commissioner may charge fraud without any hearing?

Mr. SATTERLEE. Oh, yes. He often does. I do not say that has been common practice or is now, but in the past there have been cases—and I think the representatives of the Treasury Department will agree with me—where in order to avoid a running of the statute of limitations the commissioner charged fraud without a scintilla of evidence. I had a case before the Board of Tax Appeal a few years ago where there was so little evidence of fraud that I asked the board without leaving the bench to dismiss the charge. They did retire for about five minutes. Uusually they take cases under consideration for weeks or months, but they returned to the bench and announced they could find no evidence of fraud in that case, and did it within five minutes.

Senator SHORTRIDGE. The commissioner may make the charge of fraud without a hearing?

Mr. SATTERLEE. Yes, sir.

Senator SHORTRIDGE. The taxpayer comes in and denies it?

Mr. SATTERLEE. Yes, sir.

Senator SHORTRIDGE. The issue therefore is, was there or was there not fraud?

Mr. SATTERLEE. Yes, sir.

Senator SHORTRIDGE. And you think the burden should be upon the Government to establish fraud?

Mr. SATTERLEE. To show there was fraud, and not upon the taxpayer to prove that he is not guilty of fraud. It is the hardest thing in the world, as we all know, to prove the negative of something.

Senator SIMMONS. It is the rule that obtains in all courts, is it not, that one who charges fraud must prove it?

Mr. SATTERLEE. So far as I know. I know of no court that does not follow that rule.

Another amendment that we suggest to this same section, which is perhaps a minor amendment, but we think it should go in, is this.

The CHAIRMAN. What is the position of the American Bar Association as to all cases other than fraud cases, that the results should be proven by the taxpayer himself?

Mr. SATTERLEE. In all other cases, as I tried to say when I started, we all agree that it would be impossible for the Government to collect taxes or administer taxes unless the burden of proof were upon the taxpayer, and we thoroughly concur in that.

Senator SIMMONS. That is shown in municipal jurisdictions, as well?

Mr. SATTERLEE. Surely. That is a fundamental part of tax legislation.

Senator SIMMONS. That has resulted from the necessities of the cases?

Mr. SATTERLEE. That is true.

In the middle of page 16 of the brief we suggest another amendment, which is this: The statute with respect to the Board of Tax Appeals provides that notice of proceedings shall be given by registered mail, but it has not stated to whom. We think that should be clarified by a provision like this:

Provided, That the mailing be to the attorney who has entered his appearance in the proceeding, at the address given by him, or, if no attorney has entered such appearance, to the petitioner at his address given in his petition filed with the board.

There have arisen a number of cases where petitioners lived in San Francisco, and in one case in the Hawaiian Islands, where notice was sent to him in the Hawaiian Islands, even though he appeared by an attorney whose office was in Washington and who would be the natural person to give the notice to an ordinary court procedure. The Board of Tax Appeals has become more and more a quasi court, and we think the proceedings there govering notice should conform more than in the past to the ordinary legal proceedure giving notice to an attorney.

Senator SIMMONS. Do you not think it should be given to both?

Mr. SATTERLEE. I do not think it is really necessary. If the petition is signed by the attorney, and his address is signed to it, I should think notice to him would be sufficient.

Senator SIMMONS. There is no certainty that the relationship of attorney and client is going to continue indefinitely.

Mr. SATTERLEE. The attorney is responsible until he withdraws or files notice with the board that the relationship has ceased, it seems to me.

The CHAIRMAN. The practice in the past has been that the notice has been given to the petitioner himself?

Mr. SATTERLEE. A notice has been given to the petitioner himself, who may live in a remote part of the country. Of course, the attorney is usually more on the job in his office than a petitioner may be.

Section 608 I will skip. I think that is sufficiently covered in the brief.

Section 611 I think, as you probably already know, aroused more of a storm throughout the country, particularly in the legal profession, than any other provision that has ever attempted to be inserted in a statute. I want to preface what I say about it by stating that our committee of the bar association has tried to act in the preparation of this report and in our recommendations not as individual lawyers representing clients, but as representing the bar of the country and speaking for them at least in an informal way, and in accordance with sound legal principles irrespective of the effect on any particular client.

I doubt if many lawyers could be found who could say anything in support of section 611, which, as you know, attempts to revive the right of collection of taxes against taxpayers, who at one time or another filed a claim for abatement, irrespective of when the statute of limitations ran against such taxpayer.

Senator SHORTRIDGE. It does away with the statute of limitations.

Mr. SATTERLEE. It does away with the statute of limitations. There are two grounds of attack upon this section, two principal grounds. One, and I think the most important, is that it is something that Congress ought not to enact. The other and less important ground is that Congress, at least in the class of cases affected by this section, has no right to enact it. I might mention the latter first, because it can be disposed of very briefly.

The CHAIRMAN. Your present objection and only objection is to opening up these cases after the statute has run?

Mr. SATTERLEE. Our position is that statutes of limitations once enacted by Congress, when the period prescribed by those statutes has expired, should not be reopened, and that no attempt should be made to extend the period of limitations. Let me distinguish that class of cases. As has happened in the past, certain statutes of limitation have been enforced, and other statutes, for one reason or another, it seems desirable to extend the period of limitations of those statutes. To extending a period of limitation that has not yet expired we have no objection, but where, as under section 611, the period of limitation in some cases had expired four or five or six or seven or eight years ago the taxpayer's position had been changed a number of times, transactions had been carried on on the basis of there

being no further tax liability, and then they come along and attempt to reopen those old matters. It seems to us it is something indefensible.

The CHAIRMAN. I see your brief covers it very thoroughly.

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

The CHAIRMAN. Yes.

Senator SHORTRIDGE. You are familiar with the decision of the Supreme Court in the New York & Albany Lighterage case, decided in February, 1927, are you not?

Mr. SATTERLEE. Yes, sir.

Senator SHORTRIDGE. Is not the design of this section to overrule that decision?

Mr. SATTERLEE. Precisely.

Senator SIMMONS. I understand you are making no objection to the extension of the time of limitation before the limitation has expired?

Mr. SATTERLEE. That is right.

Senator SIMMONS. But you object to any extension after that time has expired?

Mr. SATTERLEE. That is, to reviving a tax after the statute has already run. If I may say this—and I will not go very far into this, because we have tried to state a good many things—there are really two classes of cases affected by section 611. One is that class of cases where the tax has not been collected, and where this statute would give the right to the Internal Revenue Bureau to collect the tax after the statute has run. The other class of cases is where the Internal Revenue Bureau unlawfully—so the courts have held, a good many of them by now—has forced collection. That extension would prevent the taxpayer from getting that money back.. Section 1106–A of the 1926 act, as you know, not only barred the remedy, but extinguished the liability. So merely as a legal matter, I have not much doubt that if this section 611 were enacted, that under it taxes which have no yet been collected could not be collected, because the liability had expired, and the court would so hold. The Board of Tax Appeals so held as recently as yesterday.

But for that very reason there would be a great discrimination between those taxpayers who have not paid, and those who have been forced to pay at a time when the liability had already been extinguished, but they were forced to pay by threat of distraint, and there was no way of getting their money back.

Here is a bit of history that I would like to mention. Of course, this is all based on a provision of the revenue act of 1921, where the Treasury Department in perfect good faith has taken an attitude I have never been able to understand. It is the same point involved in the case Senator Shortridge spoke of. The Treasury Department, under the 1921 act, took the position that distraint was not a proceeding which had to be brought within five years, although I can recall discussing the point with representatives of the department as early as 1922. I discussed it with the then solicitor and I discussed it with a number of people. Cases were brought and have been pending in the courts for years. If the Treasury Department thought the construction the Supreme Court has now put upon the statute was not correct, they might have said something about it in the 1924 act, but they did not. The 1926 act came along and nothing was

done. But now, for the first time, in the 1928 act, when, as I say, in some cases four or five or six or seven or eight years have elapsed since the statute of limitations has run, the department wants you gentlemen or wants Congress to give it back something that it lost years ago and concerning which it has in no way tried to safeguard its rights in the meantime. It seems to me that is a very unjust position for the Treasury Department to take, and it is certainly unjust to all the taxpayers who relied on the statute of limitations. Of course, if you are going to knock out all statutes of limitations that is a different matter. If all statutes on both sides were knocked out forever, that is a matter of policy about which I will make no argument, but when you have them it seems to me they should be lived up to.

Senator SHORTRIDGE. May I ask you another question?

Mr. SATTERLEE. Surely.

Senator SHORTRIDGE. If the Government lost money it was through a misinterpretation of the law. Is that not so?

Mr. SATTERLEE. Yes.

Senator SHORTRIDGE. And having lost a considerable amount by that misinterpretation, the purpose of this is to enable the Government to get back or collect taxes which, under a proper interpretation of the law as it then stood, are now barred?

Mr. SATTERLEE. That is, of course, true to a certain extent. In some cases, however, if this section were enacted, taxes could be collected, because it is so long since any attempt was made to collect them and so long since they were barred that the taxpayer's evidence which would have shown the taxes to have been improperly assessed has been lost. For instance, a corporation has been dissolved, or its assets have been sold, and the purchaser has taken the property and paid for it on the advice of counsel that there was no outstanding tax liability.

Senator SHORTRIDGE. That section, if enacted in the form submitted here, would enable the Government to bring suit to recover taxes accruing many years ago?

Mr. SATTERLEE. Yes, sir.

Senator SHORTRIDGE. And which under the law properly interpreted, as the law stood, would be barred?

Mr. SATTERLEE. Yes, sir; it applies almost entirely to cases in which the statute of limitations ran in 1924, or prior to 1924, at least four years ago.

Senator SIMMONS. If that extension should be allowed, ought it not to be at least modified by a provision that it should not apply to bona fide purchasers in the meantime?

Mr. SATTERLEE. Well, that would give some relief, Senator, but it would not help the taxpayer who allowed his record to become dissipated.

Senator SIMMONS. It would not help the taxpayer who had not paid it, but it would the others.

Mr. SATTERLEE. I know, but you are assuming that he owed the tax. Most of those cases are cases where the taxpayer said he did not owe the tax and where, if the statute of limitations had not run against it, he would have been careful to preserve his evidence. But

the Treasury Department under this section could come in now and assert an entirely different claim.

Senator SIMMONS. And he could not set up a defense?

Mr. SATTERLEE. He would not have the evidence, if the statute of limitations ran against him in 1917 or 1918, which are the years chiefly affected.

Senator SIMMONS. How would that destroy his case?

Mr. SATTERLEE. Most of the cases involved relate to the 1917 or 1918 taxes, which could have been cleaned up years ago. The statute has now run in most cases as long ago as 1924. The liability of taxpayers was extinguished as long ago as 1924. It is very probable that in a number of those cases, perhaps in most of them, the taxpayer has not taken much trouble to preserve the record of what happened in 1917 and 1918, and the Treasury Department could make a claim now which they would have no chance of refuting.

Senator SHORTRIDGE. May I ask another question, Mr. Chairman, which to my mind is very important?

The CHAIRMAN. Yes.

Senator SHORTRIDGE. You have said you are familiar with the Lighterage case.

Mr. SATTERLEE. Yes, sir.

Senator SHORTRIDGE. Do you agree with this proposition, as stated: The Lighterage case holds that where more than five years has elapsed since the return was filed, it is proper for the Government to collect taxes for any of those years by distraint, even though such taxes were assessed within the proper time limit for assessing?

Mr. SATTERLEE. That is true as a general proposition. Of course, there are qualifications to that. That applies only to cases arising under the 1921 act, and to cases under prior acts, and where the statutes of limitations run while the 1921 act was in force, before the 1924 act was enacted.

The CHAIRMAN. I do not want to hasten you, but time is rapidly passing. I notice your brief quite fully covers some of these points.

Mr. SATTERLEE. I think the rest of the matters are sufficiently covered in the brief. I thank you very much, gentlemen. I am sorry I have taken so much of your time.

STATEMENT OF WILLIAM A. BRADY, ESQ., NEW YORK CITY

The CHAIRMAN. I will have to begin to ask the witnesses to make their statements as brief as possible.

Mr. BRADY. I was going to start with that, Senator.

The CHAIRMAN. What I have said applies more to others, because I know you generally are brief in what you say here.

Mr. BRADY. I was going to ask the committee to have patience with us this morning, because we feel there is not a complete understanding of our situation existing, either in the House of Representatives or in the Senate. It is a long time since we have been permitted to appear before this committee, and I have brought with me, and they will be brief, representatives from the actors, the stage hands, and other representatives of the theater.

I may introduce myself, gentlemen, by saying that my name is William A. Brady. I am probably one of the three oldest men in

the theater of the United States. I have served in every line. I have been an actor, I have been a writer, I have been a promoter, I have been a theater owner. I represented, and I am proud to speak of it, the motion-picture industry, appointed by President Woodrow Wilson within two weeks after our country went into the war, as the head of the activities of the motion-picture industry throughout the world; and handled that until the conclusion of the war and the election of Mr. Harding when I was succeeded by Mr. William S. Hays. I may say, gentlemen, that during that period I received no salary. I paid my own expenses. I can talk authoritatively and answer any question about the legitimate theater, about the movies, or about any other class of entertainment in the United States.

I am going to take a very short time to go back a short while in the theater, to go back to the time when in New York City Booth, Palmer, Daly, and Wallack had theaters, and when the actors included such people as Clara Morris, Fanny Davenport, Lester Wallack, Richard Mansfield, John Brougham, Rose and Charles Coghlan, John Drew, Ada Rehan, Nat Goodwin; when Philadelphia was represented by such people as Edwin Forrest, Mrs. John Drew, Otis Skinner, John McCullough, Lawrence Barrett, E. L. Davenport, Georgia Drew, and Maurice Barrymore; when Boston had its Boston Museum, with Clarke, and John Mason, where "Shenandoah," "Shore Acres," and other great American plays were produced; when Baltimore and Washington had the Fords and Albaugh; when Cleveland and Pittsburgh had the Ellslers, and Effie Ellsler created the great part of Hazel Kirke; when Cincinnati had the Pike Co.; when Louisville had Barney McCauley, who became one of the greatest comedians of this country, and Mary Anderson also came from Louisville; when St. Louis had John Norton; when Chicago had McVicker & Hooley, Julia Marlowe, and Denman Thompson; when Charleston, S. C., had John T. Owens, for that is where he came from, with a reputation almost equal to that of Joseph Jefferson; when New Orleans had the Bidwell Co., Mrs. Fiske and Joseph Jefferson. Out in Salt Lake City we had the Mormon Co. I myself, played before Brigham Young in Salt Lake, and I may say to you gentlemen that the leading man in the Mormon Stock Co. in Salt Lake City afterwards became Governor of Utah. You may remember that, Senator Smoot. In San Francisco we had the McGuire Co., the California Theater, which produced Lotta, Maggie Mitchell, Belasco, Edwin Booth. In fact, Edwin Booth played Hamlet for the first time in Sacramento. There was also Maude Adams, David Warfield, Tom Keene, John T. Raymond, William J. Florence, Madame Modjeska, and Holbrook Blinn.

Senator SHORTRIDGE. And John T. Malone?

Mr. BRADY. And John T. Malone. From Toronto came Margaret Anglin, the sister of Canada's chief justice.

I want to recall an incident to Senator Smoot when, in 1909, when he was chairman of the Committee on Patents, there was a hearing here on the disks now represented by the Victor Co., and the motion-picture people came here and attempted to appropriate without pay all of the great plays of that day, and all of the great songs of that day, without any charge. I remember a conversation

with the chairman of the committee when he said to me: "Why, Mr. Brady, you do not pretend to say that beautiful play of yours I saw in Salt Lake last week, called Way Down East can possibly be harmed by the reproduction of it on the screen?" Well, at that particular moment there were five companies playing Way Down East throughout the United States. That is how good the United States was at that time, as far as the legitimate theater was concerned. I told the Senator that three of those companies had been forced to go to the storehouse, as we call it, because of this production on the screen. At that time the Senators did not seem to know the difference between motion pictures and the legitimate theater, and between actors in the spoken drama and actors on the screen.

The CHAIRMAN. At that time there was no comparison between them, either.

Mr. BRADY. Well, there was to a certain extent. They could produce our effects, but they never could produce the spoken words, and that was proven a few nights ago during the celebrated Dodge hour, when the Dodge Motor Co. paid $50,000 for a radio hour, when all the great artists appeared upon the radio, and none of them but one made good with the audience, and that was an actor from the spoken theater, Mr. John Barrymore, who recited the soliloquy of Hamlet and saved the hour.

The CHAIRMAN. You would better make that complete by saying that we compelled them to pay for those plays.

Mr. BRADY. You did; but at first you tried to make us accept $5,000 for any of our plays, and we have since received a great deal more than that. You did force them to pay the song writers 2 cents. I believe the song writer is going to get what he is entitled to, if his song is popular enough. In other words, the song writers enjoy the unique privilege of having a price put upon their product.

Senator HARRISON. I thought Doug Fairbanks was once an actor in the spoken drama.

Mr. BRADY. He was, under my management, at $40 a week. I put him on the stage. He did not have enough vocal ability to get over the distance between Los Angeles and the rest of the country.

I know it is rather unpopular to talk about war records, so I will only talk for a few moments on that subject. I want you to remember the position taken by the theaters of this country during the war, and there has never been any charge that anybody connected with the theaters profiteered throughout the war. We turned our stage over to you. The celebrated four-minute men in war time became famous through the free use of the theater. Surely you will all recall our activities in selling Liberty bonds. And I am going to tell you a very short incident that occurred in the White House, which you may never have heard or read of.

At the time that General Haig declared to his soldiers that the English Army had its back against the wall, the President sent a message to New York that I should come to the White House immediately. I went there. Word had been left that I should be admitted, and I succeeded in getting two associates into the White House with me. I met the President and the President told us that the Root commission had just returned from Russia, where Kerensky was in command at the time, and that the principal thing that the

Russian Army wanted was pictures. To use his words, he said: "The picture has a universal appeal. The Russian soldier is the most illiterate soldier in the world. Ninety per cent of them can not read, and the other 10 per cent will not read." But they can be made to know by pictures. There was an argument going on at that time between the picture business on the one hand and the Christian associations of the country on the other, about the use of what was called "junk" films. We wanted to work separately in supplying the films to the Government, and the other people wanted the films distributed through the auspices of the bankers' committee at one and the same time.

I remember the President saying this, which under conditions like that one could never forget. He said, "Mr. Brady, I am only the housekeeper here. You people constitute one of my units, and this organization that you are opposing is another important unit of mine. I want you to get together." I said, "It is impossible." He said, "That is not patriotic." I said, "Mr. President, we are together." I left the place, and within one week 5,000,000 feet of films were placed upon steamboats and sent to Spain, sent to England, sent to France where the Germans were circulating propaganda in the Provinces to the effect that the American Army constituted forty or fifty thousand men that had spent six months trying to catch a bandit in Mexico and had failed. That was the kind of propaganda they were circulating in France. We sent two agents, one to Barcelona and another to London, and we circulated 5,000,000 feet of film to back Pershing, which demonstrated to the ignorant people in Europe that this country was really prepared. We pictured the Red Cross activities, the airplane field, the dockyards.

Now, we consider that the picture is a by-product of ours, and, as far as I am concerned, I honor the men that are in it; but my purpose here to-day, gentlemen, is to prove that you are giving the legitimate theater in this country the worst of it. The movies, for some reason, have been favored in taxation. In 1921 the gross amount of money received from admission tax in this country was $89,730,832. That year you took the tax off of 50-cent tickets. Now, that did not help us any. You might say, "Why didn't you cut your expenses down?" We could not. Our actors live, our actors eat, we have to pay the railroads, we have to leave money wherever we go. Every night we are using the same people, but that is not true of the moving picture. They can afford to spend $5,000 or $10,000 a week advertising them, because they have no expense except an operator at $40 a week. We can not compete. And as I was saying, when they cut the tax off the 50-cent ticket, that resulted in a drop that year of $16,500,000.

Now, in 1925 you eliminated all tax up to 75 cents, and that resulted in a drop of $47,000,000. In other words, you have handed to the so-called poor man's amusement, an expression that Senator Smoot used to me a few years ago and which I disputed, you have handed to the so-called poor man's amusement $63,000,000 in two years. In the last fiscal year, 1926, the gross tax collected from admissions was $17,940,636.

Senator BAYARD. You mean we handed the movies $63,000,000?

Mr. BRADY. No; I do not mean that. I mean that $63,000,000 were taken off their tax. In other words, if you are going to a theater, and you see a place over here that has no tax and another place that has a tax, you will naturally go to the place with no tax. I claim if the tax were taken off up to $3 or $3.50 the loss would be much smaller than is predicted by experts.

Senator HARRISON. What do they predict?

Mr. BRADY. They predict eight or nine.

Senator HARRISON. $8,000,000 or $9,000,000?

Mr. BRADY. Yes.

Senator GERRY. What do you favor?

Mr. BRADY. Between three and five. It might be $3.

Senator SIMMONS. Mr. Brady, do you realize the fact that in the 1926 act the Senate by a very decided majority voted to abolish all admission taxes?

Mr. BRADY. I do.

Senator SIMMONS. And your trouble is in the House, therefore, and not in the Senate, unless there has been a change in the sentiment in the Senate on that question.

Mr. BRADY. The House passed a law, which was drawn by Mr. Rainey and Mr. Mills, which took the tax completely off the legitimate drama.

The CHAIRMAN. The spoken drama?

Mr. BRADY. The spoken drama, but they failed to define it in the act.

Senator SIMMONS. I mean when the bill went to conference the Senate had eliminated the tax.

Mr. BRADY. Yes, Senator. A concession of that kind would help dramatic production, the greater part of musical shows, concerts of the climbing artists who have not as yet reached the pinnacle of a McCormack, a Kreisler, Farrar, Chaliapin, Galli Curci, or Jeritza, and, believe me, there are hundreds that would be thus benefited—hundreds of young men and women, pianists, violinists, and all that sort of thing, traveling through this country who can not command more than $1.50 or $2.50 for a lecture or for a musical entertainment. You are not only helping the legitimate drama but you are helping music, the development of American music, the encouragement of young American musicians, the encouragement of young American lecturers. Those people are being viciously hurt at the present time by this admission tax, which I will come to more completely in a moment.

Now, gentlemen, this must strike you as being ridiculous:

Under the revenue act of 1918 the tax on soft drinks, ice cream, and similar articles was 1 cent for every 10 cents or fraction.

Tax repealed.

Art, jewelry of every description, bronze, paintings were levied with a sales tax. In 1924, for example, the rate on jewelry was lowered to 5 per cent of the sales price.

In 1926 this tax was finally abolished.

The argument is often made, gentlemen, that the person who can pay $5 to go to the theater ought to pay a tax; but what about the lady who can buy a $50,000 pearl necklace, or the lady who can buy

a $40,000 fur coat? She ought to pay a tax, if the person who can afford to pay a little higher price for a theater ticket has to pay a tax.

A 10 per cent tax of the selling price was imposed on fabrics, rugs, picture frames, trunks, valises, purses and hand bags, lamps and shades, umbrellas, fans, robes, kimonas, furs, neckwear, stockings, boots and shoes, hats, caps, waists, smoking coats, etc.

This tax has been repealed.

Now, mark you, gentlemen, because Senator Smoot knows I worked with him about it. The argument was on a double tax. Besides the admission tax upon the movies there was a tax upon the finished and the raw films. I worked with representatives of the motion-picture business, as I hope the Senator will remember, for six months here with the Senator and with this committee to have that tax repealed, and it was repealed. Now, benefit No. 1 to the movies and benefit No. 2 to the movies.

There was a tax of 5 cents on telegraph, telephone, radio, and cable messages up to 50 cents and 10 cents on charges in excess of that amount.

Tax repealed.

Articles taxed by the revenue act of 1921 were: bowie knives, stilettos, brass knuckles, daggers, sword canes, dirk knives, yachts, and motor boats not designed for trade or fishing.

The tax was repealed. That tax was repealed, gentlemen. And I want to remind you now that the only business in the whole United States of America up to the present time has not received one iota of relief is the legitimate theater, legitimate music, lecturers, symphony concerts, and those things I have described. I say to the original proponent of the sales tax that the admission tax is a sales tax. Then why keep the sales tax upon the theater and remove it from these others? Why should the sales tax be removed from bowie knives, stilettos, brass knuckles, daggers, dirk knives, etc., and keep it upon an art? It is an art, gentlemen. And it is subsidized in every other country in the world except the United States of America, the most prosperous country in the world.

Now, gentlemen, I want to quote some remarks of the chairman of the Ways and Means Committee made in the debate on this bill on the floor of the House of Representatives:

Mr. CELLER. Will the gentleman yield?
Mr. GREEN of Iowa. I will.
Mr. CELLER. Why did the committee put it at $1 and not $1.50? What was the purpose of increasing the exemption only from 75 cents to $1?
Mr. GREEN of Iowa. We had to set the limit somewhere. The committee was of the opinion that this would take care of those who wanted to get into the shows.
Mr. CELLER. Those going to the spoken drama or the movies?
Mr. GREEN of Iowa. To any of them.
Mr. CELLER. The gentleman knows that in his State he can not go to a theater and hear a good production of the spoken drama for $1.

Which is a well-known fact, because in his own town of Council Bluffs the spoken drama has not been heard to my knowledge for at least 10 years, and it used to be a good show town. About the only town in his State where the spoken drama can live is Des Moines, and it is a poor living there. To continue:

Mr. GREEN of Iowa. Oh, yes; but not in the orchestra seats.
Mr. CELLER. To such productions as Eugene O'Neill or Shakespeare?

Mr. GREEN of Iowa. The trouble with the spoken drama is that you have the speculators.

Now, I am going to take just one minute on the question of speculators. Speculators in theater tickets, gentlemen, exist only in two cities in the Union, New York and Chicago, your two great metropolises. We are not pleading here to favor New York, which is a mistaken notion in the Capital. We do not represent New York. We represent the whole country. We represent Mississippi, we represent California, we represent Pennsylvania, we represent Michigan. We say to you that in five years—yes, seven years now—the State of Texas has not, with one or two exceptions, had any spoken theaters; that in your State, Senator Harrison, at Mobile, Montgomery, Selma, the drama is gone; that in your State, Senator Shortridge, does San Jose get any to-day? I played in your town. I played a week in San Jose. I played Shakespeare, and I had a fine company.

Senator SHORTRIDGE. Nellie Calhoun came from there.

Mr. BRADY. Yes. In the State of Pennsylvania they may still have it at Harrisburg, Pittsburgh, and Philadelphia, but Scranton and Wilkes-Barre do not have it any more. York, Allentown, and Reading have no more drama.

Senator WALSH. The admission tax is not responsible for that, is it?

Mr. BRADY. Largely so. I do not say it is altogether responsible. In Senator McLean's State, Connecticut, the State taxes us there. We pay 15 per cent there now, and the State takes 5 per cent.

Now, then, gentlemen, in closing the debate, Mr. Green said this:

Let me say, too, gentlemen, that it is not the tax which has put the spoken drama out of existence. The fact of the matter is that the movies have put the spoken drama out of existence, as well as the high prices which are charged for special tickets, so that nobody can get a good seat for less than $6 or $8 in New York.

Then, just because there are speculators in New York City, that means we are going to put the drama out of existence throughout the whole United States. You are told there is a law against speculating in New York State. It is not enforced, and your energetic United States district attorney forced a law through the legislature, which the Governor of the State has recently signed, whereby it is possible for the Government—mark this, gentlemen—for the Government to collect a 50 per cent tax upon this illegitimate charge you are complaining of. In other words, the Government is sharing in the spoils.

Now, Mr. Green admits that the spoken drama is going out of existence. Then, gentlemen, I think we should stop arguing on our part about the tax; I think we should plead for a subsidy, unless the United States Senate is willing that the drama shall die. The chairman of the Ways and Means Committee admits that it is dying. I will show you by statistics and facts that it is dying. It is out of existence in 90 per cent of the cities. Are you willing that the drama shall die in this country?

Senator REED of Pennsylvania. How about the prize fights, Mr. Brady?

Mr. BRADY. I do not represent the prize fights. I have managed prize fights when I was a young man.

Senator SHORTRIDGE. Your name would indicate it.

Mr. BRADY. I will answer that question directly and properly. I will answer it concretely. That any entertainment that can draw 260,000 men and $2,600,000 for two men boxing 20 minutes, you can go as far as you like with that tax.

Senator SIMMONS. That makes quite a lot of difference in your logic.

Mr. BRADY. Why?

Senator SIMMONS. I think your logic is good. I agree with you that we should dispense with this tax until we have another war.

Mr. BRADY. I agree with you, Senator.

Senator SIMMONS. I think we ought to impose our taxes upon those things that are in general use and that everybody will pay alike.

Mr. BRADY. I agree with you, Senator.

Senator SIMMONS. And then proceed in that direction very rapidly. I would like to finish up the job with this bill, if we could.

Mr. BRADY. I agree with you. I reply again to Senator Reed that the receipts for the pugilistic encounters are from the finest people. The receipts for prize fights used to come from the sporting element. Ninety per cent of the people who attended the Dempsey-Tunney fight at the world's fair grounds—mind you, at the world's fair grounds in Philadelphia—90 per cent of those people were the finest in the country. In fact, I sat between Bernard Baruch and some other great men of the Wilson administration.

Senator WALSH of Massachusetts. The Democrats all like fights.

Mr. BRADY. There were a half dozen Republican governors out at Chicago.

Senator REED of Penn-sylvania. We have to put it where it will be felt the least.

Mr. BRADY. Now, Senator, you say you have got to put the tax where it will be felt least?

Senator REED of Pennsylvania. In other words, where there are people able to pay it.

Mr. BRADY. If you put the tax on yachts and on Rolls Royces, just such things——

Senator REED of Pennsylvania. There are people coming down this week to say that we should not tax the Rolls Royces.

Mr. BRADY. I don't want to say too much about other people's business.

Senator SHORTRIDGE. You will limit it to your own business?

Mr. BRADY. I will, if you will permit. The movies are known by their stars. There is Fairbanks, who, with the exception of Charlie Chaplin, is one of the stars. Chaplin, one of the greatest clowns in years. And there are the other stars. I dare say that when the history of the movies comes to be written there will be none so distinguished as the 50 or more famous names that I named earlier in my statement that had become great because of the American drama; the great educational drama depends upon the magic of the spoken word. It may be news for you to hear, as I have heard in these conferences, education Shakespeare—somebody in the House of Representatives said, "You are constantly quoting Shakespeare here." But now you want to suppress it. Shakespeare does not succeed in the movies. Hamlet, Shylock, Macbeth, the Merchant of Venice, all of them done in the movies; no market for them. The

movies have tried to raise their audiences up. They have the pictures. They made a beautiful movie of Macbeth. The Merchant of Venice was pictured in Venice, right where the play happened, and nobody would go to see it.

The elimination of the American drama—and I am not talking for New York, gentlemen; I am not talking for Chicago, because, after all, in both those cities what they want is Behind Your Hat, and Up the Alley, and a lot of that stuff. I am talking for Denver, for Richmond, for Galveston, and the South, which was one of the greatest places we had for drama. Starting at Richmond, and going on down through the South, at Memphis, and in those Southern cities it developed to a wonderful degree.

Senator HARRISON. Practically all of the people who go from these sections in the country, either to Chicago or New York, go to the theaters and get the greatest pleasure out of it?

Mr. BRADY. Absolutely. The theaters in New York and Chicago to-day are the greatest asset that those cities have.

And speaking again of speculation, which has been fired at me more times since I have been here than I have hairs on my head, how about the Army and Navy football game? Was there speculation in that? There were more tickets in the hands of the scalpers than were in the hands of the public. How about the speculation in the Lindbergh stands that were built by New York city? Thousands of those have found their ways into the speculative channels.

How about speculation for the big movies? The Covered Wagon, or The Big Parade? In New York they speculate in anything. They speculate in airplane seats. And it is the curse of our business, and we would thank God if the Nation or the State or the city could create some law that we could eliminate it. We do not profit by it. There is a lot of fairy stories that we get money out of it. We do not. It goes to the—well, gentlemen, I don't want to raise a fuss about anybody else's business.

Senator SIMMONS. If this tax should continue, a suggestion was made to me a few days ago with reference to the elimination of this speculation that you speak about, and the suggestion was this: That the Government, instead of the present provisions of the law, impose a very high license tax upon everybody who dealt in these particular things, and allow them to charge only a certain per cent in excess of the price.

Mr. BRADY. The Supreme Court of the United States has decided that you can not put any price at which they can sell their tickets. If a man buys something he has a right to sell it at any price he can get for it. That busted that law.

Senator SIMMONS. You can increase the license tax.

Mr. BRADY. Yes.

The CHAIRMAN. Some of them get 50 cents and some 75 cents.

Mr. BRADY. Certainly; whatever they can get.

The CHAIRMAN. I am speaking of the legitimate sales.

Mr. BRADY. But the public will not go to our box offices. That is a funny thing. The public will not go to our box offices for the tickets.

Senator HARRIS. Mr. Chairman, we have only 15 minutes more this morning.

Mr. BRADY. I have two or three other statements I would like to make.

Senator SIMMONS. I sympathize with your argument about the spoken drama. The South has been denied the spoken drama, and the South is hungry for its return. I would like to see some of the good plays return.

Mr. BRADY. The South will not play us.

The CHAIRMAN. I would like to see all the discriminatory taxes removed if it was possible to do so in view of the necessary revenue.

Mr. BRADY. It has been said that we, the theaters, are political orphans. I hope this committee will not consider us political orphans. I hope they will consider us a necessity as a fine art.

I want to introduce to the committee now Mr. Frank Gillmore, the executive secretary of the Actors' Equity Association, of New York, an association that represents more than 90 per cent of the actors and actresses on the legitimate stage to-day. Mr. Gillmore, himself an actor, and successfully built his organization, which is the finest in the country. Mr. Gillmore.

The CHAIRMAN. You are not on the list here, Mr. Gillmore. How long do you want?

Mr. GILLMORE. Not more than three or four minutes.

Senator SIMMONS. Some of us will have to be in the Senate when it convenes at 12 o'clock.

The CHAIRMAN. You may take five minutes.

Senator REED of Pennsylvania. Are you going to meet this afternoon, Mr. Chairman?

The CHAIRMAN. Yes; at 2 o'clock.

STATEMENT OF FRANK GILLMORE, REPRESENTING THE ACTOR'S EQUITY ASSOCIATION AND THE CHORUS EQUITY ASSOCIATION, NEW YORK CITY

Mr. GILLMORE. Mr. Chairman, my name is Frank Gillmore. I am executive secretary of the Actors' Equity Association. As Mr. Brady stated, sir, I am here, of course, to appeal for my own people. As Mr. Brady explained to you, we represent 99 per cent of all the legitimate musical and comedy actors of the United States. That includes such great stars as Will Rogers, John Barrymore, Ed Wynn, and Ethel Barrymore; and includes, also, of course, all the other actors and actresses in the United States.

I assure you that at the present time their situation is a very sad one. For instance, Miss Jane Cowl, who is a very eminent actress, said the other day—which was published in all the papers throughout the country—she said, "Our beloved theater is plundered; a broken ship on a stormy sea."

Now, how could you prove such words as these? I must repeat some of the things Mr. Brady said, and accentuate them. In 1900 there were 1,800 legitimate theaters in this country producing and devoting themselves to legitimate drama. To-day there are only 200 or less. That is a tremendous depreciation. I must accentuate that there are a further 200 who work in a drama occasionally along with their movies. They will let the drama in once in a

while; but you are lucky to get in if you pay for the running of his film.

Mr. Brady was speaking of Texas. When I was a young man I remember I played six-weeks' stands in Texas and never went out of the State. And now, outside of Houston, I do not believe you will find one single word of the spoken drama. When you think of that enormous territory that has no drama, that is only fed by the few tent shows, it is a dreadful situation.

Now, I am certain the 10 per cent tax is not the only reason, but we do feel we are unjustly discriminated against. The actors and actresses have such poor and slim salaries to-day that many of them do not even make income-tax reports and pay income tax. Years ago actors and actresses had about 40 weeks of the year in which to work, and to-day most of them have not over 15 or 16 weeks a year, and their salaries are so pitiable that they are reduced almost below the level of the American standard of living.

Now in regard to the moving-picture theaters, you must remember that many of the great and wonderful theaters devoted to moving pictures in New York City seat 2,000 or 3,000 or 4,000 people at a performance. And they can give four or five performances a day. Unfortunately the legitimate drama can not do that. It is a more intimate thing. It is not possible for the actor and the actress to produce that many performances. And the actor can not shout his lines. And he can not, therefore, play and give his best performance in the huge buildings that the movies can show in. And an actor can not give more than eight performances a week, and yet the motion-picture theaters will give four or five a day; and they will seat 2,000 or 3,000 or 4,000 people at one performance.

Now we must have redress. We can not charge the prices with our limited audiences. We can not charge the price with our limited audiences as the motion-picture theaters can do. And therefore we need your help, and it will be a great thing for us and all the people if you will take off the 10 per cent tax.

As Mr. Brady said, a Member in the House said the other day we are all quoting Shakespeare, and yet Shakespeare's play, the "Midsummer Night's Dream," is being done in New York to-day, to a small audience. And to-day you can see the "Merry Wives of Windsor." There have been these productions of Shakespeare, and yet if you wanted to send your wife or children to see Shakespeare, or wanted to go yourself, you have to pay a 10 per cent tax over the price of your ticket. We hope you will give us relief. That is the message of the actors and actresses to the Senate of the United States.

Mr. BRADY. I will call Mr. Paul Turner.

Senator SIMMONS. Mr. Chairman, there is another matter that we want to take up this morning, and we have only about five minutes left. If you are going to have a meeting this afternoon in the Capital Building, let these hearings be continued over there, and let us have these five minutes.

The CHAIRMAN. We will hold the hearings in the Senate Finance Committee room in the Capital, beginning at 2 o'clock.

Senator HARRIS. Let me ask Mr. Brady whether he has a copy of the amendments proposed.

The CHAIRMAN. We have it in the old bill.

Mr. BRADY. It is in the House of Representatives bills.

The CHAIRMAN. The committee will meet for a few moments in executive session, and then adjourned to meet this afternoon at 2 o'clock in the Capitol.

(Whereupon, at 11.55 o'clock a. m., the committee, after a brief time in executive session, took a recess to meet in the Capitol, at 2 o'clock p. m.)

AFTER RECESS

The committee resumed its session at the expiration of the recess.

The CHAIRMAN. Is Mr. James Walton here?

Mr. WALTON. Yes, Senator.

The CHAIRMAN. We will hear you now, Mr. Walton.

STATEMENT OF JAMES WALTON, ATTORNEY AT LAW, PITTSBURGH, PA.

Mr. WALTON. My name is James Walton, attorney at law, Pittsburgh, Pa.

I appear on behalf or as the spokesman of the American Institute of Accountancy, a national organization having its headquarters at 135 Cedar Street, New York; also as the spokesman for the Pittsburgh chapter of the Pennsylvania Society of Certified Public Accountants, and on behalf of certain unorganized taxpayers. I did not appear as a witness before the House committee.

The CHAIRMAN. How much time do you desire, Mr. Walton?

Mr. WALTON. I want as much time as you want to listen to me, Senator. Whenever you are tired of listening to me I want you to tell me.

The CHAIRMAN. We want you to bring out the points briefly. We do not want any argument.

Mr. WALTON. No; I am not going to give you any argument and I am not going to engage in any kind of a political or economic argument whatsoever. I am going to talk about rates.

The CHAIRMAN. If you have anything prepared, we shall be glad to have it printed in the record, and then you may just discuss the high points.

Mr. WALTON. Yes, that is what I am going to do; and the only reason I did not submit anything prepared was that I wanted to see what it was that you wanted me to talk about first.

The CHAIRMAN. We want you to take the items that you are particularly interested in and briefly state why you are opposed to them or why you are in favor of them.

Mr. WALTON. That is exactly what I would like to do.

The CHAIRMAN. We would not want to give you more than a half hour, because we have a lot of witnesses here and the time is dragging on, you know. It will take, now, if I give them each a half hour, probably two weeks to get through.

Mr. WALTON. I was just going to say, Senator, that I did not want to get in until this other group of taxpayers has finished.

The CHAIRMAN. You may proceed now, Mr. Walton.

Mr. WALTON. I am going to take up these points, Senator, in the order of their importance that I have found them to be from the standpoint of the taxpayer.

I want to say, first, that I have never been in the employ of the Treasury Department. I have been in the practice of taxes since the World War, almost exclusively, and I present this matter from the viewpoint of the taxpayer.

The first and outstanding and objectionable feature of this act, from beginning to end, is that it is retroactive; and to make it doubly bad, the retroactivity is of varying dates. Here is a thing that is specifically retroactive; here is another thing that does not appear to be retroactive until you scrutinize it, and then you find that it goes back to 1920 or to 1917, or without any limit at all.

The CHAIRMAN. The committee is well aware of that. If you have any argument now in that connection put it into the record at this point without reading it.

Mr. WALTON. If you have heard all you want about the subject of retroactivity and feel that nothing further needs to be said——

The CHAIRMAN. I do not think there is any doubt about it. So proceed.

Mr. WALTON. I have pointed out in my brief the sections that are retroactive.

The CHAIRMAN. That may go into the record right at this point, then.

(The portion of the brief referred to and submitted by the witness relating to the general retroactivity of the bill is as follows:)

THE OUTSTANDING OBJECTION TO THE ACT IS ITS GENERAL RETROACTIVITY

Certainly we must all be agreed that it is fundamentally unfair to change the effect of the taxpayer's act after the act has been performed. Business demands that a man be able to estimate his tax liability as he goes along from one transaction to another.

Storey, the eminent jurist and textbook writer, has said:

"Retrospective laws are, indeed, generally unjust, and, as has been forcibly said, neither accord with sound legislation nor with the fundamental principles of the social compact."

It appears from section 1 of the proposed new act that Title I, of which there are 3 subtitles, 6 parts, 15 supplements and sections running up to 322 in number (though no entirely consecutive) is to be effective retroactively from January 1, 1927. Title II, of 5 parts and 18 sections, is also proposed to be made retroactive from January 1, 1927. Title I refers to the income tax proper and Title II refers to the miscellaneous taxes, such as estate tax, tax on admissions and dues, and other excise taxes. The Committee on Ways and Means of the House says (p. 12) this is the reason why the income tax title of the 1926 act is not repealed but allowed to remain in full force for the collection of taxes for 1925 and 1926, as well as taxes under prior acts, except as modified by Titles III, IV, and V of the proposed new act. There are 27 sections in Titles III, IV, and V, nearly all of which are retroactive for various periods of time back and beyond January 1, 1927, and some of them have the most far-reaching effect, as will hereafter be pointed out.

At this point, however, we are moved to ask why attempt to make Title I and Title II effective as of January 1, 1927. Not only the taxpayers but the courts and the Members of Congress are opposed to such character of legislation. Further, it results in all sorts of confusion and difficulty of administration. It is true that the revenue act of 1918 was not finally approved and signed by the President until February 24, 1919, but still was made effective as of January 1, 1918. But this was a war measure and there were the most cogent reasons for doing what was done. But this proposed new revenue act of 1928 is not to be considered by the Senate Finance Committee until April 3, 1928. Certainly that committee will take a month or six weeks upon it and surely several more weeks will be consumed by debate on the floor of the Senate. After that bill will have to go to the Conference Committee and then to the President for signature. It is at least probable that the

final approval of the act may be postponed until after the summer recess of Congress. Thus we would have an act finally approved in the latter part of the year 1928 and generally effective from January 1, 1927.

OTHER SECTIONS ARE RETROACTIVE BY OPERATION AS OF VARIOUS DATES

While Titles I and II are to be specifically retroactive, yet all through Titles III, IV, and V are section after section which will operate retroactively and as of widely different dates. For instance, section 113 (a) (8) is to operate retroactively back to December 31, 1920; section 113 (a) (7) is to operate retroactively back to December 31, 1917; and section 276 (b) and section 506 are to operate retroactively without any time limit at all. To cap the whole thing, it is proposed by section 612 to repeal section 1106 (a) of the 1926 act, and that the repeal is to be effective as of February 26, 1926, the date of original passage.

Does the present Congress want to precipitate all the confusion and litigation sure to result from such a scheme? And what occasion is there for it? How can such a proposal be reconciled with the statement which appears on page 1 of the House Ways and Means Committee report:

"We are again in the happy position of having a surplus of revenue in the Treasury * * * which enables us to reduce taxation."

By all means, rather than indiscriminate retroactivity, the act should reaffirm the sound doctrine of prospective tax legislation only.

Other sections with varying retroactive operation are 501 to 507, 601 to 619, 704, 705, and 706.

Mr. WALTON. What is the next most outstanding objection to the act? The situation in which the taxpayers and the Treasury Department find themselves—I wish Senator Reed were here; I want him to hear this.

The CHAIRMAN. He will read it, anyhow.

Mr. WALTON. All right.

The next outstanding grief that we are in, the Government as well as the taxpayers, is the situation in the Board of Tax Appeals. In my mind, next to the retroactive feature that is the thing that demands the attention of this committee more than any other thing.

Secretary Mellon just the other day—April 3—said this:

There is no use to minimize the seriousness of the situation. It is not too much to say that the whole carefully thought-out machinery, which was hopefully set up in 1924, is threatened with a complete breakdown.

He is right. I am very familiar with the situation up there and the practice up there, myself.

In spite of work by the advisory committee in the last six months, 60 per cent of the deficiencies of tax asserted were appealed. There were pending before the board 21,381 cases on March 1. Working with utmost expedition the board can only dispose of about 3,000 cases a year except by stipulation.

In other words, if they do not get any more appeals at all, it will take them seven years to come up to date.

Now, what can be done? In the first place, about half the time of the Board of Tax Appeals is consumed listening to arguments on questions of jurisdiction and on questions of the constitutionality of this, that, and the other section of the statute. Half of their time, I would say, or at least a very substantial part of their time is so taken up.

I do not believe that it was ever the intention of Congress to vest the Board of Tax Appeals, an executive branch of the Government, with jurisdiction to pass upon constitutional questions. I do not think Congress ever intended that. How can a branch of an execu-

tive department be puzzled over a constitutional question? It takes a court to decide that.

Therefore I say, first—and it seems to me that this legislation is so important that it ought to be the first thing to do—let us have a section which will specifically state that the Board of Tax Appeals has no jurisdiction to decide a constitutional question. I think that is the law already. But, if you will remember, before the House committee, Chairman Littleton of the Board of Tax Appeals, testified, and there were 2,100 cases, I think he said, or 1,600, in any event, a vast number of cases held up before the Board of Tax Appeals pending on constitutional questions. They do not belong there.

The next thing, if you will permit me to proceed along the same line, is a section in the act that reads like this:

In all cases now undecided or hereafter decided by the United States Board of Tax Appeals or by any Federal court, wherein, by reason of the statutes or otherwise, there arises a question of conflicting jurisdiction between the United States Board of Tax Appeals and the Federal courts, the statute shall be construed in favor of the jurisdiction of the Federal courts.

Put an end to the waste of time quibbling and bickering about conflicts of jurisdiction. That is all dead wood. It is forcing you to hire attorneys to represent the taxpayers and taking the taxpayers' money. Every taxpayer's case has to be argued twice now to find out who has jurisdiction.

Those two provisions will help about 3,000 cases, I imagine—maybe not that many, but a great many cases, at once.

Then something has to be done, it seems to me, to stop the number of appeals going to the Board of Tax Appeals. My suggestion on that score is to let an appeal be granted to either the Board of Tax Appeals or the Federal court, giving the taxpayer a chance to express himself as to where he wants to go. If he lives up in Minnesota or out in Wyoming he might not want to come to Washington. As to my native State, Oregon, it is a terrible imposition for a man to have to come all the way to Washington, and when he gets here he thinks he is going to have a hearing before the board and he finds that only one man is going to hear his case. The board is so pressed for time that they can not have more than one man on a case.

So I say, let the appeal be to either the Board of Tax Appeals or to a Federal court.

Second, instead of having the appeal as a matter of statutory right let it be upon the petition of the taxpayer to the Federal court, and upon the prima facie showing that he has some meritorious defense against the commissioner's assessment, give the court authority to make him put up a bond so that he can pay the tax if the decision is against him.

I know, as every other taxpayer knows, that there are hundreds if not thousands of cases up there wasting the time of the Board of Tax Appeals where the tax can not be collected regardless of the decision. They are being decided every day. The taxpayer has not the money, and you can not collect the tax.

Unless it can be established that a man can pay the tax, what is the use of wasting time with an appeal? That will cut out another thousand or so cases.

The third point is, to allow the taxpayer to express himself as to where he wants to go, whether he wants to go to the Board of Tax Appeals or to a Federal court. You will soon learn how the taxpayers feel toward your Board of Tax Appeals. That is what you want to know; and then Mr. Chief Justice Taft, through the legal machinery, will tell the circuit judges that as long as the Board of Tax Appeals is congested, direct these cases away from them.

So I have redrafted section 274 of the act so as to incorporate that idea, that instead of giving the taxpayer the right of appeal, let him get his appeal through a petition upon some kind of a showing that he has a meritorious defense, and that the tax is collectible if the decision is against the taxpayer, to relieve the congestion before the Board of Tax Appeals.

It might be well to put something in the act to tell the Board of Tax Appeals not to waste any more time worrying about constitutional questions. Thousands of cases are held up there on constitutional questions.

Senator REED of Pennsylvania. Thousands?

Mr. WALTON. Yes; under section 280 alone. Chairman Littleton told the House Way and Means Committee, at page 562, I think it is, of the hearings, that there was great congestion on that account. Here is where that operates to the disadvantage of the Treasury Department. The longer the collection of the tax is put off in the future, the less chance there is for collection. The corporation has gone out of business. So it is very advantageous to the Treasury Department to get the cases decided expeditiously.

So I have redrafted section 274 to incorporate that idea, and I submit it, hoping that you will find it meritorious, it having been brought out to the best of my modest ability. I think it will reach the problem satisfactorily.

There is one other thing that should be put in, also. Let me illustrate the situation that exists by a specific case that I have.

My client says he has a refund due. The commissioner says: "You owe us more tax."

We started the suit for a refund. The commissioner comes at us with an additional assessment. In order to keep from paying the additional assessment we have to go to the Board of Tax Appeals. We resist the additional assessment before the Board of Tax Appeals, and they say that there is no more tax, so then we go ahead with our suit in the Federal court. The commissioner says there is no jurisdiction in the Federal court and he takes an appeal from the Board of Tax Appeals to the Circuit Court of Appeals, and the same case is pending in two courts.

Therefore you see how important it is to have these cases of conflict of jurisdiction settled if we can. The legal machinery of the Government has some limitation.

The section as I have drafted it is as follows:

Where a taxpayer has filed an appeal under the revenue act of 1924, the court procedure thereafter shall be controlled and governed by the appropriate statutes in effect while said revenue act of 1924 was in effect, regardless of what proceedings may have been had in the Board of Tax Appeals after the passage of the revenue act of 1926.

I think that is the law, now, but section 283 of the act of 1926 is utterly beyond understanding. A Federal judge, from the bench, the other day said that it was a paragon of literary abortion. He can not understand it. I think that is what the act means now, that, if you went into the Board of Tax Appeals under the 1924 act, the 1924 law should govern. But there are conflicting court opinions already, and it ought to be clarified. If you do not clarify it you are going to have the general counsel send 70 or 75 or more attorneys to fight litigation all over the United States.

You have already heard about claims for abatement—filing of a claim for abatement to be deemed to have stayed the statute of limitations. That is new legislation. Let us see for just a minute what the House Ways and Means Committee says in justification. What is the idea of putting that in?

Senator REED of Pennsylvania. That is section 611 that you are talking about, is it?

Mr. WALTON. Yes, sir. Why should the filing of a claim for abatement stay the statute of limitations?

The House Ways and Means Committee in its report says:

> However, the Supreme Court has recently held in a case in which the period for assessment expired prior to the amendment of the 1924 act, that the period for collection was limited to five years—

Then they go on and say:

> Decisions upon claims in abatement are being made every day. Amounts have been paid, are being paid, by the taxpayer even though the statute of limitations may have run. Exceptionally large amounts are involved. Accordingly, it is of utmost importance to provide that the payments already made should not be refunded. In order to prevent inequality, it is also provided that the amounts not paid may be collected within a year after the enactment of the new act.

They say, further:

> Your committee appreciates the fact that this provision will probably be subjected to severe criticism by some of the taxpayers affected.

That sounds plausible, but let us look at it a minute. First of all, they are admitting that they want to vitiate a court decision. Does this committee or does Congress want to engage in the business of validating or vitiating court decisions? It seems to me that that is asking quite a bit.

If every time the commissioner gets into a jam with the courts he is going to run here to you for retroactive legislation to uphold him where the courts have said he is wrong, why should we have a tax bill at all? We might just as well pay whatever the commissioner says, because he is going to run to you at the next session.

I think that is contrary to the spirit that should prevail between the judicial and the legislative departments, that you should be asked to vitiate court decisions. If you want to do it, if you feel that you should do it, it seems to me that it should only apply prospectively, not retroactively, without limit. But that is what is proposed here, that regardless of the fact that the Supreme Court has already handed down a decision that a man gets his money back, the commissioner will still have power to collect the tax.

Senator SHORTRIDGE. How far back?

Mr. WALTON. Without limit. The statute reads, "where a claim for abatement has been filed."

I mean to say that it will apply to all claims for abatement. Of course the state of legal and judicial chaos will be terrible. What is going to happen where the case has been decided by a district court and it is on appeal to the circuit court of appeals or going up to the Supreme Court and the taxpayer has got his money back? How is it going to operate in those cases?

The next point is, that I think the House Ways and Means Committee is mistaken about some of its conclusions—

Amounts have been paid, are being paid by the taxpayer, even though the statute of limitations may have run.

If any taxpayer is paying any tax outside the statute of limitation he must be ignorant or he can not have good legal advice. I know that none of my clients have done it.

So, you see what this is going to be. It is going to be a penalty on the man who has been ignorant.

Exceptionally large amounts are involved.

I question that. Is that accurate? The fact of the case is that a large amount of the cases pending are so-called jeopardy assessments which the commissioner slapped on because the statute of limitations was closely at hand.

Another large part of them is assessments against "fly-by-night" or "war baby" corporations that could not pay back in 1924 and they can not pay now if they could not pay then.

So, I question very much whether as a matter of absolute fact there are large amounts involved.

And then, says the House Ways and Means Committee—

We do not want inequality, because some have paid outside the statute and we want to treat all alike.

When you stop and consider that for a moment it works out this way: Here is a man who has voluntarily suffered punishment through mistake——

The CHAIRMAN. Please apply yourself to the bill and never mind what the House committee said. Let us have your ideas as to the changes in the House bill.

Mr. WALTON. The reason I wanted to argue on that was so that you would understand better——

The CHAIRMAN. You have 22 minutes of your half-hour already gone.

Mr. WALTON. Have you heard all you want to on that point?

The CHAIRMAN. Yes.

Mr. WALTON. I will pass to the next point; and if you desire to indicate what you would like me to touch upon——

The CHAIRMAN. I want you to say what you want to in relation to the criticism, if there is any, of the House provisions. Just briefly state it and let it go. Just call our attention to it and say why, in your opinion, it should be changed.

Mr. WALTON. Very well.

In conclusion, then, on the point of the claim for abatement, let me state that that provision of the statute, in the first place, will not

accomplish any good. It will start a lot of controversies all over the United States. It will impose a controversy on a lot of people who now stand with cases barred by the statute of limitations. It will revive a lot of cases that people have understood and had a right to understand were closed, because the Supreme Court has said so.

So much for that.

I want you to feel free to suggest just exactly what you want me to say.

The next point I want to talk about is invalid waivers that are proposed to be validated.

Senator SHORTRIDGE. What section is that?

Mr. WALTON. Section 276(b) and section 506.

The proposal is that where an invalid waiver—that is, where a taxpayer says to the commissioner——

Senator REED of Pennsylvania. We know what a waiver is.

The CHAIRMAN. Do not tell us about that. Just tell us why you object to the provision.

Mr. WALTON. In the first place, I object to that provision. In the first place, it is nothing else than attempting to put into legislation a conclusion of law; and I do not think that is the proper scope of Congress.

Of course, if these waivers outside the statute were valid, there would not be a request of Congress to validate them. The Board of Tax Appeals has said they are valid. I do not agree with them.

The CHAIRMAN. Valid for want of consideration?

Mr. WALTON. Exactly. There is no consideration. The tax is dead.

I have cited some cases for the information of anybody who wants to look into that.

Now, let me talk a moment about the liability of transferees. This section of the bill is to give the commissioner and the Board of Tax Appeals equity jurisdiction to determine the liability of a transferee or fiduciary.

My whole thought in that is this, that if you are going to try that, you are going to invest the Board of Tax Appeals with complete plenary equity jurisdiction. They have not got it now. That section has already been held unconstitutional. The Board of Tax Appeals has held up all its decisions, apparently doing so also. The thing to do, if a lot of taxes are going to be lost, is to raise the statute of limitations so as to give the commissioner a chance. As I understand it, the commissioner thinks he is restricted, now, under section 280. in taking a case before the Board of Tax Appeals.

The proposal in the House, or as adopted by the House, to strengthen that section, is all right as far as it goes, but the essential element lacking is that there is no basic court of equity there. It is a branch of the Executive Deparment which can not determine the equitable liability of any transferee.

May I illustrate for just a minute how that operates? Would you like to have me give you a specific case?

This case came under my attention. John Smith, in 1919, had a transaction to operate and to produce a fabulous profit, but when he reported in his tax return he did not report the profit correctly, and

later on, about five years afterwards, the commissioner discovered and came after him, or his estate, for the additional tax.

In the meantime he has divorced his first wife. She has got most of the money in the divorce settlement. He married again, and his second wife is appointed executrix of his estate, which has a net value of $5,000, whereas the commissioner's additional tax is $10,000. Of course, the commissioner does not know what is in the estate. He does not know that Mary Smith, the second wife, has not that much money in her possession; but under the statute he goes ahead and proceeds against Mary, and on behalf of Mary I filed an appeal before the Board of Tax Appeals about 18 months or so ago.

That is the way that operates.

I want to say something else that I think is important. It is out of its sequence now.

You have heard quite a bit about jeopardy assessments which have caused quite a lot of complaint, and righteous complaint; but if you would adopt the suggestion that I make I do not feel that there would be any necessity for jeopardy assessments at all. The only jeopardy that ever can come in would be between the 60 days when the Commissioner notifies the taxpayer that he is going to assess him, and, if he does not like it, to make a petition for an appeal.

So I think that the proposal that I made right in the beginning—you did not hear it all, Senator Reed—would solve the difficulty that has come about through these jeopardy assessments.

The CHAIRMAN. There are not many of them now?

Mr. WALTON. No.

One word on the additional tax on reorganizations and corporate mergers. As now proposed in section 113 (a–8) it is retroactive legislation whereby transactions in one case go back to 1920 and in the other case back to 1917 and are going to be unexpectedly taxed.

I have not anything to say as to the wisdom of that kind of legislation, but I think that if that legislation is to be passed it should not be made to go back beyond the date of the passage of the new act, because it is going to mean that corporations can not merge and can not reorganize or refinance themselves in the face of that change in the law.

The House committee said—I do not know whether you want me to mention it or not——

The CHAIRMAN. We had the whole subject discussed this morning.

Mr. WALTON. I was going to say something about an illustration that the House committee gave.

The CHAIRMAN. We have that.

Mr. WALTON. I wished to point out to you how that illustration sounds plausible when you first look at it, but unless you see the full working of it you will not see how it is, first of all, taxing a profit as a fiction and then taxing it a second time as actual profit is the way it operates.

If you do not care to have me discuss that I will not mention it further. But I feel that in justice to the corporations that have acted according to the law as it was, they have fairly gone to work and refinanced themselves or reorganized according to the law as they had a right to feel it was at the time, you should not change the law now so as to go back to 1924, 1925, or back beyond that to 1920 or

to 1917 and pick up transactions and impose an unexpected tax. It is not fair.

There is a proposal in section 111 that is going to be productive of a lot of controversy, and I do not think that it will mean much additional tax. That is that when a man sells a house or any other kind of property he has got to figure depreciation running back to the time he bought it, even back to 1913, which is contrary to the Supreme Court's decision in a recent case.

I do not think the taxes it will bring in will pay for the amount of legal energy that will be expended in fighting it, because when you begin to talk about depreciation back of 1913 who can say to-day what the correct rate of depreciation was on a building 15 years ago? You are going to have a controversy every time you go back that far.

One of my cases was decided by the Supreme Court just the other day involving depreciation. Every one of them started a row.

Senator KING. Did you say that the vendee would be interested in depreciation?

Mr. WALTON. No. In selling a piece of property to determine your profit you have to——

Senator KING. I know; but I was asking whether you refer to the vendee or the vendor. You stated the purchaser.

Mr. WALTON. I did not intend to if I did, Senator.

Senator REED of Pennsylvania. You do not mean that the basis should not be decreased by the amount of depreciation that has been allowed to that taxpayer?

Mr. WALTON. I do mean that it should, Senator; but I say it should stop at 1913. That is far enough to go back, because that is all the depreciation he could get any benefit of in his tax returns. As soon as you go back beyond that you are going to get into a controversy.

Senator SHORTRIDGE. How far back of 1913 might the Government go?

Mr. WALTON. There is no limit under this section. The Supreme Court on that point says:

> We can not accept the Government's contention that the full amount of depreciation, whether allowable by law as a deduction from gross income in past years or not, must be deducted from cost in ascertaining gain or loss.

That is fair. The Supreme Court says that if a man has no right to take depreciation it is not fair to him to cut his cost down by depreciation.

The CHAIRMAN. The present House bill is exactly the present law. There is no change.

Mr. WALTON. No change in it?

The CHAIRMAN. No; it is the present law.

Mr. WALTON. I thought there was a change. I will not argue it with you. At any rate, that is section 111 (2–b). If it is without any change whatsoever it ought to be clarified, because you are going to have a lot of controversy on that.

I will not say anything about earnings prior to March 1, 1913. You have heard about that. In the brief that I will submit later I have made quite a discussion about the alleged tax on what they call holding corporations.

The CHAIRMAN. I wish you would leave that with the committee.

Mr. WALTON. The thing that I particularly point out in that is that that tax does not operate; the Government does not get any money out of it; it does not function; it will not work. Senator King will remember that we went into all that.

Senator REED of Pennsylvania. Section 220, you mean?

Mr. WALTON. Yes, sir.

The CHAIRMAN. We know about that.

Senator REED of Pennsylvania. Do you approve of section 104 of the new bill, which takes its place?

Mr. WALTON. No; I do not, because there is no elasticity to it.

Senator REED of Pennsylvania. What would you do if you were in our place?

Mr. WALTON. I would do exactly what the advisory committee has suggested—make it an inducement to a corporation to distribute. That is the way to get some tax out of it.

The CHAIRMAN. That is the position taken by many, many people. If you will leave that brief with us, we will be glad to go over it.

Mr. WALTON. Would you like to have me give you some printed copies?

The CHAIRMAN. If you like.

Mr. WALTON. A company is forced to make a distribution when it is in financial distress. It is not right. It is going to work a dreadful hardship.

Senator REED of Pennsylvania. I do not think, Mr. Chairman, he ought to go to the expense of having his brief printed.

The CHAIRMAN. No; I do not think so, either.

Mr. WALTON. There are just one or two more points that I want to mention. I have tried to put this in so that where I saw the Government was getting the worst of it, taxes were getting away that should not be getting away, it would give you my ideas about how you can stop it.

You have heard a lot of talk about consolidated returns——

The CHAIRMAN. I do not think you need to take any time on that.

Senator KING. For my benefit, if you care to furnish me with the part of your brief dealing with consolidated returns I would be glad to see it, because I am predisposed to support the consolidated returns.

I do not ask you to go into it now.

Mr. WALTON. I will give each one of you a copy of this brief. I have it set up by itself so that you can take any subject in which you are interested.

Senator REED of Pennsylvania. Why should we not have this brief printed in the hearings?

The CHAIRMAN. I stated that in the beginning.

Senator REED of Pennsylvania. There is no use in distributing your brief if it is going to be printed in the hearings.

The CHAIRMAN. Just file it with the reporter and we will have the brief printed in the hearings.

Mr. WALTON. I would like to say a few words with reference to installment sales.

Senator SHORTRIDGE. Is it in your brief?

Mr. WALTON. Yes.

The CHAIRMAN. That is one of the main subjects that is going to be discussed.

Senator REED of Pennsylvania. Do you approve of the provisions of the original House bill?

Mr. WALTON. My position on installment sales is this: When you let a man go into the installment business you are giving him something and you have a right to prescribe conditions. The complaint is that there is double taxation. Even if there is double taxation the installment people are getting away with the best of it, and you have a right to prescribe the conditions upon which a man should go on the installments basis if you want to.

Senator REED of Pennsylvania. Retroactively?

Mr. WALTON. When it comes to validating decisions I have my doubts about that.

The CHAIRMAN. I judged from what you said in the beginning that you do not want any retroactive features in the bill.

Mr. WALTON. I do not think there should be. As the bill stands now you have a retroactive feature going back to January 1, 1927. If my opinion were asked I would say, make your law prospective and thereby follow the sound rule.

There is one thing I want to say about installment sales, and that is with reference to disposing of installment obligations. If that is not attended to, every time a man goes to the bank and takes his installment obligations or pledges as collateral he has got taxable income; or if a man dies, the mere fact of his death would create taxable income. So it is very important to correct that to make it read that the sale has got to be a bona fide sale, not a mere exchange or a disposition through testament or any disposal of that kind.

I have two or three other little article that I should like to mention, but which I will not discuss.

If there are any questions, I shall be glad to answer them if I can.

If not, I thank you for your indulgence.

(The brief referred to and submitted by the witness is as follows:)

RECOMMENDATIONS IN RESPECT TO THE PROPOSED NEW REVENUE ACT OF 1928

[Submitted by the American Institute of Accountants, by James Walton, Esq., of Pittsburgh, in its behalf and by the special committee on Pittsburgh Chapter, Pennsylvania Institute of Certified Public Accountants, George F. Herde, C. P. A., J. M. Cumming, C. P. A., and James Walton, C. P. A., in its behalf and by James Walton, Esq., in behalf of certain unorganized taxpayers]

PREFACE

In this discussion there has been excluded any expression of opinion regarding rates or subjects of taxation. The motive in so doing was to limit the article to questions having no politico-economic flavor whatsoever.

The chapters have been arranged in a somewhat arbitrary order but in adopting same it was attempted to present the various subjects according to their importance as viewed by the taxpayers as a whole.

It must not be assumed that this purports to be a complete discussion of all the objectionable features of the act. That is precluded by the circumstances of the case.

I. THE OUTSTANDING OBJECTION TO THE ACT IS ITS GENERAL RETROACTIVITY

Certainly we must be all agreed that it is fundamentally unfair to change the effect of the taxpayers' act after the act has been performed. Business demands that a man be able to estimate his tax liability as he goes along from one transaction to another.

Storey, the eminent jurist and textbook writer, has said:

"Retrospective laws are, indeed, generally unjust; and, as has been forcibly said, neither accord with sound legislation nor with the fundamental principles of the social compact."

It appears from section 1 of the proposed new act that Title I, of which there are 3 subtitles, 6 parts, 15 supplements, and sections running up to 322 in number (though not entirely consecutive), is to be effective retroactively from January 1, 1927. Title II, of 5 parts and 18 sections, is also proposed to be made retroactive from January 1, 1927. Title I refers to the income tax proper and Title II refers to the miscellaneous taxes, such as estate tax, tax on admissions and dues, and other excise taxes. The Committee on Ways and Means of the House says (p. 12) this is the reason why the income-tax title of the 1926 act is not repealed but allowed to remain in full force for the collection of taxes for 1925 and 1926, as well as taxes under prior acts, except as modified by Titles III. * * * IV, and V of the proposed new act. There are 27 sections in Titles III, IV, and V, nearly all of which are retroactive for various periods of time back and beyond January 1, 1927, and some of them have the most far-reaching effect, as will hereafter be pointed out.

At this point, however, we are moved to ask why attempt to make Title I and Title II effective as of January 1, 1927. Not only the taxpayers but the courts and the Members of Congress are opposed to such character of legislation. Further, it results in all sorts of confusion and difficulty of administration. It is true that the revenue act of 1918 was not finally approved and signed by the President until February 24, 1919, but still was made effective as of January 1, 1918. But this was a war measure, and there were the most cogent reasons for doing what was done. But this proposed new revenue act of 1928 is not to be considered by the Senate Finance Committee until April 3, 1928. Certainly that committee will take a month or six weeks upon it and surely several more weeks will be consumed by debate on the floor of the Senate. After that the bill will have to go to the conference committee and then to the President for signature. It is at least probable that the final approval of the act may be postponed until after the summer recess of Congress. Thus, we would have an act finally approved in the latter part of the year 1928 and generally effective from January 1, 1927.

I (A). Other Sections are Retroactive by Operation as of Various Dates

While Titles I and II are to be specifically retroactive, yet all through Titles III, IV, and V are section after section which will operate retroactively and as of widely different dates. For instances, section 113 (a) (8) is to operate retroactively back to December 31, 1920; section 113 (a) (7) is to operate retroactively back to December 31, 1917; and section 276 (b) and section 506 are to operate retroactively without any time limit at all. To cap the whole thing, it is proposed, by section 612, to repeal section 1106 (a) of the 1926 act, and that the repeal is to be effective as of February 26, 1926, the date of original passage.

Does the present Congress want to precipitate all the confusion and litigation sure to result from such a scheme? And what occasion is there for it? How can such a proposal be reconciled with the statement which appears on page 1 of the House Ways and Means Committee report?—

"We are again in the happy position of having a surplus of revenue in the Treasury * * * which enables us to reduce taxation."

By all means, rather than indiscriminate retroactivity, the act should reaffirm the sound doctrine of prospective tax legislation only.

Other sections with varying retroactive operation are 501 to 507, 601 to 619, 704, 705, and 706.

II. The Most Urgent Need Is Corrective Board of Tax Appeals Legislation

The situation as it now is before the Board of Tax Appeals is intolerable both from the standpoint of the Government and from the standpoint of the taxpayer. Over 21,000 cases are pending undecided on March 1, 1928, and millions of dollars of tax is being jeopardized through delay. The longer a tax remains uncollected, the less chance there is of ultimate collection. Secretary Mellon correctly states the situation, quoting from the Pittsburgh Sun-Telegraph of Tuesday, April 3, 1928:

"BREAKDOWN THREATENED

"'There is no use minimizing the seriousness of this situation.' Mellon added. 'It is not too much to say that the whole, carefully thought-out machinery, which was hopefully set up in 1924, is threatened with a complete breakdown.

"'In spite of work by the advisory committee in the last six months 60 per cent of the deficiencies of tax asserted were appealed. There were pending before the board 21,381 cases March 1. Working with utmost expedition the board can only dispose of about 3,000 cases a year, except by stipulation.'

"Mellon said that to dispose of disputed tax cases a change of policy appears desirable. The Treasury will adopt a new course unless the Finance and Ways and Means Committees advise to the contrary.

"'A sensible system of administration would permit the settlement of cases whenever the odds on a question of law are all against the Treasury, instead of compelling litigation,' Mellon said."

Therefore, it would seem to be the duty of Congress to immediately strike out the evils which are causing congestion.

Firstly, we see that nearly one-half of the time of the Board of Tax Appeals is consumed in listening to arguments on jurisdictional questions and constitutional questions. From the testimony of Chairman Littleton before the House committee, p. 554, it appears there are over 1,100 cases pending which involve the constitutionality of section 280 of the 1926 act. Therefore, let there immediately be incorporated into the act this section:

"In all cases now undecided or hereafter decided by the United States Board of Tax Appeals or by any Federal court, wherein by reason of the statutes or otherwise, there arises a question of conflicting jurisdiction between the United States Board of Tax Appeals and the Federal courts, the statute shall be construed in favor of the jurisdiction of the Federal courts."

Secondly, it is not believed that it was the intention of Congress to vest the Board of Tax Appeals, a branch of the executive department, with jurisdiction to decide a constitutional question adversely to the Government. There appears to be doubt about this in the minds of some of the members of the Board of Tax Appeals. Therefore, let there be immediately enacted, this section:

"The United States Board of Tax Appeals shall have no jurisdiction whatsoever to declare unconstitutional a section of any Federal revenue statute, or to construe any Federal statute as being unconstitutional."

Thirdly, it seems to be incumbent upon Congress to do something to decrease the number of appeals going to the Board of Tax Appeals. There is no question now but what a large number of appeals are taken merely for the purpose of delay. Many other appeals are pending in which the Government will be unable to collect the tax, regardless of the decision of the board. These are simply deadwood blocking progress. Therefore, let the statute be amended so as to provide—

(*a*) That the appeal may be granted either to the Board of Tax Appeals or to a Federal court.

(*b*) That the appeal may be obtained, not as a matter of right, but on a petition to the Federal court of the district in which the taxpayer resides. That such petition shall be granted only upon the taxpayer making a primary or prima facie showing that he has a meritorious defense against the tax and that the court be empowered, in its discretion, to require a bond of the taxpayer in order that the Government may be assured that the tax will not be jeopardized while the appeal is pending. Let it be provided that there shall be a preliminary hearing on such petitions which must be presented to the Federal court within 60 days from the commissioner's notification letter, and that, upon hearing the court may grant the taxpayer an appeal either to the Board of Tax Appeals or to the local Federal court or to the Supreme Court of the District of Columbia, the taxpayer being allowed to indicate his preference. Upon perfection of such an appeal, hearings shall be had upon the merits and the appellate procedure shall then be by a writ of error to the Circuit Court of Appeals or the Court of Appeals of the District of Columbia.

To make the suggestion specific, let section 274 be amended to read as follows:

"If, in the case of any taxpayer, the commissioner, after the passage of this act determines that there is a deficiency in respect of the tax imposed by this

title or imposed by any previous revenue statute, the commissioner is authorized to send a notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the petitioner may file a petition with the district court of the United States for the district of which he is then an inhabiant, or the Supreme Court of the District of Columbia if an inhabitant thereof, praying for the allowance of an appeal on the merits of the deficiency proposed by the commissioner, and such appeal may be allowed to either the United States Board of Tax Appeals, to the district court of the United States of the district of which the taxpayer is then an inhabitant, or to the Supreme Court of the District of Columbia. Upon the making of such petition for appeal it shall be the duty of the district court, or the Supreme Court of the District of Columbia, as the case may be, and jurisdiction is hereby specifically vested in said courts, to cause preliminary hearings to be had upon said petition to determine whether or not it does appear that the taxpayer has a reasonable prima facie defense, legal or equitable, against the imposition of the deficiency proposed by the commissioner.

"Upon a satisfactory showing by the taxpayer that there is a reasonable question of the correctness and propriety of the commissioner's proposed deficiency, the taxpayer's petition for appeal shall thereupon be allowed and said appeal may be either to the United States Board of Tax Appeals, or the district court of the United States for the district in which the taxpayer is then an inhabitant, or to the Supreme Court of the District of Columbia: *Provided*, That before granting such petition, the court shall make inquiry as to whether the payment of any deficiency, ultimately found to be due from the taxpayer, might be jeopardized by delay incident to the appeal, and if so determined, it shall be the duty of the court, as a prerequisite to the granting of the appeal, to require the taxpayer to submit an indemnity bond in such reasonable amount as will adequately protect the interests of the Government, not exceeding in any case the amount of the alleged deficiency plus a reasonable amount for interest and costs. Except as may otherwise be specifically provided, no assessment of a deficiency in respect of the tax imposed by this title or any previous revenue act, and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice of the taxpayer's right to petition for appeal has been mailed to the taxpayer, nor until the expiration of such 60-day period thereafter, nor until such petition shall have been acted upon by the appropriate Federal court: *Provided, however*, That it shall be the duty of the Federal courts to act on said petitions as expeditiously as possible. Notwithstanding the provisions of section 3224 of the Revised Statutes, the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court.

"(b) Upon the granting of said petition the court shall make an order specifying whether the United States Board of Tax Appeals, or the district court or the Supreme Court of the District of Columbia shall have jurisdiction, according, so far as is consistent, to the wishes of the taxpayer in this respect. Service of a certified copy of said order upon the collector of internal revenue or upon the United States district attorney shall operate as a stay of the assessment and collection, or attempted assessment and collection of the deficiency until a final decision upon the merits. Upon hearing, the United States Board of Tax Appeals, or the appropriate Federal court to which jurisdiction is conferred as herein provided, shall hear and consider the case upon its merits, both legal and equitable and, if the hearing be before a Federal court, the taxpayer shall be granted a trial by jury upon questions of fact if he so demands. Such proceeding shall be, in all respects, in conformity with the established rules of law and rules of evidence of the Federal jurisdiction, and conform to the procedure now obtaining therein.

"(c) After a hearing, whether by the Board of Tax Appeals or by a Federal court, there shall be a judgment entered, agreeable to the facts as found, and to the law as applicable, which may be either a judgment against the taxpayer for the correct amount of the tax, or a judgment against the United States for the recovery of any overpayment which may be found to be due the taxpayer. Such judgments shall be, in all respects, similar to the judgments in all other civil actions and, if against the United States, shall be paid in accordance with the provisions of section 1089 of the Revised Statutes.

"(d) Judgments of the Board of Tax Appeals shall be subject to appellate review by either the Court of Appeals of the District of Columbia or the respec-

tive circuit courts of appeals of the United States of the circuit of which the taxpayer is an inhabitant. Judgments of the Supreme Court of the District of Columbia shall be subject to appellate review in the Court of Appeals of the District of Columbia, and judgments of the district courts of the United States subject to appellate review by the appropriate circuit courts of appeals of the United States. Such appellate review shall be by either appeal or writ of error according to manner and procedure now or hereafter legally prescribed by the judicial code and Federal statutes for appellate procedure in civil actions at law.

"(c) Further appellate review to the Supreme Court of the United States may be granted upon allowance of a petition for certiorari in the manner prescribed by section 240 of the Judicial Code."

The enactment of this simple legislation will do away with all the confusion which now exists and make it possible to repeal a great many sections in the act as it now exists, which sections have piled on the confusion. Stopping the jurisdictional and constitutional questions before the board will wipe out thousands of cases at once. It will also save many gray hairs for the Federal judges. The requiring of a prima facie showing and the possible requirement of a bond will erase additional thousands of delay and frivolous cases as well as those cases wherein collection of the tax is impossible.

The feature of allowing the taxpayer to indicate where he wishes his appeal to be heard and empowering the district judges to control the flow of cases serves a double purpose. In this way Congress can learn what the taxpayers think of the Board of Tax Appeals and can make a direct comparison of the efficiency of their work as compared with the courts proper. The importance of controlling the flow of cases so as to direct them to that court able to dispose of them most expeditiously is outstandingly evident.

Another source of confusion and consequent lost motion in the Federal courts is the utter impossibility of a clear understanding of section 283 of the 1926 act. A mere glance at the dreadfully involved phraseology of the section is enough. Conflicting court decisions are already at hand—Chicago Railway Equipment Co. v. Blair, Commissioner (20 Fed. (2d) 10) in the seventh circuit court of appeals, and Blair, Commissioner v. Curran, first circuit court of appeals, February 4, 1928, and others. Therefore, for the purpose of clarity let us have this section at once:

"Where a taxpayer has filed an appeal under the revenue act of 1924, the court procedure thereafter shall be controlled and governed by the appropriate statutes in effect while said revenue act of 1924 was in effect, regardless of what proceedings may have been had in the Board of Tax Appeals after the passage of the revenue act of 1926."

The reason for this is obvious too. A taxpayer has pleaded his case on the theory of the law in effect while the 1924 act was operative. He may have even tried his case on that theory. His subsequent court procedure should be that which was in effect when he filed his pleadings. Section 283 of the present 1926 act probably so intends but it is too complicated and involved to be understood.

III. Filing of a Claim for Abatement to be Deemed to Have Stayed the Statute of Limitations

It is proposed, in section 611, in effect, that the filing of a claim for abatement against any alleged additional tax assessed prior to June 2, 1924, shall have operated as a waiver by the taxpayer of the statute of limitations. Respecting this the House Ways and Means Committee report, page 34, reads:

"However, the Supreme Court has recently held in a case in which the period for assessment expired prior to the enactment of the 1924 act, that the period for collection was limited to five years from the date on which the return was filed. Decisions upon claims in abatement are being made every day. Amounts have been paid, are being paid, by the taxpayer even though the statute of limitations may have run. Exceptionally large amounts are involved. Accordingly it is of utmost importance to provide that the payments already made should not be refunded. In order to prevent inequality it is also provided that the amounts not yet paid may be collected within a year after the enactment of the new act.

"Your committee appreciates the fact that this provision will probably be subjected to severe criticism by some of the taxpayers affected. However, it must be borne in mind that the provision authorizes the retention and collec-

tion only of amounts properly due, and merely withdraws the defense of the statute of limitations. If it is determined that the amount paid is in excess of the proper tax liability, computed without regard to the statute of limitations, such excess will constitute an overpayment which may be refunded or credited as in the case of any other overpayment."

Here, then, admittedly, is more proposed new legislation to overcome court decisions, in this instance that of the Supreme Court in Bowers, Collector, *v.* New York & Albany Lighterage Co. (273 U. S. 346), February 21, 1927. This Supreme Court decision has been followed by Federal courts and the Board of Tax Appeals in perhaps more than 50 cases, and undoubtedly additional cases are pending hearing or pending decision. By the proposed new legislation the commissioner is to be given power to now go after and collect the alleged additional tax, notwithstanding the decisions of the courts whereby the tax has been ordered refunded.

The House Ways and Means Committee truly said this proposed legislation "will be subjected to severe criticism."

Firstly, it as well as several other proposed sections heretofore pointed out is admittedly designed to save the face of the Bureau of Internal Revenue when courts have decided the commissioner was wrong. Legislation of such a character is contrary to public policy and of utter bad faith. If the commissioner is to be permitted to run to Congress and obtain retroactive legislation to uphold him in all instances where the courts have ruled he was wrong, we do not need any revenue act at all. All that Congress needs to do is pass a bill providing that the tax shall be such amount as the commissioner may determine. Taxpayers will understand that they might as well pay everything the commissioner demands in the first instance, because the next succeeding Congress will retroactively validate everything the commissioner claims.

Secondly, it will result in a state of legal and judicial chaos indescribable. What is to be the effect on cases decided by the lower courts and pending on appeal or where the right of appeal still remains? What is to be the effect on cases pending before circuit courts of appeals or the Supreme Court or even decided by the Supreme Court?

Thirdly, the reasons for this legislation advanced by the House Ways and Means Committee appear to be based almost entirely on mistakes of fact. This committee says: "Amounts have been paid, are being paid, by the taxpayer, although the statute of limitations may have run." This can not be any more true than the platitude, "A fool is born every minute." And must legislation be designed to enable the Government to retain possession of money paid to it under a misapprehension of the law?

Fourthly, the House Ways and Means Committee says "exceptionally large amounts are involved." Is that accurate? What is the nature and character of these assessments of alleged additional tax which taxpayers have met with claims for abatement. A large number of them are so-called jeopardy assessments summarily imposed because the expiration date of the statute of limitations was close at hand. From actual experience it may be said that these random jeopardy assessments are worth only a fraction of their face value. Another large part of these assessments are against taxpayers of the war-baby fly-by-night character who were financially unable to pay when the assessment was made (prior to June 2, 1924) and, of course, are still less able to pay at this present date. Honest and responsible taxpayers, guided by the advice of honest counsel (may we assume that the majority of taxpayers and counsel are such), have paid what tax they legally and legitimately owed as soon as the commissioner assessed it.

Fifthly, the House committee says the legislation is "to prevent inequality, * * * that payments already made should not be refunded." We certainly have reached a ridiculous state of affairs when our Congress seeks to justify an unexpected additional tax on one group of taxpayers because another smaller group have lready paid such tax. To put it another way: 10 men are to be punished in order to "prevent inequality" in the punishment already voluntarily suffered by one man under a mistake.

But the truth is that the "payments already made" need not be refunded—at least that is the law of the Court of Claims. Observe:

"The plaintiff's (taxpayer's) contention that the act furnishes a right to recover all taxes collected after the expiration of five years from the date of taxpayer's return presents a theory that manifestly can not be sustained. * * *." (Toxaway Mills *v.* U. S., Dec. 7, 1925, 61 Ct. Cl. 363.)

When this case reaches the Supreme Court, the Solicitor General of the United States confessed error on authority of Bowers *v.* New York & Albany Literage Co. (273 U. S. 346) and moved the court to "reverse the judgment of the Court of Claims." Thus we are unfortunately without a decision on the merits by the court of last resort.

When the mandate of the Supreme Court, issued on the motion of the Government, reached the Court of Claims, that court said:

"* * * the cause having been reversed it only remains to obey the mandate * * * We think it proper, because of other cases, to say that the jurisdiction of the Court of Claims in this class of cases grows out of the statute providing for a refund of taxes by the Commissioner of Internal Revenue where they have been erroneously or illegally collected, and since the decision of the case by this court in December, 1925 (61 Ct. Cls. 363), the revenue act of 1926 (44 Stat. 9, 113) has been passed, which, among other things, provides:

"'SEC. 1106 (a) The bar of the statute of limitations against the United States in respect of any internal-revenue tax shall not only operate to bar the remedy, but shall extinguish the liability; but no credit or refund in respect of such tax shall be allowed unless the taxpayer has overpaid the tax.'

"The effect, if any, of this act upon the right of a party, except in the instant case, to a refund of all taxes paid after the bar of the statute has fallen is a question not concluded by the judgment herein." (Moss, judge; Graham, judge; Hay, judge; and Booth, judge, concur. June 6, 1927.)

So we see that the payments which the House Ways and Means Committee was fearful would be refunded, can not be refunded through the Court of Claims by reason of section 1106 (a) of the 1926 act.

It may be said that there is a recent contradecision where the taxpayers sued the collector for his refund in the United States District Court and relied on the common-law plea in assumpsit. In this case, however, the alleged tax was paid prior to the enactment of 1106(a) of the act of 1926. (See Gore *v.* Nichols, Collector, U. S. D. C. Massachusetts, January 19, 1928.) If Congress desires to clinch the matter, all that seems necessary is a little addition to section 1106(a) whereby it shall operate on all tax cases, whether before the Court of Claims or in the United States district courts.

Sixthly, the enactment of this proposed new legislation would be tantamount to a deceit of the taxpayers. In official regulations 45, articles 1032, issued April 17, 1919, and again in the same regulations, revised and issued January 28, 1921, and still again in the same article of regulations 62, February 15, 1922, the taxpayers were officially notified—

"The filing of a claim for abatement does not necessarily operate as a suspension of the collection of the tax or make it less the duty of the collector to exercise due diligence to prevent the collection of the tax being jeopardized. He should, if he deems it necessary, collect the tax and leave the taxpayer to his remedy by a claim for refund."

Such official regulations have never been repealed. Still further evidence that the bureau has always recognized that the filing of a claim in abatement did not say the statute of limitations is found on page 3914 and 3915 of part 18, Hearings before the Select Committee on Investigation of the Bureau of Internal Revenue, United States Senate, in the following:

"The CHAIRMAN. If the Supreme Court sustained the decision of the circuit court of the second district, then the Government really loses all of these taxes?

"Mr. GREGG (Solicitor, Bureau of Interial Revenue). Yes, sir; it would.

"Mr. NASH (Assistant to Commissioner of Interial Revenue). I would not say that, because a great many of our collectors on these claims for abatement require a bond, and they would have an action on the bond even if the court held against us on the assessment. The bond is a personal transaction between the collector and the taxpayer, a requisite that the collector requires when he accepts a claim for abatement instead of enforcing collection. I would not be surprised if the collector at Detroit has a bond on this General Motors case.

"The CHAIRMAN. But you have no record as to whether he has or not?

"Mr. NASH. As I say, it is a personal transaction in his office. It is something that was not required under the law before 1924. The 1924 act now requires a bond with a claim in abatement. * * *

"I am not familiar with the controversy that the Texas collector had with the department about requiring a bond. I have always understood that it was the privilege of the collector to require a bond, that it was his responsibility, and that the department held the collector's bond for the collection of the tax.

He was liable under his own bond. I do know that in the New York office—I spent several months there a few years ago auditing the office—that the present collector and his predecessor made a practice of requiring a bond on every claim for abatement. The collector has been subjected to a great deal of criticism on the part of many taxpayers for requiring the bond, but he has held to this policy very strictly.

"The CHAIRMAN. Would the bond be sufficient to cover such a claim as this, of $17,000,000?

"Mr. NASH. The bonds usually cover the amount of tax involved plus interest for 18 months or two years in advance.

"The CHAIRMAN. But in case the collector does not get a bond, does his bond in turn protect the Government?

"Mr. NASH. His bond is presumed to protect the Government, especially in an important case. In a case like this the collector's bond is for about $250,000.

"The CHAIRMAN. So in the event of his not requiring a bond from a taxpayer making a claim in abatement, the Government would not be protected in any such a claim as this?

"Mr. NASH. Not under the previous acts, Senator. Under the 1924 act the collector is required to get a bond."

We may now pass to the thing which has caused the trouble. Although section 3182, Revised Statutes, act of December 24, 1872, limits the commissioner's jurisdiction to determination and assessment of the tax and section 3183, Revised Statutes, act of March 1, 1879, makes it the exclusive duty of the respective collectors of internal revenue to collect the tax, the Bureau of Internal Revenue had, for a long time, been encroaching upon the duties and interfering with the collectors. Every tax practitioner knows it. Evidence of it is officially reported on pages 3932–3933 of part 18, Report of Select Senate Investigating Committee, Sixty-eighth Congress. Having been interfering with the duties of the collectors, the bureau in Washington is in an embarrassing position. An easy way out is to ask Congress for retroactive legislation.

This proposed new retroactive legislation is easily the most pernicious and the most unjustifiable of anything in the new act.

IV. IT IS PROPOSED TO REPEAL CERTAIN SECTIONS OF PRIOR ACTS EFFECTIVE TO DATE OF ORIGINAL PASSAGE

By section 606 (c) it is proposed to repeal 1106 (b) of the 1926 act effective on the expiration of 30 days. By section 612 it is proposed to repeal section 1106 (a) of the 1926 act effective February 26, 1926, the date it was enacted. The importance of 1106 (a) from the Government's standpoint is pointed out by the Court of Claims in Toxaway Mills *v.* United States supra. The House Ways and Means Committee, in explanation, says, page 33:

"Section 1106 (a) of the 1926 act failed to resolve many doubtful questions as to the legal effect which follows the expiration of the period of limitations * * *."

This means that a succeeding Congress will attempt to repeal the act of its predecessor and make such repeal effective retroactively back to the date of original enactment. Could the Democratic Congress of 1913 have repealed the Republican McKinley Act of 1897 and made the repeal effective as of 1897? The Supreme Court has said such a thing can not be done. (See Ogden *v.* Blackledge, 6 U. S. 272 (1804); Postmaster General *v.* Early, et al., 35 U. S. 136 (1827); Town of Koshkonong *v.* Burton, 104 U. S. 668 (1882); District of Columbia *v.* Hutton, 143 U. S. 18–27 (1892); U. S. *v.* Claflin, 04 U. S. 546 (1878).)

Also Judge Denio's excellent opinion in People *v.* Board of Supervisors, 16 N. Y. 424 (at 431–3), citing Ogden *v.* Blackledge, supra.

The importance of section 1106 (a) lies in the fact that once the statute of limitations has run, a tax case is closed beyond resurrection. It provides "the bar of the statute of limitations * * * shall not only operate to bar the remedy but shall extinguish the liability."

If it is repealed it will mean the reopening of any number of cases which the taxpayers have long since believed were settled and closed. It will further mean that the taxpayer public will have lost confidence in the stability of income tax legislation.

If any amendment of this section is necessary it would seem to be only a clarification of the incongruous second clause which reads, "But no credit or refund * * * shall be allowed unless the taxpayer has overpaid the tax."

This clause is worse than needless. It has merely served to cast doubt upon the question whether a taxpayer might recover a tax collected from him by distraint after the statute of limitations had expired, unless at the same time he proved the tax was otherwise not correctly owing from him. This clause has actually operated to defeat the very purpose of the section as stated by the conferees of the House and Senate, House Report 356, Sixty-ninth Congress, first session.

V. Invalid Waivers are Proposed to be Validated

By section 276 (b) and by section 506, the latter a specific amendment of 278 (c) and (d) of the 1926 act, it is proposed that a consent (or waiver) by a taxpayer to the assessment and collection of the tax, dated and executed after the statute of limitations has become operative against the commissioner, shall, nevertheless be valid and have full legal efficacy. This is a radical change from the present statute and from all prior statutes.

In the first place, this is attempting to put into legislation a conclusion of law. A waiver, which is nothing but a contract, when given after the statute has already barred collection of the tax, is totally null and void for the obvious reason that there is no consideration flowing from the commissioner upon which to base it.

This proposed legislation was before the joint and advisory committees, and after due consideration they specifically and positively recommended against its adoption, page 17, saying:

"Section 1106 (a) of the 1926 act * * * raises certain questions with respect * * * to waivers executed after the running of the limitation periods for assessment or collection. It is recommended that such waivers be not effective if executed after the running of such limitation periods."

The House Ways and Means Committee makes no comment or explanation of their reason for adopting it. But whoever is responsible for it (presumably the Treasury Department) must have recognized that all these waivers, given beyond the expiration date of the statute, were worthless, otherwise it would not have been regarded necessary to inject this proposed new legislation into the act.

The learned Board of Tax Appeals has held, in Joy Floral Co. v. Commissioner (7 B. T. A. 800), July 29, 1927, that these waivers or consents are contracts, but that the benefits of citizenship and the right to do business are sufficient consideration to validate a consent or waiver even if given after the statute has barred the tax. With fitting respect for that tribunal such decision is wrong and contrary to all precedent.

If the consent or waiver is given or executed before the statute has expired there is then a mutual good and valuable consideration. On the one hand the commissioner agrees to withhold or forbear assessment and efforts to collect while, on the other hand, the taxpayer agrees to waive the right to plead the statute of limitations and thus give the commissioner additional time to determine the correct tax liability.

The Bureau of Internal Revenue has all along recognized that such consideration there must be. Observe the phraseology employed. In appeal of Warner Sugar Refining Co. (4 B. T. A. 5, C. C. H. decision 1416), decided April 21, 1926, the waiver or consent reads:

"In consideration of the assurance given it by the officials of the Bureau of Internal Revenue that its liability for all Federal taxes for the year ended December 31, 1917, shall not be determined except after deliberate, intensive, and thorough consideration, * * * hereby waives any and all statutory limitations as to the time for assessment * * *."

To say, as does the Board of Tax Appeals, that the benefits of citizenship and the right to do business are adequate considerations after collection of the tax has become barred is like a highwayman saying to his victim in a holdup, "I have given you the opportunity to avoid being shot; that is ade-

quate consideration for the money taken from you." The controlling law on the question may be seen in the following citations:

"While a promise not to plead the statute, whether made before or after the debt is barred, does not amount to an acknowledgment thereof or a promise to pay it, yet, if made before the debt is barred, and in consideration of forbearance to sue, and the creditor does forbear to sue upon the faith of the promise, it is binding upon the debtor. * * * An agreement not to plead the statute of limitations, if upon good consideration, is valid, and forbearance to sue is such good consideration. But after a debt is actually barred by the statute, a mere naked promise not to plead the statute has no validity, as it is a mere nudum pactum." (Wood on limitations, sec. 76, vol. 1, pp. 405–406, citing many cases.)

"It is difficult to see why he may not, for a valuable consideration, agree to waive or abandon the defense of the statute altogether. This must be, however, upon valuable consideration, to entitle plaintiff to insist upon the agreement as an estoppel." (Mann *v.* Cooper, 2 Court App., D. C. 238.)

"It has always been recognized by law that if pending the running of the statute, the time of payment is extended by the creditor with the assent of the debtor, the statute does not run during the time of suspension. * * * There was a written request from the defendants that proceedings should not be taken until requested by them, accompanied by a written promise or proposition to waive the statute if the plaintiff would forbear legal proceedings, and upon familiar principles of law the subsequent compliance of the plaintiff with the request constituted a sufficient consideration for the promise." State Loan & Trust Co. *v.* Cochran, et al., 130 Cal. 253 (1900).)

To the same effect are Andreae *v.* Redfield, 98 U. S. 234–5 (1878); Randon *v.* Toby, 52 U. S. 518 (1850); Shutte *v.* Thompson, 82 U. S. 159 (1872); Wells, Fargo & Co. *v.* Enright, 127 Cal. 669 (1900); Holman *v.* Omaha & C. B. Ry. & B. Co., 117 Iowa, 271 (1902); Insurance Co. *v.* Bloodgood, 4 Wend. 652 (N. Y.); Gaylord *v.* Van Loan, 15 Wend. 308 (N. Y.); and Trust Co. *v.* Cochran, 130 Cal. 245.

There is, however, a more poignant reason for objecting to this proposed change in the law. Whom will it affect? Who has given waivers or consents after the statute has run? Only the taxpayers without competent legal advice or those in such distress financially as to be unable to meet the commissioner's threats to impose summary assessment followed by distraint and seizure of property. The taxpayer, having proper legal advice and financially able to do so, has refused to sign such waivers or consents and told the commissioner to go ahead and do his worst. If the commissioner has nevertheless forced collection by distraint, such taxpayers have recovered, with interest and costs, by instituting suit in the courts. (See Bowers, Collector *v.* New York & Albany Lighterage Co., 273 U. S. 346.)

Thus, by this pernicious legislation, the ignorant and financially crippled are to be caught while the wise and well to do are escaping.

Liability of Transferees and Fiduciaries in the Case of Transferred Assets

By section 272 (k) and sections 311 and 312, and sections 602, 604, and 605, some radical proposed new legislation has been incorporated in the bill. The House Ways and Means Committee tells us (p. 24, their report), that section 280 of the act of 1926 does not specifically provide any limitation period in the case of a transferee, and that they have provided for this in section 311 (b) (2) of the proposed new act. They also tell us that they have incorporated some new legislation as 311 (b) (3) by providing that the personal liability of the fiduciary may be assessed not later than one year after such liability arises, or not later than the expiration of the period for the collection of the tax upon the decendent's estate, whichever is the later and that this change has been made to prevent the running of the statute of limitations in a case where the executor disposes of the assets of the estate during the latter part of the six-year period.

This legislation respecting the liability of transferees and fiduciaries warrants careful consideration. In the first place, section 311 (a) (1) (Section 280 (a) (1) of the 1926 act corresponds), attempts to prescribe a method for the assessment, collection, and payment of (1) the liability at law or in equity, of the transferee of property of a taxpayer; and (2) the liability of a fiduciary under section 3467 of the Revised Statutes.

Prior to the enactment of section 280 in the act of 1926, which is now proposed to be reenacted with certain changes designed to strengthen it, it may safely be said that no one, at least no lawyers, ever considered that an individual's liability "at law or in equity" could be determined in any other way than by a proceeding in a court of law or in a court of equity of competent jurisdiction.

In the second place, neither the transferee of a transferor, nor the fiduciary of a donor has any liability whatsoever at law for the antecedent income tax liability of the transferor or the donor. Only by a court of equity of competent jurisdiction and with full plenary equity power can such liability be established and in no other way. It is true that under section 3467 of the Revised Statutes of March 2, 1799, it is provided:

"Every executor, administrator, or assignee or other person who pays any debt * * * before he satisfies and pays the debts due to the United States * * * shall become answerable in his own person for the debts due the United States."

But this is a contingent liability. The executor or administrator must have due notice of the debt and he is liable only to the extent of the value of the assets coming into his hands. Furthermore, the United States must proceed in the proper courts when it seeks to enforce this liability. Observe:

"The assignee (or executor) is liable only if he has had notice of the debt. * * * And only to the extent of the value of the assets coming into his hands." (U. S. v. Clark, 25 Fed. case, 447, No. 14807; U. S. v. Barnes, 31 Fed. 705.)

"To secure priority, the right thereto must be asserted in that (bankruptcy) court and worked out through the bankruptcy court." (U. S. v. Murphy, 15 Fed. 589.)

For the commissioner or even the Board of Tax Appeals to attempt to determine the liability of an executor, administrator, or assignee under this section is simply out of the question. It is utterly beyond their jurisdiction.

Naturally, when the commissioner tried to enforce this section its constitutionality was attacked. The matter came up in the United States District Court of Kentucky in the case of Owensboro Ditcher & Grader Co. v. Lucas, collector, 18 Fed. (2d), 798, decided April, 1927, and the court most properly declared the section unconstitutional. Not only that, but the court issued an injunction restraining the collector from attempting to proceed under it. This fact is pointed out on page 15 of the report of the joint and advisory committee.

Now, in order to overcome the evident unconstitutionality of the section it is proposed by section 602 to amend Title IX of the revenue act of 1924, by adding new sections 912 and 913. By section 912 it is proposed that the burden of proof in a proceeding before the Broad of Tax Appeals shall be upon the commissioner to show that an individual is liable as a transferee of property of a taxpayer. By section 913, upon application to the board a transferee of property of a taxpayer shall be entitled, under rules prescribed by the board, to a preliminary examination of books, papers, documents, correspondence, and other evidence of the taxpayer. It is further provided by this proposed section 913 that the board may require, by subpœna, the production of all such books, papers, documents, correspondence, and other evidence which, in the opinion of the board, is necessary to enable the transferee to ascertain the liability of the taxpayer or preceding transferee, and will not result in undue hardship to the taxpayer or preceding transferee. This proposed addition to the statute was recommended by the joint committee and the advisory committee (pp. 15–16). In their recommendation these committees point out:

"Section 280 (of the 1926 act) is capable of harsh application, and many complaints have been received about it. Properly employed, it serves a useful purpose, particularly in cases of colorable transfers. Nevertheless, it deprives the transferee of important advantages which he would have as a defendant in the Federal courts. Chief among these is the right, by appropriate process, to bring the transferor and other transferees before the court, etc."

The important, outstanding, and insuperable defect in this scheme of legislation is (1) that the commissioner is not a court of law or a court of equity; and (2) that Congress has not vested the Board of Tax Appeals with full plenary equity jurisdiction, nor any equity jurisdiction at all.

Such board can not render a decree, nor a judgment, nor can it compel the attendance of witnesses. Moreover, it is conceded that this Board of Tax Appeals is merely a quasi-judicial tribunal with restricted and limited powers,

all of which is discussed in more detail hereafter. Substantially all that the Board of Tax Appeals has any power to do is to prevent the commissioner from forcing payment of the tax by a distraint proceeding in certain limited cases. So, to assume that the commissioner or the Board of Tax Appeals can determine the liability "at law or in equity" of a transferee, is out of the question. As the court said in the Owensboro-Ditcher case, to attempt to do so would deprive an individual of his property without due process of law.

Inasmuch as this entire scheme of legislation would undoubtedly be upset in the courts, it probably needs no further discussion. However, it might be pointed out that by section 272 (k) and section 311 (e) it is proposed that a deficiency letter mailed to the taxpayer at his last-known address shall be sufficient "for the purposes of this title, or if mailed to the person subject to the liability at his last-known address shall be sufficient for the purposes of this title even if such person is deceased."

If upheld as constitutional, a letter sent to a dead man at his last-known address shall be sufficient to fasten a tax liability on some one else—his children, his heirs, his beneficiaries, his legatees, or his transferees, indiscriminately. How can it possibly be mailed to the person subject to the liability when such person can only be determined at a subsequent time by an appropriate proceeding in a court of law or in a court of equity?

Another incongruous thing appears in the last clause of 311 (b) (2):

"The period of limitation for assessment of the liability of the transferee shall expire one year after the return of execution in the court proceeding."

To understand this it is necessary to know that by section 605 the commissioner is still permitted to utilize his common-law remedy through a proceeding in a regularly constituted court of law or in a court of equity against anyone whom he may consider or regard as the transferee of the assets of a taxpayer. In other words, he can try to force anyone whom he considers a transferee or fiduciary to accept the jurisdiction of the Board of Tax Appeals or he can bring suit against such alleged transferee or fiduciary in the district courts of the United States on the equity side. It is not certain but what from this section the commissioner might resort to both proceedings. If he should fail in one, he migh resort to the other. But the beginning of the suit against the transferee suspends the operation of the statute of limitations. (See 277 (3) and (4) of the act of 1926 and the correlated sections of all prior acts.) If the commissioner is able to prevail in his court proceeding against the alleged transferee or fiduciary, he will obtain on behalf of the United States a decree and judgment against such transferee or fiduciary. Whether or not a money judgment in favor of the United States is subject to any statute of limitations need not be discussed at this point. It will certainly remain alive as long as is provided by the respective law of the particular State in which the judgment has been had. Thus it will be seen that there is utterly no necessity for the commissioner to have one year after the return of execution in the court proceeding within which to assess, because if he is able to recover at all through a court proceeding no assessment is necessary. The commissioner, on behalf of the United States, will recover by virtue of the court's decree and judgment.

Section 311 (d) provides for a suspension of the "running of the statute of limitations where the commissioner has mailed a deficiency letter to the transferee or fiduciary, or during the period in which the commissioner is prohibited from making assessment in respect of the liability of the transferee or fiduciary, and for 60 days thereafter."

The substance of this entire scheme of taxation is that the Commissioner says:

"First, John Smith, I accuse you of being a transferee;

"Second, I will take upon myself the powers of a court of equity to determine whether or not you are a transferee;

"Third, I will determine the question without giving you an opportunity to appear in your defense; and

"Fourth, If you complain of what I have done, you must come to Washington and subject yourself to the alleged jurisdiction of the Board of Tax Appeals."

But that is not all. By section 604 it is proposed to be enacted:

"No suit shall be maintained in any court for the purpose of restraining the assessment or collection of (1) the amount of the liability, at law or in equity, of a transferee of property of a taxpayer in respect of any income, war-profits,

excess-profits, or estate tax; or (2) the amount of the liability of a fiduciary under section 3467 of the Revised Statutes in respect of any such tax."

This section 604 is new legislation, yet it comes under Title III, which purports, under section 1, to contain only modifications of the revenue act of 1926 and prior acts. If this section has any legal force or efficacy at all, it does not appear whether it is intended to be retroactive, or if so intended, whether it shall be retroactive back to the beginning of 1926 or to the beginning of 1927. Under and by virtue of this section 604 the commissioner, in addition to being the accuser, judge, jury, and executioner of the unfortunate transferee or fiduciary, is proposed to be made safe and immune from any interference by any court. By way of explanation or justification of this section 604, the House Ways and Means Committee report (pp. 31, 32) says:

"The enforcement of the liability (transferee's) through court process has been ineffective. * * * Because of a recent decision of a Federal district court (Owensboro-Grader v. Lucas, referred to above), * * * the committee deems it advisable to provide specifically that the administrative proceedings should not be interferred with by collateral court proceedings."

This statement by the House Ways and Means Committee at once leads to the question, Why has the enforcement of the transferee's liability through court process been ineffective? There are only two possible reasons. The first is that the commissioner has not pursued the remedy of court process vigorously and diligently. The second is that the Federal courts are more kindly disposed toward taxpayers than the Bureau of Internal Revenue. But is that any reason to attempt to vest the Commissioner of Internal Revenue with this alleged jurisdiction to indiscriminately assess one man's tax, who frequently may be dead, against some other man, upon the commissioner's mere assertion that such man is transferee or fiduciary?

The whole scheme is ill-conceived, would work a dreadful hardship on any individual whom the commissioner might single out as an alleged transferee, and, what seems to be most important, it is unnecessary. The solution of the whole question is either, first, give the commissioner an additional period of time within which to proceed in a court of law or in a court of equity against transferees or fiduciaries, if such additional time is necessary to save loss of taxes legitimately due. The alternative is to vest the Board of Tax Appeals with full plenary law and equity jurisdiction. The latter would undoubtedly meet with the violent objection of taxpayers living at a distance from Washington.

In conclusion on this point, it may be interesting to observe, by a concrete case, how this alleged "fiduciary liability" works out. John Smith, then living with his wife Jane, makes a fabulous profit on a transaction in the year 1919. When he makes his tax return for that year, on March 15, 1920, the commissioner asserts, nearly five years thereafter, that the profit was erroneously reported and that $10,000 additional tax is owing. In the meantime, in 1920, the man has divorced his wife Jane, and in the year 1921 he marries Mary Brown. In the year 1923 he dies. Mary Brown is appointed administratrix of his estate, which, it is found, amounts to not more than $5,000 net. His first wife has gotten the largest part of the profit he made in 1919 in the divorce settlement, and she is out of the picture. The commissioner, nevertheless, immediately proceeds under section 280 against Mary Brown Smith without, of course, knowing (or caring?) that she has never received estate funds equal to the amount of the claim for additional tax.

It has been stated that there are now before the Board of Tax Appeals more than 1,100 undecided cases involving this question. Why? The only possible explanation is that the board is waiting for Congress to inject retroactive constitutionality (sic) into the statute. It is sorrowful to contemplate the loss in tax collection which will result from the delay.

VII. ADDITIONAL TAX ON REORGANIZATIONS RETROACTIVE BACK TO DECEMBER 31, 1920

This particularly iniquitous proposed new legislation appears as subsection (8), paragraph (a), of section 113. On its face it looks like a mere carry-forward of section 204 (a) (8) of the respective acts of 1924 and 1926. But on scrutiny it will be discovered that a very important excepting clause in the

law as it has stood since 1924, has been omitted. Note the difference in phraseology:

ACT OF 1924 AND PRESENT ACT OF 1926	AS NOW PROPOSED IN 113 (A) (8)
If the property (other than stock or securities in a corporation, a party to a reorganization) was acquired after December 31, 1920, * * * by the issuance of its stock * * * the basis for determining gain or loss shall be the same as it would be in the hands of the transferor. * * *	If the property was acquired after December 31, 1920, by a corporation, by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) * * * the basis for determining gain or loss shall be the same as it would be in the hands of the transferor. * * *

It will be seen that under the new proposed legislation, even when one corporation, through a merger or reorganization, exchanges its stock for the stock or securities of a predecessor corporation, the basis for determining the gain or loss on the sale or disposal of the stock of such predecessor corporation will be the cost (or March 1, 1913, fair value, whichever is applicable) to the stockholders of the predecessor corporation.

In the first place, it is doubtful if this section is constitutional. The decision of the Supreme Court in Bowers *v.* Taft, where the basis for gain or loss of property acquired by a donee is under consideration, will probably control the constitutional question here involved.

In the second place, it is retroactive legislation of the most pernicious kind and will levy a penal tax on transactions which have been legitimately consummated on the strength of the law as it then existed.

Thirdly, it will prevent, or at least discourage, corporate reorganizations and mergers which are necessitated by the growth and development of the country's industrial and commercial life. For instance, President Coolidge himself recognizes the necessity of railroad mergers and reorganizations as being economically advisable.

The House Ways and Means Committee (in its report bottom p. 18, top p. 19) attempts to justify this proposed new legislation by a situation illustrated as follows:

"Suppose that individuals buy all the stock (1,000 shares) of Corporation A at $100 a share at a time when the assets of A are worth $100,000. Suppose the assets of A appreciate in value and become worth $1,000,000. Suppose further that the shareholders of Corporation A organize a new Corporation B and exchange their stock in Corporation A for the stock of Corporation B. This transaction under the 1926 act and under the proposed bill is a tax-free transaction. Corporation B then sells the stock owned by it in Corporation A for $1,000,000, which is the fair market value of the assets of A. Obviously the gain of Corporation A should be $900,000, the amount by which the $1,000,000 realized from the sale exceeds $100,000, the cost to A's stockholders of their stock, since the transfer of their stock to B in exchange for the stock B was tax-free."

This illustration is all right as far as it goes. But the learned House Ways and Means Committee apparently fails to see that the $900,000 of profit is not Corporation B's profit at all. It accrued and came into being before Corporation B was organized. So far as Corporation B is concerned, the $900,000 of "profit" is a pure and simple fiction. Still, there might be some justification of resorting to taxing fictionary profit if the actual or real profit is escaping. But that doesn't happen here. When Corporation B distributes to its stockholders the $900,000 proceeds from the sale of the stock of A Corporation, such distribution will again be taxable to these stockholders as dividends at varying rates up as high as 20 per cent. Thus, the profit on the same transaction is to be taxed, first, by a fiction to Corporation B at the rate of 11½ per cent and then the actual profit is again taxed to the stockholders at vary rates up to 20 per cent.

Why force a corporation to pay a tax on a theoretical profit which accrued long before the property, the subject of the taxation, came into the hands of the corporation? The Government loses no tax by leaving the law as it is. Let the corporation pay a tax on the profit which actually accrues to them and let the

stockholders pay a tax on that which they receive by way of dividends, or by way of liquidation distribution in excess of the original cost of March 1, 1913, value, to them.

The change proposed to be made in section 113 (a) (7) from the present law, as contained in section 204 (a) (7) of the act of 1926, is precisely the same in design and effect. The same saving clause, "other than stock or securities in a corporation, a party to the reorganization," is proposed to be omitted. Section 113 (a) (7) specifically refers to those cases where, after a reorganization, 80 per cent of the interest or control remains in the same persons. By this objectionable section, where there has been a reorganization effected through the exchange of stock or securities and 80 per cent of interest or control remains in the same persons, the basis for determining profit in the case of the sale of the stock by the acquiring corporation is to be the cost or March 1, 1913, fair value to the transferors. And this is to apply to reorganizations effected as far back as December 31, 1917. The House Ways and Means Committee report (p. 19) says, regarding its motive, that the purpose for the change in 113 (a) (7) and 113 (a) 8):

"* * * To remove any doubt the new bill (proposed new bill) omits these words of limitation thus making it clear beyond doubt that in the example above Corporation B would have a basis of only $100,000 for the purpose of computing the gain derived from the sale of its stock in Corporation A. * * * The bill therefore makes this clarifying change."

There is no need to clarify 204 (a) (7) and 204 (a) (8) as they appeared for four years in the respective acts of 1924 and 1926. It is perfectly plain from these sections that it was not then the intent of Congress to penalize by way of an added alleged tax corporations which merged or reorganized. If the House Ways and Means Committee now proposes to put an insuperable obstacle in the way of such mergers or reorganizations, by every token of justice and fair dealing, it should not be made to apply to transactions already consummated.

VIII. BASIS FOR DETERMINATION OF GAIN—TO BE DIMINISHED BY DEPRECIATION AND DEPLETION ON COST PRIOR TO MARCH 1, 1913

In the last sentence of subsection (2) of paragraph (b) of section 111 it is provided that where property is acquired before March 1, 1913, and the cost is in excess of the March 1, 1913, fair value, depreciation on such cost shall be computed from date of acquisition regardless of how long before March 1, 1913; that in such cases cost less depreciation both before and subsequent to March 1, 1913, shall be the basis for the computation of taxable gain or deductible loss. This is substantially the same as provided in section 202 (b) (2) of the act of 1926. It is contrary, however, to the decision of the Supreme Court in the United States v. Ludey (274 U. S. 295), decided May 16, 1927. However, that case was decided under the provisions of the 1917 act in which there was no provision in any way similar to section 202 (b) (2) of the 1926 act. In the Ludey case the Supreme Court said, among other things:

"We can not accept the Government's contention that the full amount of depreciation and depletion sustained, whether allowable by law as a deduction from gross income in past years or not, must be deducted from cost in ascertaining gain or loss."

This conclusion of the Supreme Court is manifestly just and fair to the taxpayer. In computing taxable gain in the year 1928 it does not seem fair that depreciation for some remote period back of 1913 should enter into the calculation when the taxpayer neither claimed or received any benefit from such ancient depreciation. Moreover, this particular section will be a breeding ground for an unlimited number of controversies. Who can say in 1928 what the proper depreciation deduction was for 1912, 16 years ago, and even beyond that? The commissioner, of course, uses what has sometimes been termed the "straight-line" method of applying arbitrary fixed rates, straight down the line from date of acquisition. Such method is not applicable in all cases and depends entirely upon the extent and degree of replacement and upkeep. (See Haugh & Keenan Storage & Transfer Co. v. Heiner, Col., 20 Fed. (2d) 921.) In the recent case of Noaker Ice Cream Co. v. Commissioner (B. T. A. Docket No. 11397, decided January 7, 1928) the Board of Tax Appeals split on this question by a 9 to 7 decision. That case, however, was under the revenue act of 1918.

IX. DIVIDENDS OUT OF EARNINGS ACCUMULATED PRIOR TO MACH 1, 1913, ARE TO BE MADE TAXABLE

By section 115 (a) of the proposed new act dividends out of corporate earnings accrued prior to March 1, 1913, are to be taxable in exactly the same way and at exactly the same rates as ordinary dividends. This change is proposed to be made effective back to January 1, 1927. This will put back into effect the Supreme Court decision in the case of Lynch *v.* Hornsby (247 U. S. 339). It was to overcome the effect of this decision (in the district court) that a provision was inserted in the act of 1916, section 2 (a) (2), that dividends to be taxable must be out of earnings accumulated subsequent to March 1, 1913. This provision has been consistently incorporated into every one of the succeeding revenue acts. As alleged justification for the proposed change the House Ways and Means Committee report says (p. 20):

"Over 14 years have elapsed since March 1, 1913, and most corporations have distributed the surplus accumulated by them prior to March 1, 1913. It seems an appropriate time (particularly in view of the resulting simplification) to eliminate this exemption."

In the first place, if it were true that most corporations have distributed the surplus accumulated by them prior to March 1, 1913, then what is the purpose of this change in legislation? If such surplus has been distributed, it will not result in any benefit to the Government by way of an additional source of taxation.

In the second place, it is, indeed, difficult, in fact almost ridiculous, to justify this proposed change on the basis of resulting "simplification." Wherein comes the simplification? In the one case the particular dividend is nontaxable, but by the proposed change in the law it is to become taxable in full.

Thirdly, the House Ways and Means Committee is very much mistaken when it assumes that most corporations have distributed the surplus accumulated by them prior to March 1, 1913. Under the law (sec. 201 (b) of the respective acts of 1918, 1921, 1924, and 1926) there can be no distribution of surplus accumulated prior to March 1, 1913, until there has been a complete and entire distribution of all surplus accumulated subsequent thereto. Since no corporation can survive which attempts to distribute all its current earnings, it thus necessarily follows that every present corporation which was in existence prior to March 1, 1913, is almost sure to have on its books earnings accumulated both prior to that date and subsequent to that date.

Fourthly, by unanimous consensus of public opinion, we are agreed upon tax reduction. Why, then, go out and dig up a new subject of taxation which for 12 years the taxpayers have been lead to understand would be tax free.

X. SPECIAL TAX ON PERSONAL HOLDING COMPANIES

By section 104 (a) and (b) we have over two pages of proposed new legislation. Says the House Ways and Means Committee (p. 17, their report):

"A personal-holding company is defined to mean any corporation (except a banking or insurance corporation) if 80 per cent or more of its gross income is derived from rents, royalties, dividends, interest, annuities, and gains from the sale of securities, and if either 80 per cent or more of its voting stock, as defined, is owned or controlled directly or indirectly by not more than 10 individuals, or the right to receive 80 per cent of its dividends is vested in such individuals directly or indirectly. It is believed that corporations falling within the class thus described are more likely to accumulate their surplus to evade surtaxes than other corporations. Provision is made in section 104 that if such a company permits its undistributed profits, as defined in the section, to exceed 30 per cent of the sum of its net income plus dividends and tax-free interest received an additional tax shall be imposed on such net income so increased, equal to 25 per cent of the undistributed profits."

To legislate that a corporation shall be deprived of its right to decide for itself how much of its earnings shall be accumulated, with the alternative of suffering an added exaction of so-called tax, which savors very much of a penalty, is so outstandingly opposed to sound public policy that it should not seriously be considered for a minute. Many corporations, coal companies for instance, and corporations generally in the agricultural sections, are now husbanding their resources to the very limit. Many of them would be caught

in the mesh of this ill-conceived proposed section 104. Other so-called family corporations such as Ford Motor Co., committed to an extensive program of expansion, would find themselves in serious difficulty. It is not enough to merely assume that this particular section was motivated for a salutary purpose. What little good it might possibly accomplish will be offset a thousandfold by the irreparable damage which will result from it.

It should be noted that neither the joint committee nor the advisory committee recommended any such legislation as this. And the administrative difficulties are outstandingly evident. Arbitrarily 80 per cent is fixed as the dead line of demarcation between the sheep and the goats, without elasticity. The man who divides his holdings with his family escapes if there are more than 10 in the family, but is caught if he has a family of less than 10.

XI. CORPORATIONS FORMED OR AVAILED OF TO EVADE SURTAX

This subject is covered in section 104 (c) of the proposed new act, which is similar to section 220 of the 1926 act and the same section of all the previous acts back to the act of 1918. There is one difference however, that the additional so-called tax (or penalty), on corporations formed or availed of to evade surtax is now to be 25 per cent of the net income whereas, in the prior acts it was 50 per cent of the net income. (P. 18, House Ways and Means Committee Report.)

The Joint Committee and the Advisory Committee recognized that this statute was obscure and difficult of administration, saying (p. 11):

"The two greatest difficulties facing the administration in applying the present provision consist, first, in proving the 'purpose' to evade, and, second, in proving what constitutes 'the reasonable needs of the business.' The evidence necessary to prove the first point is almost always unobtainable, and the definition of the reasonable needs of a business, required in the second case, is generally beyond the power of the bureau, at least, in the case of operating companies.

"The incentive to incorporate in order to avoid surtaxes has largely disappeared. In fact, there is now noted a tendency to disincorporate. To-day a resident of New York, subject to the maximum surtax, who holds property through a corporation, pays in Federal and State taxes on the corporate income 10 per cent more than he would pay in State tax and normal Federal tax as an individual."

It was further recognized by the select committee of the Senate, Sixty-eighth Congress, that this section was not only difficult of administration but that there was a serious question as to whether it was constitutional. It is also to be noted that even Mr. Gregg, the then solicitor of the Bureau of Internal Revenue, recognized the administrative difficulties. The outstanding relevant portions of the report of that committee are found in part 18, pages 3862, 3863, 3866, 3867, 3868, 3991, and 3992, and read:

"Mr. MANSON (counsel for committee). Here is the case of the Halsey, Stuart Co. and the Corporation Securities Co. (Consolidated), of New York. They are one were $2,583,018.07. They declared $70,000 dividends. They declared a stock dividend of $2,500,000. Their assets are entirely invested in securities, and it is very clear that they do not come under section 220.

* * * * * * *

"Senator JONES of New Mexico. By the way, have we been furnished with the information which we asked for some days ago as to how much tax had been collected under section 220?

"The CHAIRMAN. No; I would not say that we had been furnished with the information. We had a general statement from Mr. Gregg yesterday, but no figures were mentioned.

"Mr. GREGG. I do not have any figures.

"The CHAIRMAN. Are we going to get the figures?

"Mr. GREGG. I can take up the three cases that I have been able to find and ascertain the amount of tax involved in them; but I told the committee that it was trivial. Section 220 of the 1924 act, of course, has not been in operation; but it is better than the old act, much better.

"Senator JONES of New Mexico. Well, I anticipated that the amount of tax will not be much more than under the old acts, and I do not think it should be, because these are legitimate transactions.

"Take the case of Halsey, Stuart & Co. that you have mentioned there. That, to my mind, clearly does not come within the provisions of section 220.

"Mr. MANSON. It does not come within the provisions of section 220.

"Mr. GREGG. There are very few cases where you can apply section 220, although I think section 220 under the new law can be applied to the family corporation.

"Senator JONES of New Mexico. I consider the Warner Co. a family corporation, now that it is out of the active business for which it was incorporated; and I certainly think the Bonfils Corporation, of Denver, was a family corporation.

"Mr. GREGG. From Mr. Manson's statement of the facts, it certainly would appear to me that section 220 would apply to that case.

"Senator JONES of New Mexico. I doubt that it is constitutional. I do not think, under an income tax law and under authority merely to levy income taxes, that you can force a dissolution of a corporation.

* * * * * * *

"Mr. MANSON. It is manifest, as we have gone through these, that section 220 does not reach the evil that it was intended to reach, to the extent that I think Congress anticipated that it would.

"Senator JONES of New Mexico. I might say here, as one individual Member of Congress, that I never expected that it would.

* * * * * * *

"Mr. MANSON. Under such circumstances, of course, as applied to manufacturing companies and things of that sort, there is no force or effect to the statute whatever.

* * * * * * *

"Once the commissioner attempts to pass on questions of that sort, I can see no limit to the discretion this act gives him. I believe that the act vests him with that discretion. I do not know of any case in which he has attempted to exercise it. I can see many cases. There are some of these cases that I have called to the attention of the committee where it is clear that they come within that.

"Senator JONES of New Mexico. If the charter of the corporation authorizes them to do that sort of thing, how can the commissioner be vested with lawful authority to say that that is not within the business of the corporation?

"Mr. MANSON. The corporation laws of many States will permit a corporation to be authorized to do anything that is not inherently wrong.

"Senator JONES of New Mexico. I have had occasion to investigate the charter of the United States Steel Corporation and that charter is broad enough to cover every kind of imaginable line of business.

"Mr. MANSON. They could not run a national bank, but outside of that I suppose they could do anything.

"Senator JONES of New Mexico. They could not run a national bank; that is true; but they could own the stock of a national bank.

"Mr. MANSON. Yes.

"Senator JONES of New Mexico. I think that is true generally of modern charters of corporations, that they make the charter so that it can engage in any line of legitimate business, and then it is up to the directors and stockholders to determine what line shall be the principal line, or which shall be the side line, or a possible line.

"The CHAIRMAN. I would like to ask Mr. Gregg if he will not present one of those three cases, so that we may get the theory on which the bureau applied it in one of those cases.

"Mr. GREGG. Yes, sir.

"The CHAIRMAN. In other words, we have not a single case before us as to how the bureau has applied it in the few cases that it has applied it.

"Senator JONES of New Mexico. And if there are three cases, let us have all three of them. I would like to have every case where that section 220 has been applied.

"The CHAIRMAN. The number, of course, makes it sound humorous, but, at the same time, I would like an interpretation of how it should be applied, and whether we get any results from the application.

"Mr. GREGG. I rather think that the committee, from the remarks this morning, will think that we applied it where we had no authority to apply it.

"Senator JONES of New Mexico. If you have made it work, we want to know that. I assume that among all of the taxpayers of the country there are some of them who are stupid, and it may possibly be that you have found two or three stupid ones and you have caught them by reason of their stupidity.

"Mr. GREGG. And not by reason of our alertness.

"Senator JONES of New Mexico. Your alertness in discovering the stupidity may be commendable.

"Mr. GREGG. The chairman seems to appreciate the humor of that.

* * * * * * *

"Mr. GREGG. Here is a statement prepared on March 15, 1924—we have not had one prepared since then—giving a list of the cases where the question of section 220 was raised in the audit, and giving the disposition and status as of that time as of those cases.

"If the committee wants me to, I can read it. It probably is not complete. I happen to know one case where that was considered which is not on here; so I know it is not complete. No accurate records have been kept of the section 220 cases.

"The CHAIRMAN. You, then, have no information as to the amount of tax collected under section 220?

"Mr. GREGG. No. I can give you a list of the ones that we have been able to find, where section 220 was raised, and what action was taken on it.

"The CHAIRMAN. I would like to have that in the record.

"Senator JONES of New Mexico. Yes; I think that ought to be read.

"Mr. GREGG. Do you want me to read it?

"The CHAIRMAN. Please.

"Mr. GREGG. The question was raised in the case of the Bermont Oil Co. for the years 1918, 1919, and 1920.

"As to the disposition of the case, it was returned to audit on November 2, 1923. Section 220 not applied.

"Senator JONES of New Mexico. Section 220 not applied?

"Mr. GREGG. Yes, sir. Bronx Iron & Steel Co. The question was raised for 1918, 1919, and 1920. Section 220 not applied.

"Crescent Bed Co. (Ltd.), New Orleans, La. The question was raised for the years 1918, 1919, and 1920. Section 220 applied for all years involved. The case is now in the solicitor's office on appeal.

"Senator JONES of New Mexico. You have not gotten your money yet?

"Mr. GREGG. No, sir. Dodge Bros. (Inc.), Detroit, Mich. The question was raised for 1918, 1919, 1920, and 1921. Section 220 applied for 1918, 1919, and 1920. This was prepared as of March 15, 1924. The case went to the solicitor's office, and it is indicated here that it is in the solicitor's office on appeal. I know that the case has been disposed of and section 220 was not applied.

"Dodge Bros. Realty Co., Detroit, Mich. The same question was raised there, and it is indicated as being in the solicitor's office for a decision on appeal. Section 220 was not applied.

"Hamtranck Heating & Plumbing Co. The question was raised for 1918, 1919, 1920, and 1921. Section 220 was not applied.

"Kent Iron & Steel Corporation. The question was raised for 1918, 1919, and 1920. Section 220 was applied for 1918, but not for 1919 or 1920.

"Senator JONES of New Mexico. It was applied for the year 1918?

"Mr. GREGG. Yes, sir.

"Senator JONES of New Mexico. Has the money been collected?

"Mr. GREGG. I do not know what the status of it is. Has it, Mr. Nash?

"Mr. NASH. I do not think so.

"The Murlyn Corporation. The question was raised for 1918, 1919, and 1920. Section 220 was applied for 1918 and 1919. The case is marked 'In the solicitor's office on appeal.' I do not know what action was taken on the appeal. I do not remember it, but I do not think it has been acted on.

"Rockaway Rolling Mill. The question was raised for 1918, 1919, and 1920. Section 220 was applied for 1918; sent to audit March 11, 1924, for assessment, since no waivers were filed in the case. The appeal in that case will be taken after the assessment is made.

"Shermar Investing Corporation. Section 220 was applied for 1918 and 1919. It is in the solicitor's office on appeal.

"Theodore Smith & Sons Co. (Inc.). Returned to audit June 22, 1920. Section 220 was applied for all the years involved.

"Senator JONES of New Mexico. What became of that case? Have you gotten the money in that case?

"Mr. NASH. That would have to pass through the collector's office to see whether or not the collections have actually been made. I assume from what Mr. Gregg has read that the assessments have been made.

"Mr. GREGG. Storz Beverage & Ice Co. Section 220 applied for all the years involved, the question being raised for 1918, 1919, and 1920. The case is in the solicitor's office on appeal.

"Talbott Commercial Co. The question was raised for 1918, 1919, and 1920. Section 220 was applied for all years involved, and that case is in the solicitor's office on appeal.

"The CHAIRMAN. When will those appeals be decided, Mr. Gregg?

"Mr. GREGG. I do not know, sir. It is quite possible that some of them have been decided. I did not have an opportunity to check them very carefully, because I did not get this report——

"Senator JONES of New Mexico. There are not many of them. Suppose you have them checked over and see whether any money has been collected on any of them.

"The CHAIRMAN. In view of the fact that the bureau is going to file some statement with the committee later, they might file a statement with respect to that inquiry of Senator Jones.

"Mr. GREGG. I have gone through the cases on appeal, where the solicitor, on appeal, held that section 220 applied. I can read the opinions in those cases, if the committee desires.

"The CHAIRMAN. I would like to have them, because I think that is important.

"Mr. MANSON. Are those opinions published, Mr. Gregg?

"Mr. GREGG. I do not think so. I am very sure that they are not."

It will be noted from what was brought out by this select committee that up to May, 1925, there was little or no tax collected under this particular section. Undoubtedly, taking into account the added difficulties, the fact that the section was of doubtful constitutionality, and the fact that little or no tax was resulting therefrom the joint committee and the advisory committee recommended (p. 11) in lieu of section 220, that some incentive be given corporations to make legal distributions, saying:

"Allow the corporation a deduction in computing net income equal to, say, 20 per cent of the excess of dividends paid over dividends received, the deduction in no case to be more than, say, 25 per cent of the corporation's taxable net income before such deduction. In the computation, no account should be taken of stock dividends."

This recommendation seems reasonable and, moreover, it seems feasible. There is no explanation as to why this very meritorious recommendation was not adopted unless, it might perhaps be a statement on page 2 of the House committee report, which reads:

"* * * Your committee (House Ways and Means Committee) did not have time to properly consider all of them (the recommendations of the joint and advisory committee)."

XII. CONSOLIDATED OR AFFILIATED RETURNS

It was recommended by the joint committee and concurred in by the advisory committee "that consolidated returns as such" be discontinued or abandoned. But in lieu thereof, it was suggested that where one affiliated corporation sustains a net loss, such loss, with the consent of the corporation sustaining it (p. 14), should be offset or charged against the net income of any other corporation with which it was affiliated. This would accomplish substantially the same result as to permit the filing of a consolidated or affiliated return, as has been done under the previous statutes as far back as 1917. It would seem that the House Ways and Means Committee intended to adopt the recommendation of the joint and advisory committees (p. 20, their report), but section 118, proposed by the House Ways and Means Committee, was dropped from the bill while it was under consideration on the floor of the House.

Therefore, in the proposed bill we find sections 45 and 141 (a) as the proposed controlling legislation on this subject. Section 45 is a carry forward of section 240 (f) of the revenue act of 1926. But there has been a change of phraseology

which, though appearing inconsequential, yet in fact is insidiously menacing to taxpayers. Under section 240 (f) of the act of 1926 the phraseology was:

"The commissioner may, and at the request of the taxpayer shall, * * * make an accurate distribution or apportionment of gains * * * deductions * * * and consolidate."

By section 45 the phraseology proposed is:

"The commissioner is authorized to distribute or allocate income * * * if he determines * * * it necessary, in order to prevent evasion of taxes or clearly reflect income."

We thus see that hereafter the whole thing is to be placed in the hands of the commissioner. Whether or not such a delegation of power is constitutional, or whether or not the section would be unconstitutional as being too arbitrary or capricious is a question. But it must be considered that probably one-half of the vast flood of tax litigation has arisen from regulations which the taxpayer has contended the commissioner made without authorization in the law itself.

Naturally, the commissioner will see to it that the interests of the Government, so far as the amount of tax is concerned, are amply satisfied. Thus the objection to the change in the phraseology of this section 45 is outstanding.

But if the phraseology were allowed to remain as it was in section 240 (f) of the act of 1926, with an inclusion of the clause "at the request of the taxpayer shall," it would then seem that we have all the legislation we need upon the subject of consolidated or affiliated returns. Section 141 (a) provides that the present law respecting consolidated returns shall remain in effect for the year 1927 and 1928 only. There can be no righteous objection to this if the text of section 45 is altered so as to give the taxpayer himself something to say in the matter.

When a manufacturing or industrial corporation expands its business into a new State it has been found, owing to legal complications, that it is expedient to organize a new and separate corporation to conduct the business in the new State. For the first several years the new corporation is almost sure to sustain a loss getting started. If the parent corporation is to be denied a deduction in its taxable income of the loss sustained by its new subsidiary or, in fact, if there is even any doubt about it, it will at least have some deterring effect on expansions of business generally, and this would certainly be decidedly against public policy.

It must be remembered that the entire scheme of consolidated returns was conceived by the Treasury Department and may be said to be now fairly well worked out. Whether a group of corporations may or may not file a consolidated return is now settled in nearly all cases. The abolishment of consolidated returns would require an unscrambling of consolidated accounts which, over a period of 10 years, have been laboriously worked out by the corporations, to the satisfaction of the commissioner. The result would be hardship to both the Government and to the taxpayer. New controversies would arise as the result of the enforced change, and the probabilities are that Congress would eventually conclude or recognize that considerable amounts of tax were being lost because of the friction that affiliated corporations are dealing with the parent corporation at arm's length when, in fact, they are not but are in reality the mere branches of the parent. It is probably safe to say that any law which forbids corporations to be taxed in accordance with fact and compels a tax in accordance with fiction is almost certain to prove unsatisfactory.

XIII. Investment Sales

New legislation governing the manner and method of reporting income from installment sales is continued in section 44 (a) (b) (c) and (d). The substance of the changes is, First, that the initial payment may be 40 per cent instead of not more than 25 per cent of the selling price, as the commissioner's regulations have heretofore provided; Second, that in computing net income for the year of change or of any subsequent year, amounts actually received during such years on account of sales made in prior years must be included in the computation of current taxable income, regardless of whether heretofore fully included in taxable income while taxpayer was on the accrual basis; and third, that there shall be a realization of gain or loss if the installment obligations are distributed, transmitted, sold, or otherwise disposed of.

There has never been any statutory authority for reporting taxable income on the installment basis until the revenue act of 1926. But in each of the

regulations promulgated by the Treasury Department, governing the revenue acts of 1917, 1918, 1921, and 1924, the commissioner specifically permitted the making of computation or returns of taxable income on the installment basis.

When the question reached the Board of Tax Appeals in the case of appeal of B. A. Todd (Inc.) (1 B. T. A. 762, decided March 16, 1925), the board held that such manner of making returns was neither warranted by the statute nor did it accurately reflect the income of the taxpayer. Therefore, in the revenue act of 1926, section 212 (d), Congress pecifically authorized the making of returns on the installment basis and, by section 1208 of the same act of 1926, sought to make section 212 (d) have a retroactive effect so as to apply to all the previous revenue acts of 1916, 1917, 1918, 1921, and 1924. Whether or not a subsequent Congress can retroactively interpret the revenue acts of previous Congresses running back as far as 10 years is extremely doubtful. The important thing from the standpoint of the taxpayers is however, whether or not, during the year or years in which the taxpayer goes on the installment basis, he must include in the income of that year the profit realized on sales made in prior years, upon which he has already paid a tax on the accrual basis at the rates applicable in such prior years.

The commissioner's regulations upon this question have vacillated. Regulations 33, articles 116–120, interpreting the act of 1917, are indefinite upon this point. Article 42 of regulations 45, promulgated April 17, 1919, and the same article of the same regulation promulgated December 29, 1919, attempting to interpret the act of 1918, provides that income of this charac er, resulting from sales in prior years, must again be reported in the years of change to installment basis. Then came a letter issued by the Treasury Department, dated July 17, 1920, which was given general publication, and shor ly thereafter, Office Decision 623, 3 Cumulative Bulletin 105, in which it was provided that payments received during the year of change to the installment basis resulting from transactions of prior years, upon which a tax had already been paid, need not be included in the income of the current year on the installment basis. This was followed by Treasury Decision 3082, 3 Cumulative Bulletin 107, to the same effect; by the 1920 edition of regulations 45, issued January 28, 1921, again to the same effect; by the same article 42 of regulations 62, in interpreta ion of the act of 1921, and by the same article 42 of regulations 65, interpretation of the revenue act of 1924, all in accord. Thus, for the period April 17, 1919, to July 17, 1920, he Treasury Department ruled that the income from prior years' sales must again be reported on the installment basis to the extent of the proportionate part of the cash receipts from such prior years' sales realized during the current year of change to the installmen basis. Then from July 17, 1920, until October 15, 1926, the rule of the Treasury Department was exactly to the contrary—that such income need not be brought into the computation of the current year of change to the installment basis, it having been reported as taxable income in the prior year or years while the taxpayer was on the accrual basis. On October 15, 1926, regulations 69 were issued interpreting the act of 1926 and, by article 42, the Treasury Department again went back to its original interpretation which prevailed from April 17, 1919, to July 17, 1920. The nex event was the decision of the Board of Tax Appeals in the case of Blums (Inc.) (7 B. T. A. 737, July 26, 1927), in which the Board of Tax Appeals held that, when Congress enacted section 212(d) and section 1209 of the revenue act of 1926, it was the intent to adopt the Treasury Department's original interpretation which prevailed for a little over two years and not the interpretation that prevailed from July 17, 1920, and thereafter.

It is evident that the correct interpretation of the statute must remain in doubt until the courts have passed upon it. Upon this point the House Ways and Means Committee (p. 15) says:

"The committee does not deem it desirable retroactively to validate or invalidate such construction (by the board in the Blum decision) but leaves the matter to judicial determination."

It should be noted that since section 44 of the proposed new act is proposed to be made effective as of January 1, 1927, the House Ways and Means Committee does attempt to retroactively validate the Blum decision back to January 1, 1927, but stops there. Much objection has been raised by the taxpayers that, where installment sales of prior years have been fully reported and full tax paid thereon upon the accrual basis, it is double taxation to require that any part of such profit must again be included and tax paid upon it when the taxpayer changes to the installment basis. It is true that it is double taxation, but, even so, except in those rare instances where the business is on the down-

grade, the taxpayer is still able to save tax by going upon the installment basis in spite of it. Moreover, in granting a taxpayer the privilege of changing to the installment basis, Congress has undoubtedly the right to prescribe the terms and conditions upon which it may be done.

In considering this question the joint committee and the advisory committee report (p. 12):

"On the other hand, there is no substantial ground in equity for making the payment of a low rate of tax in a previous year a ground for permitting a taxpayer to return an altogether subnormal amount of income in a later high-tax year.

"The double-taxation feature in the past has not, in our opinion, imposed any seriously unjust burden. This conclusion is strongly supported by the fact that the original regulations embodied this feature, yet the option was freely availed of under those regulations. The adoption of the method has always been optional. The substance of the grievance of complaining taxpayers in regard to the past in reality seems to be that under amended regulations, for a time in force, other taxpayers of the same class received much more favorable treatment. It does not, however, seem that this inequity as between taxpayers in the same class should be remedied by a further concession to the class at the expense of the general body of taxpayers."

It may be said, however, that the illustration of the amount of tax saved (p. 15, House Ways and Means Committee report) in the case of a taxpayer changing from the accrual to the installment basis must be an extreme case. By that illustration, in the year 1919 it is shown that a taxpayer reduced his tax from $497,854.20 to $135,336.70, in spite of the double-taxation feature, with lesser proportions of saving for the years 1918 and 1920. No savings to this extent can possibly be accomplished if averages are taken.

Objectionable feature.—This is paragraph (d) of section 44, which provides that there shall be a realization of gain or loss if installment sales' obligations are distributed, transmitted, sold, exchanged, or otherwise disposed of, and the basis for making the computation of gain or loss shall be the excess of the face value of the installment obligation over an amount equal to the income which would be returnable were the obligation satisfied in full. In simple English, this means that if an installment obligation is disposed of, profit immediately is realized to the extent of the excess of the amount realized therefor over the cost of the merchandise of which the installment obligation represents the consideration.

If the realization resulted from a bona fide sale and represented cash or substantially the equivalent of cash, there could be no complaint by the taxpayers. But what is to result if the disposal comes about through a liquidation of the business. And what is to be the interpretation if the taxpayer pledges his installment obligation as collateral security. The Treasury Department has been known to hold that such pledging as collateral constitutes a disposal. It unquestionably is technically a conditional disposal. And what is to be the result if the taxpayer discounts his installment obligations at a bank, which bank accepts them, not on the financial strength of the maker's signature, but on the financial strength of the indorsement of the taxpayer. This is frequently done and undoubtedly would have to be considered a disposal, although in truth and substance it is really a borrowing by the taxpayer.

Section 44 (d) should be made to read:

"If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, exchanged, or otherwise disposed of through a bona fide sale for (1) cash or (2) property having a readily realizable market value, gain or loss shall result * * *."

XIV. Legislative Power to be Delegated to the Commissioner

All through the proposed new act it is repeated time after time that this and that shall be so and so, "under regulations prescribed by the commissioner with the approval of the Secretary." All this reiteration might be dismissed as surplusage, were it not for a statement which appears at the bottom of page 19 and the top of page 20 of the report of the House Ways and Means Committee, where it is said:

"It is necessary to delegate to the commissioner power to prescribe regulations, legislative in character."

This statement at least discloses the intent of the committee and might be interpreted as disclosing the intent of Congress. With this statement to back

him up and with his repeated authority to draft regulations all through the act, the commissioner is sure to carry a taxpayer into court whenever his regulations are disputed. Therefore, it may be predicted that here is the seed for a lot of litigation which could be forestalled by clarifying the act.

The law is:

"Congress can not delegate legislative power to any executive officer although it may confer upon executive officers power to enforce the statute and to determine the existence of facts." Pittsburgh Melting Co. *v.* Totten, 232 Fed. 694; 146 C. C. A. 620; 248 U. S. 1. United States *v.* Sugar et al., 252 Fed. 79; 164 C. C. A. 191; 248 U. S. 578. United States *v.* Butler et al., 195 Fed. 657; 115 C. C. A. 463. Hurwitz *v.* United States, 280 Fed. 109. United States *v.* Blasingame, 116 Fed. 654. Iselin *v.* United States, 270 U. S. 245.

Even if it were constitutionally possible to delegate legislative power to the commissioner whereby he could determine the tax to be at such figure as he saw fit, such would make the act so arbitrary as to offend the fifth amendment to the Constitution. (See Nichols *v.* Coolidge, decided by the United States Supreme Court, May 31, 1927.)

The CHAIRMAN. Is Mr. J. Borton Weeks here?

Mr. WEEKS. Yes.

The CHAIRMAN. Mr. Weeks represents the American Motorists Association.

STATEMENT OF J. BORTON WEEKS, PRESIDENT AMERICAN MOTORISTS' ASSOCIATION, PHILADELPHIA, PA.

The CHAIRMAN. Will you give your name and address to the reporter?

Mr. WEEKS. J. Borton Weeks, Philadelphia.

Mr. Chairman and gentlemen of the committee, I shall, by your leave, consume but a very few minutes in expressing the viewpoint of the American Motorists Association on the portion of this bill which deals with the 3 per cent tax or the 1½ per cent tax on the sale of automobiles.

My principal purpose in asking an opportunity to appear before you to-day and to be heard is to correct an impression that has gone out in the last few days to the effect that the automobile owners of America are not interested in the proposed repeal of this tax, and that only the automobile manufacturers are interested. I think the real situation is just the reverse. While the automobile manufacturers may be active in the matter, the people who are really interested are the people who buy and the people who pay are the automobile owners of America.

Senator KING. Are not the dealers, and not the manufacturers, the ones who are largely responsible for this sentiment in favor of the repeal of taxes on automobiles?

Mr. WEEKS. I would say that the dealers unquestionably contribute somewhat to that sentiment, but after all, when all is said and done, the people who pay are the automobile owners.

You are all familiar with the advertisements that appear profusely in the newspapers and magazines stating the prices f. o. b. this place and the other place of manufacture. That is not the price that you and I pay for an automobile. That is the manufacturer's price.

The CHAIRMAN. If you had no tax at all on automobiles, it would not change it.

Mr. WEEKS. That is exactly true; but the tax is added to that. When you buy from the dealer you pay that f. o. b. price plus a tax.

The CHAIRMAN. Certainly.

Mr. WEEKS. And plus certain service charges to get the car delivered.

The CHAIRMAN. Do you represent the American Automobile Association?

Mr. WEEKS. No, sir; the American Motorists' Association. The American Motorists' Association is an organization operated entirely independently of the American Automobile Association.

The CHAIRMAN. What position do you hold?

Mr. WEEKS. I am president of it.

The CHAIRMAN. Where is its headquarters?

Mr. WEEKS. We have headquarters here in Washington and in Philadelphia.

Senator KING. Is it composed largely of dealers?

Mr. WEEKS. No, sir. It is composed exclusively of automobile owners. The structure of the organization is that the American Motorists' Association is a national affiliation of a large number of automobile clubs located in different parts of the country.

Senator KING. I would like to say that I have had hundreds of letters and telegrams in regard to this matter, but not one single one has come from the ordinary public. They have all come from dealers and representative manufacturers.

Mr. WEEKS. I might say that so far as the American Motorists' Association is concerned, it is a national organization of automobile owners which is not in any way contributed to or in any way subsidized by the manufacturing interests. We are entirely a civic organization supported exclusively by the dues of the individual members to the various clubs comprising the national organization.

The CHAIRMAN. What organizations are subsidized?

Mr. WEEKS. I would ask to be relieved of the necessity of making that statement, if you do not object.

The CHAIRMAN. Why? The committee ought to know something about it.

Mr. WEEKS. I think it is very well known that the American Automobile Association is largely contributed to by the National Automobile Chamber of Commerce.

Our association is purely an organization of individual automobile owners which receives no support from any sources but our own members' dues.

Senator SHORTRIDGE. You are here opposing the 3 per cent or the 1½ per cent?

Mr. WEEKS. Yes. We are opposing any tax, and we are, if you please, refuting the statement of the distinguished Secretary of the Treasury to the effect that the motor-car owners are not interested and that the business end of the automobile life of the country is all that is interested.

Our organization has put itself and our various member clubs, through its magazines, on record publicly as being opposed to a continuance of this tax.

Senator REED of Pennsylvania. Do you think you will get the benefit of it if the tax is reduced or repealed?

Mr. WEEKS. May that question be made a little more specific, Senator?

Senator REED of Pennsylvania. Yes. In the past we have reduced taxes on automobile parts and reduced taxes on automobiles themselves; but so far as I am able to learn the facts, the purchaser got mighty little benefit out of it. It was absorbed by the automobile companies themselves. I could give you illustrations of that which lead me to wonder whether, if we do what you say, the people whom you represent will be the beneficiaries.

Senator COUZENS. Will the Senator say how anybody but the user could be affected?

Senator REED of Pennsylvania. The manufacturer will get it.

Senator COUZENS. The manufacturer has been passing it on or adding it to his invoices. I have seen hundreds of invoices to that effect.

Senator REED of Pennsylvania. I will give you some illustrations. We reduced the tax on automobile parts on February 26, 1926, and this is the way some of the invoices of the Packard Motor Car Co.——

Senator COUZENS. May I correct the Senator before he commences to quote those? I have no reference to automobile parts. I am talking about motor cars; and this one tax that is now before us is on motor cars and not on parts.

Senator REED of Pennsylvania. I will follow that with motor cars.

Senator KING. There may be some analogy.

Senator COUZENS. No; because it has been some time since we have had a tax on parts.

Senator REED of Pennsylvania. It was repealed in 1926. In May, 1925, the Packard Co. charged $11.55 for the exhaust manifold on their Model 443-8 Sedan.

Senator SHORTRIDGE. At that time there was a tax of 5 per cent?

The CHAIRMAN. Three per cent.

Senator REED of Pennsylvania. That included the tax. The tax was taken off in July, 1926, and the purchaser of that manifold did not get the 3 per cent. The manufacturer did. The selling price was announced at $11.55.

Another part in May, 1925, was $97.85. The tax was taken off, and in July, 1926, the price was announced as $97.85, and raised in August, 1927, to $130.

For cylinder and piston, May, 1925, the list price, including tax, which they are always careful to mention was $100.60. In July, 1926, the tax was off, and the announced price was $100.60.

It did not do the purchasers of those parts much good to take the tax off, did it?

The tax they state usually is lumped with an item for handling and transportation. The best information that I can get is that those items were not reduced when the tax on passenger cars was reduced from 5 to 3 per cent.

I have a large number of illustrations here. Here is one. When the tax was reduced from 5 per cent to 3 per cent under the 1926 act, effective March 29 of that year, the Chevrolet Motor Co., during February, delivered a car at Royal Oak, Mich., to the user, for a price of $688. The reduction of the tax from 5 per cent to 3 per cent made a difference in the price which the dealer would be re-

quired to pay of $10. During the month of March the Chevrolet Motor Co. absorbed this amount of tax and delivered the car to Royal Oak for $678. On April 1, two days after the law was repealed, the Chevrolet Co. increased the price $5, making it $683, placing the $5 in a reserve fund to be used for the junking of old cars. The purchaser knowing he was getting the Chevrolet at $5 less naturally would make no complaint. The Chevrolet Co. thereby absorbed 50 per cent of the reduction.

I have a lot of illustrations here all tending to show that the motorists of the country will be disappointed if they do get the tax repealed.

What is your answer to that?

Mr. WEEKS. My answer is that in the first place, so far as an analogy is drawn between accessories and automobiles——

Senator KING. But this was automobiles.

Mr. WEEKS. Yes; but I am answering the accessory aspect of it first.

There has always been in the billing by the manufacturer for new cars a distinct item of tax included over the advertised price, so that the public is sensitive to that situation and can readily ascertain whether it is getting that saving or not.

I understand, furthermore, that the automobile industry has definitely pledged itself in public utterances—and that is the only thing I can rely on—that in the event of this reduction it will have no effect upon the advertised price of their cars, and this tax item will be eliminated from the price which is charged to the dealer.

Senator KING. Do you think they would consent to a provision in the bill, assuming that we might insert such a provision without subjecting ourselves to criticism, that they are bound to carry out those understandings?

Mr. WEEKS. Is your question, should the bill contain such a provision?

Senator KING. Do you think the manufacturers would be willing to have that provision put into the bill, that they are bound to carry out those understandings?

Mr. WEEKS. I have no contact with the manufacturers and I can not speak for them.

The CHAIRMAN. Did you ever see an invoice from a manufacturer in which the tax was separate from the price of the car?

Mr. WEEKS. No, sir.

The CHAIRMAN. Of course. There never was one.

Senator COUZENS. I deny that. That is absolutely not correct.

The CHAIRMAN. What is that?

Senator COUZENS. That the automobile tax is not added to the list price.

The CHAIRMAN. I did not say it was not added. I asked him if he ever saw an invoice from a manufacturer in which the cost of the car was one item and the tax another item.

Senator COUZENS. There are thousands of such invoices.

The CHAIRMAN. I have never seen one, nor have I ever heard of one.

Senator KING. I have seen invoices showing the price of the car and the tax, but not separately stated.

Senator COUZENS. I have seen them separate and distinct.

The CHAIRMAN. Did you ever know a dealer to do it?

Senator COUZENS. That is the one who does do it, because he is the one who deals with the individual purchaser.

The CHAIRMAN. I have never seen any invoice with the tax separate.

Senator COUZENS. We will get some invoices in here to show it.

The CHAIRMAN. Where a dealer has sold a car and then added the tax to it——

Senator COUZENS. Where the list price of the car is quoted, say, "$600, f. o. b. Detroit."

The CHAIRMAN. I am speaking of the dealer.

Senator COUZENS. Where the list price was stated in one item and the tax in another item. I say I will produce invoices to show that that is correct. It is immaterial whether it comes from the dealer or the manufacturer. I will point out that the tax is added in a separate and specific item; and if this law is repealed they can not add that to their invoice.

Senator REED of Pennsylvania. Has your association ever made any effort to protect your members against this imaginary freight charge that is added to the price of cars?

Mr. WEEKS. We made no effort aside from our appearances before the House committee on this measure.

Senator REED of Pennsylvania. I am speaking of the freight charges, this f. o. b. Detroit freight calculation, which in most cases is wholly imaginary.

Mr. WEEKS. No; we have not.

Senator REED of Pennsylvania. Was it ever brought to your attention that during the average year the Ford Co. makes over $20,000,000 in imaginary freight allowances which are added to the delivery price of the car, although the car is actually assembled near the point of delivery?

Mr. WEEKS. No, sir; that is information to me.

Senator SHORTRIDGE. Do you mean to say that they charge the ultimate purchaser or add to the price of the car the item of freight which the shipper did not pay?

Senator REED of Pennsylvania. Absolutely.

The CHAIRMAN. Certainly—millions of dollars.

Senator REED of Pennsylvania. In a case against the Ford Motor Co., which was tried before Judge Sears in Detroit, the evidence brought out showed that the Ford Motor Co. in 1923 had made a net profit on freight charges pretended to be paid and not actually paid of $25,953,000; in the first 11 months of 1924, a profit of $22,918,000.

Senator SHORTRIDGE. That is obtaining money under false pretenses.

Senator REED of Pennsylvania. Of course, they sell their product for all they can get.

Senator SHORTRIDGE. But if they positively assert that they have paid so much freight and have not paid it——

Senator REED of Pennsylvania. The price quoted is f. o. b. Detroit.

Senator COUZENS. They do not assert that, Senator.

The CHAIRMAN. But they get the difference, all the same.

Mr. WEEKS. The tax is not included in the f. o. b. Detroit figure. The tax is always over and above that. That is one of the items that go in along with the freight and the servicing of the car to bring it into shape to deliver it to the customer.

The CHAIRMAN. Certainly.

Senator KING. Has your association made an examination to find what the charges were for freight service? Did you know they were charging you f. o. b. for cars, assuming that they were shipped as cars, made up and assembled ready for delivery instead of shipping them in part to some assembling point, where the freight, of course, was very much less than if they shipped the car itself, and they were also charging the dealers and it was passed on, of course, to the consumers, service charges which some believe they never rendered, or at least that they did not render sufficient service to make the amount that they have included in their costs?

Mr. WEEKS. I know there is and always has been more or less of a discussion over what the difference is, what comprises that difference between the f. o. b. price and the price the purchaser paid. Naturally the service charge is going to vary somewhat. It includes the getting of the car in condition for delivery. Some dealers put more gas and oil in than others and do various other things to the car in order to get it in shape for delivery. Freight of course varies, and the tax is added.

The CHAIRMAN. You had no idea that the Ford Co. made $25,000,000 a year, had you?

Mr. WEEKS. No, sir; I had no idea, if that is a fact.

Senator SHORTRIDGE. Take, for example, a Ford car. The price at Detroit f. o. b. would be how much—say, $500 or $600? It is to be delivered at Menlo Park, Calif. What items now are added to that f. o. b. price?

Mr. WEEKS. The freight would be added; the tax would be added; the service charge to get that car in readiness to deliver to the customer would be added. It might be that that particular dealer would have to send several miles to have that new car, when it is taken off the freight car, towed to his shop to get it in readiness to deliver. The mechanics work on it, tune it up, run it around and put oil and gas in it and get it in shape to deliver to the customer.

The CHAIRMAN. That is part of the retailer's job. He gets his percentage of the amount that he sells the car for and all of that expense is included in what he charges.

Senator COUZENS. Not necessarily.

The CHAIRMAN. He has to pay it, anyhow.

Senator COUZENS. The consumer has to pay most of it.

The CHAIRMAN. First, the dealer has to pay it, and then he passes it on to the consumer. The manufacturer does not pay it.

Senator COUZENS. Oh, no.

Mr. WEEKS. I respectfully suggest to this committee that you can no doubt go out in this locality or any other locality and gather lots of cases, but in the long run, if all of the fixed items of tax or other charges are added to the cost of an article which is to be eventually sold to the public, the public will have to pay if an item is added, and will benefit if the item is deducted.

Senator SHORTRIDGE. That is your position?

Mr. WEEKS. Yes, sir. I might say also—and I am not going to take much more of your time—that this measure was originally an emergency measure, and that since its enactment originally the automobile owners have paid $1,100,000,000 under this excise tax to the Federal Government, and if there is any relevancy in making a comparative assertion the Federal-aid contributions of the Government during that period have been $658,460,000.

Senator WALSH of Massachusetts. What sources did the aid come from?

Mr. WEEKS. The Federal Government.

May I be permitted to file this five-page brief with the committee which summarizes our viewpoint?

The CHAIRMAN. Yes. Just hand it to the reporter and it will be inserted in the record.

(The brief referred to and submitted by the witness is as follows:)

AMERICAN MOTORISTS ASSOCIATION,
Washington, D. C.

To the honorable Senate Finance Committee:

Mr. Chairman and gentlemen of the committee, I represent the 250,700 members of our association, which is composed of individual clubs throughout the country, and also have the honor to be the president of that association and also the Keystone Automobile Club—the largest motoring club in the East—having 46,000 members.

At the outset I desire to again emphatically renew my denial made on Wednesday of this past week, following Secretary Mellon's testimony before your committee to the effect that the motorist is not interested in the repeal of this tax.

Speaking in behalf of this quarter of a million users, who are members of our clubs, I desire to say to you unequivocally that as users we are unalterably opposed to a continuation of this tax.

Our association has repeatedly gone on record with the Treasury Department and Congress, insisting that the tax, as a war-time measure, should have been repealed when the emergency was passed.

The repeal of this 3 per cent excise tax is not a matter of dollars with them, but of principle.

The theory of the Government at the outset was that the tax was a just one because it taxed luxuries. That theory still prevails in the minds of the administration, as exemplified by Secretary Mellon's statement before the House Ways and Means Committee, on the opening of the hearings on the House side when the Secretary compared the automobile tax and a tax on the Dempsey-Tunney fight.

In his rather extensive analysis the Secretary compared the automobile excise tax with that of the tax paid by cigar and cigarette smokers, tobacco chewers, world series, prize fight and theater tickets, showing clearly that the automobile user is not discriminated against and that he is not paying a higher rate than the users of the foregoing mentioned luxuries.

The automobile user objects to this classification and as stated at the outset advocates the repeal of the 3 per cent excise tax as a matter of principle.

As an argument for its retention the Secretary further avers that it is but a 3 per cent tax and is levied upon the factory, or wholesale price, which he points out is much smaller than the retail price, the automobile tax amounting to but 2 cents for every dollar paid by the ultimate consumer. The figures show, however, that this is the equivalent of $23.50 per vehicle which was paid on 2,790,804 automobiles during the year ending August 31, 1927, and which netted the Federal Government $65,574,303.

The contention is that because the tax is small it is just. We dispute this. If the principle is wrong, it is wrong. With probably not the same degree of feeling but still with a slight inclination that way, the motorist feels much as did the participators in the Boston tea party. That tax was small but it was not just.

Stripped of all camouflage, this is a sales tax, pure and simple, sought to be retained because it affords a simple and convenient way of raising a goodly sum for the Federal Government. The fear has been openly expressed by the Secretary that the Government will lose this source of income. His testimony on this before the House Ways and Means Committee was as follows:

"Once the automobile tax is repealed it can not be reimposed in time of peace."

Our reply is that if it were a just tax it could be reimposed. The fact that once it is off the books that it is lost forever, appears to the motorist as being argument for its repeal, rather than its retention.

If this be a sales tax, as we contend, then you have opened the flood gates for sales taxes on every other commodity sold throughout this country—a theory of taxation which has never been accepted as sound.

The Secretary, before your own committee, has suggested that this tax is being fought solely by the automobile manufacturer. It is a fact that the automobile industry has been the prime mover in the fight for its elimination, but we feel that they have no selfish motive in urging its repeal. They do not pay the tax but merely act as a collection agency for the United States Government.

The fear that the manufacturer will not cut his price if the tax is repealed may or may not be justified. It is certain, however, that if it is retained he can not, and we believe that if it is removed the law of supply and demand will force the manufacturer to pass this reduction on to his customers.

I do not desire to burden you with figures, as you doubtless have them by heart by now in so far as they relate to the automobile industry. There are just two figures, however, that I desire to call your attention to, the aggregate amount that has been paid by the automobile users of the country in excise taxes, which is approximately $1,100,000,000. In the same time, since October 4 1917, the date of the excise tax, the Federal Government has expended $658,460,000 in Federal aid for highways.

As a principle of taxation, the motorist is firm in the belief that the taxes he pays should be expended in improvement of highways, but as the figures stand approximately half he has paid has been expended by the Federal Government in other channels.

During the last fiscal year, according to the figures of the Bureau of Public Roads, the 21,889,896 motorists of the country paid a total of $474,304,078 in license fees and gasoline taxes, while the expenditures of the Federal Government were less than 8 per cent of this sum for Federal aid.

To recapitulate, the motorists' viewpoint may be briefly summed up as follows:

1. We believe that the tax is unfair, discriminatory, and unnecessary and should be repealed.
2. The tax was a war-excise tax, originally imposed on musical instruments, sporting goods, articles of wearing apparel, perfumes, fur articles, firearms, and a number of items in addition to automobiles. The majority of these taxes have been removed.
3. The retention of the automobile tax is unfair and discriminatory in view of the removal of the tax from numerous other subjects.
4. The necessity for the tax no longer exists.
5. The retention of the tax in the Government's permanent fiscal plan is unwarranted and would be an unfair discrimination against the man of very moderate means, who comprises the big percentage of the passenger-car users of to-day.
6. It is a tax on a necessity and should be so considered in the construction of any tax program.

AMERICAN MOTORISTS' ASSOCIATION,
By J. BORTON WEEKS, *President*.

The CHAIRMAN. Mr. Kirk D. Holland will now be heard.

STATEMENT OF KIRK D. HOLLAND, ESQ., TAX COUNSELOR, WASHINGTON, D. C.

The CHAIRMAN. Do you wish to be heard in regard to section 424?

Mr. HOLLAND. Yes, sir.

The CHAIRMAN. Have you a brief?

Mr. HOLLAND. Yes, sir.

The CHAIRMAN. Do you want that brief made a part of the hearing?

Mr. HOLLAND. Yes; if you please.

The CHAIRMAN. You may just hand it to the shorthand reporter, and he will make it a part of the record.

Mr. HOLLAND. All right.

The CHAIRMAN. You may state whom you represent.

Mr. HOLLAND. I have stated that in the beginning of the brief and I will just read it now.

The CHAIRMAN. You do not need to read the brief, I take it.

Mr. HOLLAND. I am just going to comment on it a little. It is only composed of two pages.

The CHAIRMAN. I thought you said you would let that be made a part of the record. Suppose you do that and just comment on it and say what you have to say by way of comment.

Mr. HOLLAND. All right.

Senator WALSH of Massachusetts. It is very short, Mr. Chairman.

The CHAIRMAN. I know. But there is no use of his reading that to us. He may just go ahead and comment on it.

Mr. HOLLAND. All right.

(The communication referred to is here made a part of the record, as follows:)

WASHINGTON, D. C., *April 10, 1928.*

Hon. REED SMOOT, *Chairman, and*
Members of the Finance Committee,
United States Senate.

GENTLEMEN: I represent the following manufacturers: American Bosch Magneto Corporation, Robert Bosch Magneto Co., Wagner Electric Corporation, Parts Corporation, Kokomo Manufacturing Co., Spicer Manufacturing Corporation, Mechanics Machine Co.—all manufacturers of electrical units or universal joints.

Our objection to section 424 is as follows:

The main clause of the section limits the application of the law to manufacturers who were assessed taxes only under subdivision (c) of sections 900 and 600 of the revenue acts of 1921 and 1924, respectively. Under the said sections was listed 21 subdivisions. If the main clause should read "No refund shall be made of any tax illegally or erroneously collected," then the provisions under subdivisions (a), (b), and (c) would apply to all manufacturers or business enterprises, and no refunds would be made to any of them, because all taxes are, directly or indirectly, passed on to the consumer in the price of the article or service.

I only suggest this change for your consideration, to forcibly bring to your attention that section 424 does not grant us the same equal rights extended to other taxpayers. We believe where taxes have been determined to have been collected illegally or erroneously from the manufacturer, they should be refunded. We believe they should be refunded to those manufacturers upon whom a tax was imposed by subdivision 3 of said section of said revenue acts, the same as to all other taxpayers. We are not asking for a special provision in the law which will grant us some special privilege. We are only asking that we be allowed to secure refund under the same uniform provisions of the law that apply to all other taxpayers.

Subdivision (a) of section 424 H. R. 1 restricts the payment of judgments of courts to actions begun prior to February 28, 1927, to only such manufacturers from whom a tax was illegally collected under said sections of said revenue acts. No such date applies to any other class of taxpayers in respect to payment of judgments of courts.

Subdivision (b) provides that no refund shall be made of taxes illegally collected unless such amount was not directly or indirectly collected from the purchaser. Why make this apply to these manufacturers only?

We are only asking that subdivisions (a) and (b) be amended to read as follows:

"(a) Except pursuant to a judgment of a court; or

"(b) Unless it is established to the satisfaction of the commissioner that such amount was in excess of the amount properly payable upon the sale or lease of an article subject to tax or that such amount was *collected on an article not subject to tax* and was not directly or indirectly *invoiced to and* collected from the purchaser or lessee *by the manufacturer, producer, or importer*, or that such amount, although collected from the purchaser or lessee, was returned to him prior to February 28, 1927"; or

I have changed subdivision (a) only by striking out the date. The subdivision will then treat judgments rendered by the courts in our favor, the same as judgments decided in favor of other taxpayers.

The words in italics have been inserted in subdivision (b) and represent the changes desired.

The date in subdivision (a) is manifestly unfair to manufacturers, who were going along with the Treasury Department under the impression that their claims would be paid, and under the further impression that they had plenty of time under the statute of limitations in which to file petitions for refund in the Federal courts. I refer to such manufacturers as the Spicer Manufacturing Corporation, whose claim was allowed in December, 1926, prior to the above date, but was never paid. Notice of adjustment was mailed to its representative, and now under the provisions of this act a judgment of a court would not be paid except "in an action duly begun prior to February 28, 1927." The claim of the American Bosch Magneto Corporation and the other manufacturers named above were only finally rejected by the Treasury Department in the fall of 1927. At that time petitions were filed in the United States Court of Claims asking that judgments be allowed against the United States in favor of each of the above manufacturers.

In the case of the Wagner Electric Corporation and the Mechanics Machine Co. they received, after the date named in subdivision (a), the following notice from the commissioner:

"You are advised that the evidence submitted in connection with your claim No. ——— * * *, shows that you did not pass the tax on to your customers but that the tax was paid by your firm. It appears, therefore, that your firm can not comply with the terms of the law.

"* * * your claim * * * is hereby rejected."

We only ask that you do not take away from us the privilege which is extended to all other taxpayers of entering suit against the Government within two years after claims have been rejected by the Treasury Department; and if the courts decide that such taxes have been illegally collected from us, and render judgment in our favor, that same be paid.

Yours very truly,

KIRK D. HOLLAND.

Amendment to House revenue act No. 1, section 424, subdivisions (a) and (b), page 188, to read as follows:

"(a) Except pursuant to a judgment of a court; or

"(b) Unless it is established to the satisfaction of the commissioner that such amount was in excess of the amount properly payable upon the sale or lease of an article subject to tax or that such amount was *collected on an article not subject to tax* (and was not directly or indirectly *invoiced to and* collected from the purchaser or lessee *by the manufacturer, producer, or importer*), or that such amount, although collected from the purchaser or lessee, was returned to him prior to February 28, 1927; or

Strike all the words after "court" in subdivision (a), as indicated above

In subdivision (b) insert the words which are in italic.

Mr. HOLLAND. As I have stated in my brief, I represent the American Bosch Magneto Corporation, Springfield, Mass., the Robert Bosch Magneto Co., the Wagner Electric Corporation, the Parts Corporation, the Kokomo Manufacturing Co., the Spicer Manufacturing Co., and the Mechanics Machine Co. They are all manufacturers of electrical units and of universal joints.

Our objection to section 424 is, first, that the main clause of the section limits the application of it to subdivision (c) of sections 600 and 900 of the revenue acts of 1918, 1919, 1921 and 1924.

Under these sections 600 and 900, there were 21 other subdivisions taxing other lines of manufactures, and the other 21 subdivisions are permitted to get refunds, and only subdivision (c) is prohibited under this law from securing refunds, unless they return the money to the ultimate consumer, which it is impossible to do.

Senator KING. Well, then, you want to keep it.

Mr. HOLLAND. Do you mean, do we want to keep the money?

Senator KING. Yes.

Mr. HOLLAND. Sure, we want to keep the money that we paid.

Senator KING. Yet you charge it to the ultimate consumer, do you not?

Mr. HOLLAND. We did in the sense that we charge our capital tax to the ultimate consumer.

Senator KING. Sure. You charge it to the people that you sold to, and you got it, and now you want a refund of the money.

Mr. HOLLAND. It went in as expense, the same as with other manufacturers.

Senator KING. I am opposed to that.

Mr. HOLLAND. Well, let me say one other thing, so that you may be opposed to it too.

Senator KING. All right.

Mr. HOLLAND. Let us make in general, with no refunds, providing that no refunds shall be made for any taxes illegally or erroneously collected, and then no one will get any refunds at all.

Senator KING. You want us to sanctify the wrongs we have committed by committing another.

Mr. HOLLAND. Oh, no. We are not asking you to extend to us any special legislation, but that you will fix it so that we can get something back that is contrary to what anybody else has. But we are just wanting to get ours back under the same uniform provisions of law as anyone else enjoys.

The CHAIRMAN. Do you want this to be retroactive?

Mr. HOLLAND. No; we want to strike the date out, first, in subdivision (a). We do not see any reason why we should put this back and make it—well, for instance, I will say, answering the Senator in regard to whether we want it back or not and keep it——

Senator KING. I thought you were talking about the years 1923, 1924, and 1925.

Mr. HOLLAND. We go back to 1919, when it was first made.

The CHAIRMAN. 1921 was the first act.

Mr. HOLLAND. Well, no; we paid our taxes in 1919.

The CHAIRMAN. Not under this clause. The first act was in 1921, and that was section 900, and then in 1924 it was continued.

Mr. HOLLAND. We paid a tax in 1919 as well.

The CHAIRMAN. There was no question that ever arose as to that.

Mr. HOLLAND. We have it up right now, where we are denied a refund. I handed you one exhibit there, Senator.

The CHAIRMAN. You may just go on with your statement. The principle is exactly the same, whether for one year or another.

Mr. HOLLAND. All right. He asked about 1921. Now, we think that if it is a good thing to apply this to people under subsection (c) of sections 600 and 900, then it ought to be as to every other manufacturing enterprise. And if they base a tax on another clause then you ought to refuse to refund it to them for the same reason. If you will make it read as to the main clause all right.

Senator SHORTRIDGE. Have you suggested in your brief the language?

Mr. HOLLAND. Yes, sir. I have it attached to my brief.

Senator WALSH of Massachusetts. Would your amendment affect other industries than those you have named?

Mr. HOLLAND. Oh, yes. It would affect several other industries that were taxed as manufactureres of automobile parts.

Senator WALSH of Massachusetts. Accessories or parts.

Mr. HOLLAND. Yes, sir.

Senator WALSH of Massachusetts. How would it affect the revenues, Mr. Chairman?

The CHAIRMAN. You know, Senator Walsh, it came about first in the appropriation bill, the making of a direct appropriation to cover these items that the tax was collected upon and which the court held were not parts of an automobile. Then on the floor of the Senate there was a long discussion, and an amendment was adopted to the appropriation act, preventing the payment of any claims unless it could be shown that they were not passed on to the ultimate consumer. Now, that is how it came up. In the case of the witness here, it was passed on, but now he wants the law here to say that, notwithstanding he collected that money from the ultimate consumer, that he collected that much more money than he would otherwise have done, that he wants it back.

Senator WALSH of Massachusetts. Up to the time of this amendment they all paid it, as I understand.

Mr. HOLLAND. May I say that when I suggested here in answer to a question by Senator King that we admit we passed it on, that we do not admit we passed it on except in the sense that everyone else passed it on: for instance, as a part of the expense. And you refund income taxes to manufacturers erroneously assessed——

The CHAIRMAN (interposing). Let us get at it in this way: In the case of your companies in arriving at the cost of an article you take every expense connected with it into consideration?

Mr. HOLLAND. Certainly.

The CHAIRMAN. Now, in that consideration of cost items you included the 3 per cent included in the law at that time?

Mr. HOLLAND. Yes, sir: just like State and county taxes.

The CHAIRMAN. Exactly.

Mr. HOLLAND. But I will read to you from a letter received from the Treasury Department. This is addressed to the Mechanics Machine Co.:

> You are advised that the evidence submitted in connection with your claim, including the statement from your secretary, shows that you did not pass the tax on to your customers but that the tax was paid by your firm. It appears, therefore, that your firm can not comply with the terms of this law, and your claim is, therefore, rejected.

The CHAIRMAN. That is true.

Senator REED of Pennsylvania. They paid the tax but absorbed it themselves.

Mr. HOLLAND. Yes, sir.

Senator REED of Pennsylvania. And that is why you can not get the money back that was illegally taken from them?

Mr. HOLLAND. Yes, sir.

Senator REED of Pennsylvania. So far as the Wagner Co. is concerned, I understand it will be taken care of by the bill as it comes to us from the House of Representatives.

Mr. HOLLAND. We do not think so. I talked to Mr. Alvord, and when we get that he is going to contend that only such concerns as paid the tax—that is, that sold their product and maybe a year afterwards the Treasury Department assessed them the tax, and then they had it up, of course, then it would not be passed on, because it was not figured on in the expenses. They are the only ones. That is, the 2 per cent that failed to pass it on, that the House talked about. They are the only ones. Now, then, there was no tax——

The CHAIRMAN (interposing). You did not lose one cent there.

Mr. HOLLAND. Yes: I represent a concern, and I own 40 per cent of the stock, that the Treasury Department says must pay this tax, that the Treasury Department assessed this excise tax, and they threatened to close our business, and we had to go to the banks and borrow the money, $90,000 at one time, and we protested that it would bankrupt the concern. We did that and we lost the entire business on that account.

The CHAIRMAN. Well, that is a different proposition.

Mr. HOLLAND. It is the same proposition.

The CHAIRMAN. No; that is quite a different proposition. What I mean to say is this: As I understood your testimony, you state that whatever item you had to sell, and I do not know what it was, but whatever item you sold, in arriving at the cost of it you took into account every expense and included in that expense was the 3 per cent tax imposed upon automobile parts. Now, that being the case, you sold that at your regular profit——

Mr. HOLLAND (interposing). No; that is a mistake. I did not say that.

The CHAIRMAN. Well, what I mean to say is this——

Mr. HOLLAND. It cut our profits.

The CHAIRMAN. You put it into your cost, and therefore you sold the item on the basis of cost plus whatever percentage it was. Now, when you sold that you never thought that you would ever get that 3 per cent back, did you?

Mr. HOLLAND. Well, we did not know at the time that we would, notwithstanding the fact that we protested. But, Senator Smoot, when you say that we put it in and calculated the cost, we could not help recognizing the fact that it was costing that much additional.

The CHAIRMAN. Certainly.

Mr. HOLLAND. But I do not mean to say that we sold at a profit always then. We may have lost money on it.

The CHAIRMAN. Certainly; and that is the case in all businesses.

Mr. HOLLAND. We did not increase the cost of our items. I stated a few minutes ago in answer to Senator King's question that the

consumer would not get the tax back if we got it back, that it would not benefit him. But we will turn it around the other way: If we increase the taxation and add the tax to the manufacturer, and he does not increase his price, then is the consumer paying it?

The CHAIRMAN. Well, the manufacturer does, or if he did not maybe he could not make the sale.

Mr. HOLLAND. Yes; that is true.

Senator REED of Pennsylvania. I think the Congress has got itself into an impossible position in trying to trace this thing down to the person who pays it. I do not see what right we have to extort money from the taxpayer which under the law he was not obliged to pay and then refuse to refund it on the ground that somehow or other he has arranged his business to make up the loss from somebody else.

The CHAIRMAN. When the bill was reported to the Senate no such thing was contained in it. But the Appropriation Committee made a direct appropriation, and Senator McKellar brought it up on the floor of the Senate and it was overwhelmingly voted into the bill.

Senator COUZENS. Was not that on the recommendation of the Treasury Department?

The CHAIRMAN. No; I think not.

Senator COUZENS. I feel that it was.

The CHAIRMAN. They did not appear before the Appropriations Committee I know.

Senator COUZENS. Mr. Alvord says they did. I think they recommended it in the House of Representatives.

Senator REED of Pennsylvania. We might as well say that a State should refund a tax collected illegally on the ground that the party who paid it had had many costs. You can not unscramble this thing.

The CHAIRMAN. That is true.

Senator COUZENS. It only provided that where it could be so located. If it was scrambled and then unsegregated, of course, it was not proposed that it should be returned.

Senator REED of Pennsylvania. I think it is immoral for the United States to retain money that it says it has illegally collected.

Senator COUZENS. But here is the case: Assuming, for instance, that we were to refund all of these automobile taxes, and the automobile dealers or manufacturers had added the tax to their invoice, would it be fair to refund all these taxes after having collected it from the automobile users?

The CHAIRMAN. You can not do it justly.

Senator COUZENS. This gentleman represents the American Bosch Magneto Corporation. I should like to ask him if in billing their magnetos out to anyone, whether to an individual purchaser or to a manufacturer, they added any tax.

Mr. HOLLAND. No; not to the manufacturer, of course, because there were exemption certificates. We did not charge any tax to a manufacturer because he paid a tax himself on what he did. But in the beginning, for a few months anyway, we did add the tax separately on the invoice. Afterward objection was raised and we were forced to discontinue that tax, and we did not raise our price but absorbed the tax. We notified our customers accordingly. So far as that was concerned in the acceptation of the term we paid the tax ourselves.

Senator COUZENS. In those cases where you state you added the tax until objection compelled you to take it off, was that it?

Mr. HOLLAND. Yes, sir.

Senator COUZENS. Do you want the Government to refund that tax to you, too?

Mr. HOLLAND. Well, not necessarily.

Senator COUZENS. Have you made claim for that?

Mr. HOLLAND. No.

The CHAIRMAN. Your proposed amendment would do that.

Mr. HOLLAND. No; we are not making claim for that. My proposed amendment does not suggest that where we bill the tax separately, because we do not say anything about (c) clause of this amendment. It is only in subdivision (b) that we ask any change, and there we ask a change of the wording to definitely determine what you mean by "indirectly passed on."

The CHAIRMAN. Here is what you say:

> Unless it is established to the satisfaction of the commissioner that such amount was in excess of the amount properly payable upon the sale or lease of an article subject to tax or that such amount was collected on an article not subject to tax * * *.

That is what you mean for us to put in?

Mr. HOLLAND. Yes, sir.

The CHAIRMAN. And you say:

> And was not directly or indirectly invoiced to and collected from the purchaser or lessee by the manufacturer, producer, or importer.

Mr. HOLLAND. Now, that is it. If we did not bill it, then we say we did not pass it on. And if we did bill it, we do not want it back.

The CHAIRMAN. Well, your own statement was that you put it into the cost and sold the article with no intention whatever of getting a rebate.

Mr. HOLLAND. No; we do not say that.

The CHAIRMAN. Well, you did say that.

Mr. HOLLAND. May I correct myself if I said that? We say in the beginning we did bill it as a separate item. We are not asking here that that be changed, and we are not asking for the money back. We say only where it was not invoiced; that is the language we use. We want a defining of the passing of it on. That is what we want defined.

Senator COUZENS. When the amendment was made that Senator Smoot referred to, it was particularly provided that you might even get it back, if you passed it on to the purchaser and could prove it. We went further than you asked at the time.

Mr. HOLLAND. But they do not agree to that in these letters. We did not pass it on at all, and they say we can not get it back.

Senator COUZENS. But that is not our interpretation.

Mr. HOLLAND. Here are two cases where they do not do it. And here is another case, that of the Spicer Manufacturing Co., where the claim was allowed in December, 1926, and they refused to pay it on account of this appropriation bill.

The CHAIRMAN. What is the date of those letters?

Mr. HOLLAND. This one is dated December 29, 1926.

The CHAIRMAN. That was based upon the appropriation bill.

Mr. HOLLAND. The claim is allowed, and then——

The CHAIRMAN. The letter from the department at that time was not based upon the 1926 law but upon the appropriation bill that was passed in 1926.

Mr. HOLLAND. That is right. But we want to say that we never have gotten the money.

The CHAIRMAN. Because you have not been able to show that it was passed on as provided for in the appropriation bill.

Mr. HOLLAND. In December, 1926, no; this provision never was attached to the appropriation bill of that year. It was passed February 28, 1927.

The CHAIRMAN. What was that?

Mr. HOLLAND. This proviso, that you must return it to your customers.

Senator REED of Pennsylvania. The claimant was allowed two months.

Mr. HOLLAND. This was cut two months before that time.

Senator COUZENS. But no appropriation was made to pay the claim.

Senator REED of Pennsylvania. That is right.

Mr. HOLLAND. Under this act we can not expect to get our money even then. We thought we were going to get our money back. And this letter says that a check by the disbursing clerk of the department for the amount refunded is forwarded herewith, but it was not done.

Senator WALSH of Massachusetts. How does the Treasury Department feel toward this matter? Are they sympathetic with your position?

Mr. HOLLAND. No, sir.

The CHAIRMAN. Mr. Alvord calls my attention to the fact that at that time there was no money at all available with which to pay, and they had to wait until the passage of the appropriation bill; and if there had not been that provision in the appropriation bill all claims would have been paid, but the provision in the appropriation bill prevented the Treasury Department from paying them.

Senator KING. Because of the proof required in the act.

Mr. HOLLAND. We say to you that we were forced to sue on this adjustment claim, but we say that the committee put in this law——

The CHAIRMAN (interposing). We understand the situation thoroughly. If there is any other point you want to present to the committee we will be glad to hear you. You are not the only person; there are a good many others interested in the same thing.

Senator KING. You have presented fully in your brief your point, as I understand it.

Mr. HOLLAND. Yes. All we want is an opportunity to go into court and have the court give us a judgment and we ask that it be paid.

The CHAIRMAN. Your proposed amendment is here before the committee.

Mr. HOLLAND. Yes, sir.

The CHAIRMAN. All right, we thank you.

(The witness left the stand.)

The CHAIRMAN. Now, Mr. John F. McCarron.

STATEMENT OF JOHN F. McCARRON, ESQ., ATTORNEY AT LAW, WASHINGTON, D. C.

The CHAIRMAN. You may go ahead and give your full name, address, and whom you represent.

Mr. McCARRON. I have given my name and address, and I represent myself and clients. I first desire, gentlemen of the committee, to direct your attention to page 209 of the bill, section 608, paragraph (b), and with your indulgence I shall read that particular section of the bill:

> In the case of a claim filed within proper time and disallowed by the commissioner after the enactment of this act, if the refund was made after the expiration of the period of limitation for filing suit, unless within such period suit was begun by the taxpayer.

That is held to be an erroneous act upon the part of the commissioner. I wish to say, gentlemen of the committee, that that provision is bound to bring about a multiplicity of suits. At the present time, and as the practice has been for a great many years, when a claim is filed within the statutory time and is rejected, if you do not sue within the two-year limitation, you may have that claim reopened after the expiration of the two-year limitation providing that that ruling has been upset by the commissioner himself or by a court of competent jurisdiction.

Up to the present time that practice has worked out very well in that regard. And I may say to you, Senators, that if a small taxpayer had his claim rejected it would not justify him to go to court, but under the provisions of this bill he would be required to file suit within two years after the rejection of his claim in order to preserve his rights. And yet there might be a suit pending in court that would settle 500 cases, or perhaps 1,000 cases, and it would not be necessary for those suits to be filed. Yet under the provisions of this bill the taxpayer would be required to file a suit within the two-year limitation, otherwise he would be barred from having his claim reopened under a court decision.

I can think of that in a number of cases——

Senator KING. Let me interrupt you: Do you think there is any analogy between a case where the Government has collected taxes and the ordinary obligations between individuals? It seems to me you can not invoke that. I do not see where the taxpayer may sit down idly, speculating upon the result of a lawsuit, before he presents his claim. If 40 people owe 40 other people, they may not sit down and wait for another to sue in order to bring about the establishment of a controverted question, and that situation has run into some legislation, or produced some legislation in advance to stop the running of the statute of limitations because some lawsuit is pending.

Mr. McCARRON. Let me say in answer to your question: We will say that here is a section of the law where the courts have not interpreted it. A case is pending in court. And over here is a taxpayer who has a refund claim for $100, and he feels he has the right in his contention, that that tax should not be assessed. A taxpayer who has a larger claim may go to work and file suit, and he carries that suit on up to the Supreme Court of the United States, and the Supreme Court, we will say, affirms his contention. The $100 claim-

ant, if the taxpayer had not filed his claim within the two-year limitation, gets no refund.

Now, I say that that is not right. I say that that taxpayer should have the benefit of that proper ruling that is made by the court. And it has been the practice and is the practice at the present time. And I say to you Senators that this will bring a multiplicity of suits. I say to you frankly, sirs, that I shall advise my clients to file suit within the two-year limitation in order to protect their rights. But it is not right to compel them to go to the expense of filing an individual suit, and then go and ask the court to hold up the trial of the case pending the determination of the same question in another suit.

Senator REED of Pennsylvania. Mr. McCarron, do you know of any other section of the tax law or situation in the system of taxation in which a taxpayer who allows the statute of limitations to run against him gets the benefit of someone else's diligence?

Mr. MCCARRON. I do not, Senator Reed. And I will say that I am not asking that he be not barred because of the fact that he has not been diligent. But when he files his claim for a refund within the four-year limitation, or five-year limitation, under the particular act under which he makes his claim, he has been diligent to the extent that he has filed it, and taken advantage of the statutory period.

But now you want to increase the statute of limitations on him by saying that unless he files a suit within the two-year limitation period he shall get no benefit from a subsequent ruling; and it may take more than two years to get such a ruling.

Senator REED of Pennsylvania. In other words, for the purpose of toleing the statute along you would treat the filing of a claim for refund as equivalent to bringing suit?

Mr. MCCARRON. I would, and that has been and is the practice, if you please, Senator Reed, at the present time. In other words, I would give to these taxpayers who come in and file claims within the statutory time the benefit of whatever subsequent ruling would be made by the courts. I think they are justly entitled to it.

Senator WALSH of Massachusetts. Of course, we have passed many bills here paying back money as the result of the decisions by the Supreme Court of the United States.

Senator REED of Pennsylvania. Yes; but I think this is very bad policy. The man who sits placidly by and sleeps on his rights should not have the benefit of other people's diligence.

Senator WALSH of Massachusetts. Could not he file his claim with the commissioner?

Senator REED of Pennsylvania. That is Mr. McCarron's point, that the filing of a claim for refund should be considered as beginning suit and prevent the running of the statute of limitations.

Senator KING. Would you also add to his position that he would stipulate to abide by the result of the trial in the other case, and that if it is adverse he will abide by it?

Mr. MCCARRON. I think that is a matter of law, and that it would have to be determined by the facts of the particular case. I think stipulations of that kind are entered into at the present time between the commissioner and the taxpayer, to abide by the decision; or where the courts have continued the trial of cases the lower court, pending a decision in some other case in the higher court.

But, Senator Reed, I want to make one observation in answer to your last statement, if you please. I want to illustrate this, that where you have a test suit in which you may be testing out a question, you file your refund claim within the statutory time, and that one test suit may decide 2,500 claims. I may say to you, without any degree of boasting or anything of the sort, that I had a case in the Supreme Court of the United States, and I represented the S. S. White Dental Manufacturing Co., of your own State, on the question of whether or not the sequestration of its property in Germany was a loss under the taxing statute. That was a very important question, so much so that we won that case in the lower court, in the Court of Claims, and the Supreme Court of the United States granted a writ of certiorari to review the judgment below, and that case was affirmed by the Supreme Court of the United States about a year ago.

The Board of Tax Appeals has cited that case in the Remington Typewriter case that was decided by it. I simply mention that to represent a class of cases. But I am looking at the small taxpayer as well as the large taxpayer. You can conceive of a situation where a man has only $150 coming to him, and he does not want to go to the expense of filing suit, of employing an attorney, and paying for the printing of his petition and whatever other costs may be involved. He should not be required to do that.

I think if I correctly quote the Secretary of the Treasury, when he was here last week he said they are trying to get away from these legal propositions and endeavoring to arbitrate questions.

I wish to say that I wrote a leter to Congressman Rainey, of Illinois, a member of the Ways and Means Committee of the House, at the time this matter was up in the House, and I should like to insert a copy of that letter at this time as a part of my remarks, and in more detailed explanation of this particular section.

The CHAIRMAN. That may be done.

(The letter referred to is as follows:)

DECEMBER 14, 1927.

Hon. HENRY T. RAINEY,

United States House of Representatives, Washington, D. C.

MY DEAR MR. RAINEY: With further reference to my telephone conversation with you in regard to subparagraph (b) of section 608 of the new tax bill, H. R. 1, which is set forth on the top of page 212 of said bill, I have to say that, in my judgment, the entire paragraph of subsection (b) should be stricken from the bill. The subsection will certainly bring about a multiplicity of suits. Under the law at the present time when a claim is filed within the statutory time and is rejected by the Commissioner of Internal Revenue or, if not acted upon by him within six months after the date of the filing of the claim, suit may be commenced within two years from such date or from the date of the rejection of the claim. Under subsection (b) if a test suit is pending in court and there are 500 other cases involving the same point, it will be necessary to file a suit in each of said cases in order to protect the rights of the taxpayer. This ought not to be, and it will mean greatly increased work for the Department of Justice and the general counsel's office of the Bureau of Internal Revenue, as well as added expense to the taxpayer. It is bound to bring about a great congestion of the dockets in the courts and can serve no useful purpose. The present practice of reopening a refund claim filed within the statutory time where the erroneous ruling is overturned by a court decision or by a subsequent ruling of the commissioner is very satisfactory. The Government does not lose anything because if it is an erroneous ruling, it should be corrected and if the ruling is correct, there will be no need to reopen the refund claim. Furthermore, the small taxpayer who is unable to

afford the expense of filing suit in court will be denied relief in the event of a favorable court decision in a test case involving the same situation as in his claim.

I recall your attention to this paragraph in the hope that something may be done toward eliminating it from the bill as it is bound to work an injustice to a large number of taxpayers causing them added expenses, and it is also bound to cause a large expenditure by the Government in defending such suits.

Very truly yours,

JOHN F. MCCARRON.

Senator WALSH of Massachusetts. Don't you think something ought to be done to stop this multiplicity of suits?

Senator REED of Pennsylvania. Yes; and I was wondering while Mr. McCarron was talking whether we might not sanction an agreement between the commissioner and a group of taxpayers as a class, that the ultimate fate of their cases should be determined by some pending suit. In other words, instead of requiring them to go to the expense of bringing individual suits, and incurring the employment of an attorney and other expenses by reason of having a separate suit docketed for each taxpayer in the class that we might get the same result by permitting an agreement between the taxpayer and the commissioner that the decision should, in the long run, be controlled by the test case.

Senator WALSH of Massachusetts. It is done in many other cases. I have in mind at this time an immigration case which was held up pending the settlement of a case.

Senator REED of Pennsylvania. If I were one of a thousand persons who had a claim against you and I brought suit it would be quite the businesslike thing for the other 999 not to sue but to abide by the decision in my test case. And I was wondering whether some such plan might not be worked out. I can see the disadvantages of the situation against which Mr. McCarron protests. It means thousands of unnecessary suits if we insist upon the present bill. At the same time I do not see any justice in a man sleeping on his rights for 10 years and then waking up and wanting to have a refund.

Mr. MCCARRON. Where he files his claim for a refund and makes his protest he has served notice on the Government of the United States that it is an erroneous ruling and that he should not have been required to pay that tax and that he demands a refund of it.

Senator REED of Pennsylvania. You are talking about the small taxpayer who sometimes feels aggrieved enough to ask a refund.

Mr. MCCARRON. Yes; or any taxpayer.

Senator REED of Pennsylvania. I am thinking also of the taxpayer who hires a lawyer every year and makes claim for everything that his imagination can possibly justify. Your suggestion would give him the benefit of anything decided on any one of fifty questions that he raises.

Mr. MCCARRON' The reason I am suggesting to strike out that provision in the section is that the present practice has worked very well over a period of years. It seems to me that we ought to let it alone. We are trying to change the administration feature, one that I feel from my personal knowledge in the practice of the tax law has worked very well, and I think that statement can be concurred in by those who are familiar with the practice.

Senator WALSH of Massachusetts. Did your committee deal with this matter, Mr. Parker?

Mr. PARKER. Yes; indirectly.

Senator WALSH of Massachusetts. Did you make any recommendation on it?

Mr. PARKER. That was one of the legal phases. We made a report on it, but the explanation is quite a long one and I do not suppose you would want us to go into it at this time. But it is connected up with it.

Senator REED of Pennsylvania. The present practice and the practice suggested by Mr. McCarron, and the one that I have mentioned, are all exceptions to the general rule that a failure to comply with the statute should extinguish the remedy. We are all agreed, I think, that the general rule is wise, but the question is as to the exception that might be provided.

The CHAIRMAN. Is that all?

Mr. MCCARRON. There are one or two things I should like to direct your attention to. I refer now to page 184 of the bill, section 412, club dues tax, and I will read that particular section:

(d) As used in this section the term "dues" includes any assessment irrespective of the purpose for which made; and the term "initiation fees" includes any payment, contribution, or loan required as a condition precedent to membership, whether or not any such payment, contribution, or loan is evidenced by a certificate of interest or indebtedness or share of stock, and irrespective of the person or organization to whom paid, contributed, or loaned.

I wish to direct your attention to the case of Charles K. Lukens *v.* United States, No. E-486, decided by the Court of Claims on November 11, 1926. I think this particular paragraph seeks to nullify that decision of the Court of Claims, that was acquiesced in by the Bureau of Internal Revenue. That decision stated that a tax upon a proprietary certificate of ownership in a club is not an initiation fee. Now, this particular paragraph seeks to cover that particular classification, that is, proprietary certificate, by calling it an initiation fee.

Senator WALSH of Massachusetts. If you joined the Congressional Club out here and should buy a bond for $1,000, and by paying $100 you are taxed on the $1,000, you are exempt on what?

Mr. MCCARRON. If it is a proprietary certificate at the present time under the Lukens case you are exempt from taxation. But before that decision the Treasury Department ruled that that was an initiation fee and the tax was on the initiation fee. The Court of Claims stated in the Lukens case that it is not an initiation fee and the department acquiesced in that decision. Now, by the terms of this paragraph it seems to me that it seeks to nullify the decision of the Court of Claims in the Lukens case.

The CHAIRMAN. Why should it not be considered an initiation fee?

Mr. MCCARRON. Because of the fact, as the Court of Claims pointed out very well in its opinion, and I am not going to read you the opinion, but I should like to read an excerpt from the court's decision, which I think is very clear in that regard:

From the facts of this case it is evident that the plaintiff is one of the owners of the property and franchises of the club, and that the proprietary share of stock makes him so. He together with the other members of the club elected a board of directors which proceeded to set up by-laws for the government of the club. Among those by-laws was one fixing an initiation fee of

proprietary members of the club, which they so fixed at the sum of $100. It is not perceived how the purchase and ownership of the stock can be construed into being an initiation fee. It has none of the earmarks of such a fee. There is no definition in the statute nor any words therein which lend themselves to such a construction. The words "initiation fee" used in the statute must be given their common and ordinary meaning, which is the payment of a sum of money that will enable a person paying it to enjoy the privileges of the club, and which once paid will never be returned to the person paying it. In this case a share of stock or its value can be in certain contingencies repaid to the party paying it or to his estate. We can not construe the statute to enlarge the meaning to impose a tax not contemplated nor included. The meaning of the words of this act can not be enlarged to include that which has been omitted by the Congress.

In other words, the court having construed it to mean that a proprietary certificate is not taxable, and the cases having been settled along that line, it seems to me it is unfair to other taxpayers to come along now and say that because they have an ownership in a club, that that shall be construed as an initiation fee, when, as the court very clearly puts it, a share of stock or the equivalent value of it may be paid back to the member or it may be paid to his estate. But an initiation fee is something different, and that is something that passes out of the ownership or control of the member, and he does not get it back. But in the case of a certificate of ownership he has something in the club of a tangible nature that will be paid back to him or to his estate. It seems to me therefore that the purpose of this section is clearly to nullify the decision by the Court of Claims, and I do not think that should be done.

Senator WALSH of Massachusetts. Is not there a distinction between an initiation fee which includes a proprietary ownership in a club and one that does not?

Mr. MCCARRON. There is as construed by the Court of Claims in this case under the existing law.

Senator WALSH of Massachusetts. If you have to own a bond and to pay a certain sum in order to be initiated into a club, why should not all that be included as an initiation fee?

Mr. MCCARRON. For the reason, as I have just pointed out, that you become a part owner of the club by reason of your proprietary certificate. But as the holder of an initiation receipt you do not become an owner. There is the distinction. And there may be different members in a club, there may be proprietary members, and there may be other classes of membership, other members who are not proprietary members, and yet all will pay an initiation fee, and this proprietary certificate is entirely separate and distinct from an initiation fee.

Senator WALSH of Massachusetts. You make no distinction between membership in a club which permits its members to voluntarily own stock or certificates in the club and one that compels them to own them in order to become a member.

Mr. MCCARRON. Yes. As it now stands, this construction having been put upon the act by the Court of Claims and acquiesced in by the department, it should stand, I think.

Senator SHORTRIDGE. Is that certificate assignable?

Mr. MCCARRON. I think it many cases it is.

Senator SHORTRIDGE. To a nonmember?

Mr. MCCARRON. Yes; I think so. But that would depend entirely upon what the by-laws provided. But as a general rule I would say

it would be assignable, because it is an interest that you hold, the same as if you would go out and buy an interest in an apartment house, because in these apartment houses where shares of stock represent ownership, it seems to me you are in the same category.

Senator SHORTRIDGE. It is your contention that Congress should not be called upon to override this decision?

Mr. MCCARRON. Yes, sir.

Senator REED of Pennsylvania. We are constantly called upon to meet court decisions, and it keeps Congress jumping around like a boy killing snakes.

Mr. MCCARRON. Very much so, and in that case, if my recollection serves me correctly, there was no effort sought by the Government to get a writ of certiorari from the Supreme Court of the United States. It was acquiesced in.

Senator REED of Pennsylvania. They got their writ of certiorari from us.

Mr. MCCARRON. That is where they are seeking it now. I may say to you that that Lukens case came from your own State.

Senator REED of Pennsylvania. That does not matter to me.

Mr. MCCARRON. One more point and then I am through. On page 215 of the bill, I think, there should be one section stricken out. Paragraph (d), and this deals with section 614, interest on overpayments. My suggestion is that you amend lines 9 and 10:

After the expiration of such period even though allowed prior thereto.

That you strike out the words "even though allowed prior thereto" and insert "February 28, 1927." The purpose of that, Senators, is this: You will recall that in the appropriation act of February 28, 1927, there was placed a provision that all claims in excess of $75,000 should be sent to the Joint Committee on Internal Revenue Taxation and remain there for a period of 60 days before they should be paid. My proposition is that there has been no interest paid during that period. Under article 1371 of Regulation 69 of 1926 act, and it is also in the act itself, the commissioner is given authority to sign the first schedule of overpayments, and therefore the refund shall date from the payment of the overpayment or the erroneous tax to the date of the signing of the first schedule. This first schedule is signed prior to the expiration of the 60 days.

My point is that this class of taxpayers who do claim less than $75,000 do not have to wait the expiration of the period of 60 days in order to get their money, and now that the Government is paying interest to the taxpayers on the money that it holds and that belongs to them, as well as collecting interest from the taxpayer on money that belongs to it, it seems as a matter of fairness and equity and justice that during that 60-day period the claim remains here, it having already been adjudicated, that interest should be paid. It seems to me that that could be very easily corrected by the amendment that I suggest.

I thank you very kindly for your courteous hearing.

Senator WALSH of Massachusetts. What is the attitude of the department toward that suggestion, which seems to be a very simple one?

Mr. ALVORD. The provision in the deficiency act that the refunds in excess of $75,000 be submitted to the joint committee was not in-

serted in the suggestion of the Treasury. The provision, however, did require the stopping of the running of interest, and it rather seemed to me that interest ought to be allowed up until as near the point as you possibly can of the date of payment.

Senator WALSH of Massachusetts. I agree with you.

The CHAIRMAN. Now Mr. Butler may come around.

STATEMENT OF CHARLES HENRY BUTLER, ESQ., ATTORNEY AT LAW, WASHINGTON, D. C.

Mr. BUTLER. Mr. Chairman, I simply want to call the committee's attention to the fact that up to the present time under the Treasury decision, I think No. 3240, the commissioner has opened claims where there has been a decision in favor of the taxpayer, or a reversal by himself of his own decision, although the time to sue had expired.

I want to call the committee's attention particularly to the class of cases like Nichols *v.* Coolidge, which is one of the cases affecting estate taxes, and which was held by the Supreme Court for nearly a year. During that time a very large number of claims based upon it were decided adversely to the taxpayers. Numerous taxpayers, who were affected that way, including ourselves, were given to understand that under 3240, if Nichols *v.* Coolidge was decided adversely to the Government those claims would be opened.

After the decision we applied to the commissioner's office, and our claim was reopened, and we were told that the amount affected by Nichols *v.* Coolidge would be allowed, but with the statement that there were some other adjustments which would reduce the refund. While the adjustment was going on, this question of 1106 came up, and the commissioner has declined to proceed with the rehearing of our claim. We were so told by the general counsel's office.

This was exactly opposite to what happened in a case which we had, affecting munitions taxes. We argued the case in the Court of Claims, which decided in the taxpayer's favor, and the department decided not to apply for certiorari. That refund was allowed by the court, but the commissioner opened a claim which he had denied two years and six months before, and allowed it, although the time to sue had expired, and that claim was paid prior to the time we collected the claim allowed by the Court of Claims.

Now comes this question: Under the provision of H. R. 1 as passed by the House it has been suggested and there seems to be an idea in the general counsel's office that it is not sufficiently plain to justify opening claims denied prior to passage of this act and we hope that the section will be construed or so modified that T. D. 3240 will not be affected as to claims denied prior to the passage of this act where there have been decisions justifying the reopening of claim.

As to claims denied subsequently to the passage of the act, whether the same practice as has prevailed heretofore shall be applied is a matter for prospective legislation. But we hope that this provision which is already in H. R. 1 will be so clear that the commissioner will consider its intent to be that these claims, where suits have not been brought relying upon his promise to reopen will not be affected and that they can be reopened under the custom which has prevailed under the income tax law and its administration for many years.

For instance, take taxation of stock dividends. I do not know how many thousands of refunds were made there. Taxpayers generally were notified that if that case were decided adversely to the Government they would get their refunds. In these other cases they got them, regardless of the fact that suits had not been brought within two years.

Now, to make a sudden change where there are many cases under consideration which would be reopened by the commissioner under the practice, which he has held up because he thinks Congress contemplates he should not have opened them. I hope that it will be made so plain that the general counsel's office may interpret that T. D. 3240, allowing these claims denied before the passage of the act and affected by subsequent decisions may be treated as heretofore.

The CHAIRMAN. The committee will now stand adjourned until to-morrow morning at 10 o'clock.

(Whereupon, at 4 p. m., Tuesday, April 10, 1928, the committee adjourned until the following morning, Wednesday, April 11, 1928, at 10 o'clock.)

REVENUE ACT OF 1928

WEDNESDAY, APRIL 11, 1928

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

The committee met, pursuant to adjournment, at 10 o'clock a. m. in the committee room, Senate Office Building, Senator Reed Smoot presiding.

Present: Senators Smoot (chairman), McLean, Curtis, Shortridge, Edge, Reed of Pennsylvania, Couzens, Gerry, King, Harrison, Walsh of Massachusetts, and Barkley.

The CHAIRMAN. If the committee will come to order we will begin the hearing. Is Mr. Henry, of the American Automobile Association, here? Is Mr. Martel here?

Mr. George P. McCALLUM. Mr. Chairman, I will speak for Mr. Martel, inasmuch as he is before a committee in the House of Representatives.

The CHAIRMAN. You may come forward and make your statement.

STATEMENT OF GEORGE P. McCALLUM, ESQ., VICE CHAIRMAN OF THE MOTOR BUS DIVISION, AMERICAN AUTOMOBILE ASSOCIATION

The CHAIRMAN. You may give your name and address.

Mr. McCALLUM. My name is George P. McCallum. I am vice-chairman of the Motor Bus Division of the American Automobile Association, with offices in the Mills building, Washington, D. C.

Speaking for the motor-bus operators generally, we would like to make the request that the excise tax be taken off of automobiles generally, and motor busses in particular. It is my province to speak more particularly, however, with reference to the motor bus. Our association represents about 3,500 operators using about 20,000 busses. This industry has grown very rapidly in the last two years, so that to-day we are probably classed among the large public utilities. No other public utility at this time is bearing any portion of this excise tax, and in view of the development of motor-bus transportation throughout the country, assuming, as it does, such large proportions, and contributing, as it does, to such a large extent to the transportation system of the country, we feel justified in asking this committee particularly to remove the excise tax from motor busses.

The CHAIRMAN. Your busses never pay any tax toward maintaining the roads, do they?

Mr. McCALLUM. I will get to that in just a moment.

The CHAIRMAN. You intend to cover it, do you?

Mr. McCALLUM. Yes, sir.

The CHAIRMAN. All right. You may proceed.

Mr. McCALLUM. There are 44,500 units of a modern, luxurious design of motor busses in operation, common-carrier busses, operating over 263,000 miles of road. In addition to those 44,500 busses in common-carrier service, there are 36,000 motor busses used in carrying school children and teachers.

For the year of 1927 common-carrier motor busses carried 2,220,000,000 passengers. If you add to that the 300,000,000 school children that were carried, then the motor busses of this country carried better than two and one-half billion passengers.

On the question of tax, to which you just referred, the total annual tax on common-carrier busses, under the 1926 law, excluding Federal income tax and personal property tax, amounted to $22,000,000.

The CHAIRMAN. That was on the property itself?

Mr. McCALLUM. Gasoline tax and so on. If the Federal income tax and personal-property tax levied against the $500,000,000 worth of equipment, terminals, etc., were included, then the total tax would run between $28,000,000 and $30,000,000. The license fees and the gasoline tax alone amount to a little over $500 per bus per year. If you add to that the Federal excise tax and other taxes which we pay, it brings it up to $700 per bus per year.

In answer directly to your question, Mr. Chairman, we certainly do contribute a direct tax to the highways of this country. Motor busses use a lot of gasoline, and in nearly every State there is some form of license tax. In addition to that, we pay some kind of license fee for the privilege of operating in the various States. In Michigan we pay $1 per hundred for a license fee to get our permit to operate. In addition to that we pay a tax of 3 cents.

The CHAIRMAN. $1 per hundred what?

Mr. McCULLUM. $1 per hundredweight. For that reason, and particularly calling your attention to the fact that the motor-bus industry has grown until it is to-day one of our large public utilities, we are respectfully asking that this excise tax be removed from the motor bus. You did remove it from the truck, because it was serving a public purpose. We are doing the same thing.

Senator COUZENS. May I ask the witness if the manufacturer adds the excise tax?

Mr. McCALLUM. Oh, yes. We pay that tax, and, of course, that is reflected in the rate structure; must be.

Senator COUZENS. I am not referring to that. I am talking about when you buy a bus from the manufacturer. Does he add to the price of the bus the war tax?

Senator WALSH. As a separate item?

Senator COUZENS. Yes; as a separate item.

Mr. McCALLUM. I do not know whether it is carried as a separate item, but we pay it, of course.

Senator COUZENS. Well, I do not know. There is some contention that the tax is absorbed in some cases by the manufacturer. Is it billed to you separately on your invoice when you buy a bus?

Mr. McCALLUM. I could not answer that question. I wish to state that the bus people of the country are in hearty accord with

the Statements made by Mr. Henry, president of the American Automobile Association, with respect to the removal of the tax from all automotive products. They feel that the tax was an emergency war-time levy and its continuance now that the emergency is past and other industries have been relieved would constitute an unjust discrimination against automotive trade and private transportation by individuals. They are, however, more particularly concerned with the removal of the 3 per cent tax on the motor bus, for they feel that a more questionable discrimination has been countenanced by the Government in classifying and taxing the bus under the same head with the private passenger car when it ranks with the largest of our present-day public utilities.

When the excise tax was first levied under the emergency war revenue act which became effective in October, 1917, there was every excuse for Congress not making a separate classification for the motor bus. Such bus transportation as was provided at that time was either by revamped motor trucks or by extended and otherwise enlarged passenger-car chassis. Service was infrequent and sporadic, and very few people, if any, dreamed that the bus would ever reach the status of a great and much-valued public utility.

In the past 10 years, however, a great evolution has taken place, and to-day it is possible to reach practically every part of the country by motor bus; 44,500 units of a modern luxurious design, operating over 263,000 miles of route on regular and frequent schedules are providing transportation between nearly every city and hamlet in the country. In addition to these 44,500 busses in common-carrier service, 36,000 other busses are being used every school day in carrying school children back and forth from home to school.

According to 1927 figures, the yearly common-carrier bus traffic of the country has reached in round numbers a total of 2,220,000,000 passengers, not counting the 300,000,000 passengers carried by school busses. The grant total of all passengers carried by busses would amount to over two and a half billion. Surely an agency of travel of this magnitude is big enough to take its place under its own name with the great utilities of the country and receive the same consideration in matters of taxation as is extended to other public-service groups.

Secretary Mellon, in his report to the House Committee on October 31, said that in his opinion the automobile is a semiluxury article and the excise tax upon it should be retained. I do not care to go into the merits, either pro or con, of the Secretary's contention for I think his arguments were very ably refuted by Mr. Henry. However, I should like to comment that while it is hardly likely Mr. Mellon intended to include the bus in his characterization of the passenger car, his reference, under the classification of the law and with no exception being made for the bus, implied that all passenger carriers were luxuries. As a consequence, if the recommendation of the Secretary were to be accepted with no distinction being made between private and public carriers the motor bus would continue under the handicap of being the only public utility suffering from a war time emergency levy.

To refer further to Secretary Mellon's report, mention was therein made of the heavy taxes paid to the United States Government by the railroads. The motor-bus industry, aside from the Federal ex-

cise tax, is also contributing very heavily to the Federal Government. Not counting the tax paid on income by the different bus manufacturers, the bus industry, with a gross annual operating revenue of $312,500,000, makes a big contribution each year to the Government in the form of individual and corporate income-tax returns.

For a comparatively recent entrant into the field of transportation the motor bus is laboring under an enormous tax burden. The Federal excise tax from which we seek relief here to-day is one of many levies imposed upon us. This tax alone is relatively light when measured against our total tax bill. Let me cite you a few figures: The total annual taxes on common-carrier busses under the 1926 law, excluding Federal income taxes and personal-property taxes, amounted to over $22,000,000. If the Federal income tax and the personal-property taxes levied against the $500,000,000 worth of equipment, terminals, garages, etc., were included, the total would run up to twenty-eight or thirty million dollars. This means that the average tax per motor bus engaged in common-carrier service, in license fees and gasoline taxes alone, amounts to a little over $500 per year. With all taxes included in the total the average figure runs to nearly $700 per year. Considering the fact that the average gross revenue per bus is $7,000 per year it can be seen that over 7 per cent of the annual gross receipts is spent in taxes. As all taxes are charged against the cost of operation and thus reflected in the rate structure the burden is, of course, borne by the public.

The motor bus is very new in its rôle of a public utility, dating its existence in public service from the year 1917. It isn't right that its early development as a necessary economic factor should be handicapped by heavy governmental penalties when all of our other transportation facilities were given every advantage in their youth, even to the point of subsidy.

This committee, gentlemen, has an opportunity to lighten the load somewhat and to encourage the progressive development of highway transportation. Taking the bus chassis production figure of 15,000 for the year 1926 and using an average valuation factor of $6,000 per unit, the total amount of the excise tax paid annually to the Federal Government by the bus industry will hardly exceed $2,750,000. Considered in terms of governmental tax income this does not represent a great amount, but considered in terms of relief to the operator and to the public, this item, if deducted from the bus operators annual tax bill, would make a very appreciable difference.

In the committee's last revision of the revenue act, presumably because of the utility feature involved, the 3 per cent tax on motor trucks was repealed. Other units of transportation, including the railroads and pipe-line carriers, were relieved of all emergency war-time taxes as early as the year 1922. This being so, is it fair that the motor bus, now one of the greatest and most necessary of our public utilities, should continue to suffer under a war-time levy? We do not think so and we are sure that this committee with the facts before it will not think so. We appeal to you gentlemen of the committee not for a concession which is not rightfully ours but for consideration comparable to that extended to all other agencies engaged in the public service.

Remove the 3 per cent tax on motor busses and you remove an unnecessary burden from transportation and, in view of the application of the tax to school busses, also from education.

STATEMENT OF PAUL W. PINKERTON, ESQ., CHICAGO, ILL., REPRESENTING THE ILLINOIS CHAMBER OF COMMERCE

The CHAIRMAN. You may state your name and residence.

Mr. PINKERTON. My name is Paul W. Pinkerton, 30 North La Salle Street, Chicago, Ill. I represent the Illinois Chamber of Commerce. I am a member of the firm of Ellis, Pinkerton & Co., certified public accountants, and am president of the American Society of Certified Public Accountants, the national organization of my profession.

The CHAIRMAN. Are you going to read from that statement?

Mr. PINKERTON. Not all. I have had copies of it distributed for the use of the members of the committee.

The Illinois Chamber of Commerce, through the members of its constituent chambers, has a total membership of 60,000 business and professional men of the State of Illinois, representing practically every range of human endeavor, and representing practically the full spread of human income. We feel that because of the position of Illinois in the economic life of the Nation the opinion of the Illinois Chamber of Commerce and the opinions of its members represent a cross section of the opinion of the citizenry of the entire United States of America.

I appeared before the Ways and Means Committee of the House of Representatives, and I am not going to bother the Committee on Finance with any repetition of the testimony which was given before the Committee on Ways and Means.

The CHAIRMAN. Thank you. We have the whole of it here.

Mr. PINKERTON. I merely want to call attention to some things which have come up in H. R. 1 since the hearings before the Committee on Ways and Means of the House of Representatives.

The first of these had to do with section 611 of H. R. 1. Going back into the historical background for section 611, we find that in prior years it was possible for a taxpayer to avoid immediate payment of tax by filing a claim in abatement when he objected to an assessment which was made against him. It is said that the Commissioner of Internal Revenue assumed that these claims in abatement acted as waivers and that he did not have to proceed to take any action toward collection within any time limitation whatever. After the statute of limitations had run he attempted to collect some of the taxes which he had originally proposed to assess and which had been abated by the filing of these claims in abatement. The Supreme Court held that the earlier law provided that the tax must be collected within a certain number of years, and that nothing in the way of a claim in abatement postponed or extended that privilege, and that, therefore, the commissioner had no right to collect the tax after the expiration of the statute of limitations.

The CHAIRMAN. Mr. Pinkerton, were you here yesterday when Mr. James Walton addressed the committee?

Mr. PINKERTON. I was not.

The CHAIRMAN. His statement made to the committee was practically the same as yours in relation to section 611. We gave him over half an hour to go into it.

Mr. PINKERTON. Would it be fair for me to ask if his statement was convincing?

The CHAIRMAN. The committee has not fully decided that, and will not until the hearings are over. I must not express an opinion. My opinion is there may be a change in section 611 as reported from the House.

Mr. PINKERTON. Thank you. May I just say for the record that the Illinois Chamber of Commerce is very strongly opposed to the theory of section 611 on three major grounds: First, it is unfair in that it grants to the Treasury Department the right to reopen innumerable cases without granting the same right to the taxpayer; second, that unless fraud is involved business should not be subjected to this reopening of old cases. In the interest of economic stability, a case once closed should be forever closed, because wherever we have that condition business is kept in constant turmoil. And third, because this is an entering wedge into a new type of retroactive legislation, whereby a statute of limitations can be repealed after it has once run. Nothing like that, so far as I know, has ever been attempted before. It is a very dangerous precedent. We are unalterably opposed to it.

May I say also that I know personally nobody who is affected by section 611; and on my committee, the committee on Federal taxation of the Illinois Chamber of Commerce, there was only one member who knew anybody that might be affected by it. Because none of us has any acquaintance with any person who might be affected by it, none of us is personally interested, yet we feel that it would be an extremely dangerous precedent to build into the income-tax legislation any provision of that character.

Proceeding then to section 612, a very short section, which proposes to repeal as of the date of passage a certain section in the revenue act of 1926. This, gentlemen, is another example of retroactive legislation. The section which it is proposed to repeal is confusing and hard to understand, to say the least. Perhaps it should be gotten off the books, simply because no two people seem to agree as to just what it says. But there is one thing in that section which it is proposed to repeal that should remain for itself, and that is the provision that the bar of the statute of limitations shall not only operate to bar the remedy but shall extinguish the liability. We have not had that in income-tax legislation until the act of 1926 was passed. It is unfortunate that that sentence was made a part of such a complicated, twisted, distorted section as the one in which it appears in the act of 1926. That sentence that the bar of the statute of limitations shall not only operate to bar the remedy but shall extinguish the liability should remain, in our opinion, in all income-tax legislation.

The CHAIRMAN. Are you satisfied with sections 607 and 608 and the elimination of section 604?

Mr. PINKERTON. It does not seem to me that sections 607 and 608 exactly and fully and practically cover this particular point in section 612.

The CHAIRMAN. Why do they not? Can you tell me why they do not? Those sections were intended for that. If you know why they will not do it, I want you to say so.

Senator SHORTRIDGE. The statute of limitations refers to the remedy.

The CHAIRMAN. Yes.

Senator SHORTRIDGE. The ordinary statute of limitations does not extinguish the liability or the debt due, but simply affects the remedy, prevents the enforcement of the right.

Mr. PINKERTON. I do not believe, as I remember sections 607 and 608, that they anywhere provide that the bar of the statute of limitations shall finally extinguish the liability.

The CHAIRMAN. I know that is the object of them, to accomplish that very thing, in our opinion. In your brief do you recommend a change?

Mr. PINKERTON. We did not make that recommendation in the written brief.

Senator SHORTRIDGE. In reference to section 612?

Mr. PINKERTON. In reference to section 612. Section 612 is not mentioned in our written brief. Sections 607 and 608 enlarge and clarify the situation with respect to the statute of limitations.

Senator SHORTRIDGE. Do you favor them as they came to us from the House?

Mr. PINKERTON. At least, we have found no fault with sections 607 and 608.

The CHAIRMAN. The committee agreed with your position, but the committee also thought that sections 607 and 608 did just exactly what you are asking to be done. If they do not, we want to change them. Therefore, if that is the only subject you want to discuss at this time, I would suggest that you sit down and if you think of any amendment to it that you think will make it more plain, let us know what it is.

Mr. PINKERTON. I can simply say that if in sections 607 and 608 they will add the statement that the bar of the statute of limitations shall not only operate to bar the remedy, but shall also extinguish the liability, we will have definitely and finally and clearly the valuable part of the section of the revenue act of 1926 which section 612 proposes to repeal.

Senator COUZENS. Before the witness leaves that question, I should like to ask him about it.

The CHAIRMAN. Certainly.

Senator COUZENS. In regard to the statute of limitations, referred to in section 611, you said you were speaking for the entire membership of the Illinois Chamber of Commerce in opposition to that section.

Mr. PINKERTON. Yes, sir.

Senator COUZENS. Will you commit your membership not to have introduced any special bills for rebate after the statute of limitations has run?

Mr. PINKERTON. The Illinois Chamber of Commerce is very much opposed to the attempt of the Treasury or any individual group in coming and asking for retroactive legislation, except such as may be merely in the way of clarifying it.

Senator COUZENS. That is not the point I raise. Frequently private bills are introduced asking that the Congress relieve certain taxpayers because the taxpayers let the statute of limitations run, and they ask for a special bill to waive the statute of limitations in that respect, so as to get a refund from the Government, but object to a waiving of the statute to enable the Government to recover.

The CHAIRMAN. There is not a session of Congress but what numerous bills of that nature are not only introduced, but a good many of them are passed.

Mr. PINKERTON. May I answer the Senator's question by reading a few sentences from our brief:

> Since our objection may seem from the above arguments to be based on the unfairness of extending the statute for the benefit of the Government without making a similar extension for the benefit of taxpayers, you might be led to feel that we would be satisfied were the Congress to make an equal extension for the benefit of taxpayers. That is not the case. It is our firm belief that national prosperity is materially retarded by the constant effort to upset matters which have been settled. Business is kept in a state of turmoil and all those rules of executive efficiency which require that matters be disposed of once for all are made impossible of application in the case of Federal taxes. We insist, and we believe that you will agree with us, that in the interest of economic stability a case once finally closed should in the absence of fraud be forever closed. Feeling as we do, we naturally must agree that there should be the same limitation upon the taxpayer's right to claim refunds.

Senator COUZENS. I think we agree with that. I asked you if you could commit your members not to have introduced special bills for special relief, because the taxpayers let the statute of limitations run.

Mr. PINKERTON. I wish I could. I wish I could promise they would not.

Senator BARKLEY. How could the Illinois Chamber of Commerce bind anybody in that way?

The CHAIRMAN. He is here to speak for the chamber.

Senator BARKLEY. He can not bind the individuals.

The CHAIRMAN. Certainly not.

Senator COUZENS. I simply wanted to point out the inconsistency in the attitude of some of the people appealing against any retroactive feature which helps the Government, and insisting upon such retroactive features for relief for themselves.

Mr. PINKERTON. Mr. Chairman, another thing which was introduced into H. R. 1 after the hearings before the House Ways and Means Committee was the change regarding consolidated returns.

The CHAIRMAN. May I suggest to you that we have had that up before the committee. If you have in this report of yours a real suggestion to the committee, we would be glad to have it. That is one of the sections that has been passed over, and one of the sections that the committee, when they come to perfect the bill, is going to make the changes in.

Mr. PINKERTON. I am very glad to hear that. I will then leave the matter as presented in the brief, saying that the Illinois Chamber of Commerce is very much opposed to the elimination of consolidated returns.

Then, gentlemen, is the question of the revision of what was section 220 in the revenue act of 1926?

The CHAIRMAN. That is section 104.

Mr. PINKERTON. Yes, sir.

The CHAIRMAN. I think we have had all we want on that.

Mr. PINKERTON. All right, Senator. I feel that you are at least sympathetic with our view in respect to it.

The CHAIRMAN. Yes.

Mr. PINKERTON. May I bring up one other matter, the question of claims in abatement. It was formerly possible, if a taxpayer filed a return which showed a greater tax liability than he afterwards discovered to be his true tax liability, provided he had not yet paid all the tax shown in the first return, for him to file a claim in abatement and pay the tax shown by his amended return rather than that shown in the original return. Just an example, and this is an actual case:

An individual taxpayer had his return made up by his bookkeeper from his checkbook, in which he had noted carefully the source of all his receipts and the purpose of his disbursements, so his return could be prepared showing all his cash transactions. That return was filed and one-fourth of the tax paid. Shortly afterwards this particular taxpayer said to his bookkeeper: "You did not take out as a deduction that $10,000 of bonds that I gave to my church." That was a church to which he had given outright $10,000 of bonds toward a building it was going to erect. It was not on his check book, of course. The bookkeeper had either overlooked it, forgotten it, or knew nothing about it. That taxpayer was compelled to pay the tax shown by his original return and file a claim for refund and wait two or three years for an examination, and submit proof of the fact that these bonds had actually been transferred in that taxable year.

The CHAIRMAN. What year was that?

Mr. PINKERTON. 1926. The refund has not yet come through, but he has been examined. It seems to us that that taxpayer, upon the filing of his amended return, before he had paid the remaining three installments of his tax, should have been relieved from the necessity of paying the tax shown in his original return, and have been allowed to pay the amount shown by his amended return. The Government's assessment is made on the basis of information furnished by the taxpayer in his return. If he finds that information was incorrect and corrects it, it seems to me the Government should be as willing to take his second statement of his tax liability as to take his first statement. I know in a good many cases that situation has worked real hardships.

The CHAIRMAN. It is since 1926, because that is the rule of the bureau now. The bureau will deduct the amount of the tax that would be due in such a case as you refer to of the $10,000 of bonds, if it were shown to them or called to their attention or proved to them, and it would not take very long to do it.

Mr. PINKERTON. May I ask, Mr. Chairman, if you agree with my stand on that?

The CHAIRMAN. Yes. In a case such as you have stated it ought to be done. There is no question about that being done.

Mr. PINKERTON. May I ask if you will investigate that matter?

The CHAIRMAN. Yes.

Mr. PINKERTON. I have had cases of that kind with the office of the collector at Chicago since March 15 of this year, and they told me absolutely and finally that nothing could stop the taxpayer paying that tax.

Mr. ALVORD. The bureau is supposed to have investigated such situations in the last six months.

Mr. PINKERTON. The collector's office at Chicago is not aware of that fact.

I want to thank you gentlemen for your patience.

Senator BARKLEY. Mr. Chairman, if we get through with the Agricultural bill to-day I am compelled to leave town for a few days. I would like to register myself in favor of the entire removal of this automobile tax. If it should be voted on by the committee before my return, I would like to be so recorded.

The CHAIRMAN. I will see that you are.

Senator BARKLEY. I would like to make the same request as to the admission tax.

The CHAIRMAN. Very well. The committee will stand adjourned until 2 o'clock in my office in the Capitol.

(Whereupon, at 12 o'clock noon, the committee adjourned for the noon recess, to meet again at 2 o'clock p. m.)

AFTER RECESS

STATEMENT OF THOMAS P. HENRY, ESQ., PRESIDENT OF THE AMERICAN AUTOMOBILE ASSOCIATION

The CHAIRMAN. You may state your name to the reporter.

Mr. HENRY. My name is Thomas P. Henry, and I am president of the American Automobile Association.

The CHAIRMAN. Did you appear before the House committee?

Mr. HENRY. Yes, sir.

The CHAIRMAN. I thought you did. If there is any point you did not cover before the House committee we would like to have you cover it now. There is no necessity for repetition, because we have that record here.

Mr. HENRY. My statement would be along somewhat similar lines, but in many respects somewhat different. I expect to bring up to date the answer of the car owners to the argument of the Secretary of the Treasury.

The CHAIRMAN. You may proceed.

Senator COUZENS. A witness on the stand yesterday stated that your organization was subsidized by the motor-car manufacturers. Is that correct?

Mr. HENRY. No; that is not correct.

Senator COUZENS. Do they contribute to your maintenance at all?

Mr. HENRY. In no way.

Senator KING. Have they ever done so?

Mr. HENRY. The bus division of the American Automobile Association, which was established two or three years ago on the suggestion of the National Automobile Chamber of Commerce, was con-

tributed to by the National Automobile Chamber of Commerce, but no money collected from passenger-car owners throughout the United States has ever been expended in the interest of that bus division. The National Automobile Chamber of Commerce, up to $10,000 a year, agreed to contribute that much in proportion to the amount the bus operators contributed, and the American Automobile Association was the instrument to get the bus association started. It has never in any way been supported by the American Automobile Association or the passenger-car interests, and none of the money from that organization has been used by the American Automobile Association in connection with the passenger-car interests of the Nation.

Senator COUZENS. Was your organization effected for the purpose of securing legislation, or to promote more of an association and cooperation between the users of cars?

Mr. HENRY. Originally it was established with the avowed intention of promoting the good-roads movement of the country, and was the national organization in this country that got the first Federal-aid bill passed. It was introduced and written by the officials of the American Automobile Association, or, I should say, written by the officials of the American Automobile Association, the original bill that was signed by President Wilson.

Senator BARKLEY. I do not think that statement ought to go into the record unchallenged. The American Automobile Association favored that legislation, but the Good Roads Committee of the House of Representatives framed the bill that was finally passed, and it was amended in the Senate. It may have been on the suggestion of the American Automobile Association, but I do not think it is quite fair to say the bill they presented was passed without dotting an "i" or crossing a "t."

Mr. HENRY. No claim was made to that effect.

Senator BARKLEY. I know the Good Roads Committee of the House of Representatives held exhaustive hearings and rewrote that measure a number of times. It was amended on the floor of the House.

Mr. HENRY. I said we prepared the first bill that was introduced.

Senator BARKLEY. I thought you said you prepared the bill as it was signed by the President.

Mr. HENRY. I did not mean to give that impression.

To answer your question directly, Senator Smoot, the total income of the American Automobile Association for last year was $847,246.77, which was expended in the interest of the motorists of the country. Of that amount $10,000 was received from the National Automobile Chamber of Commerce toward the establishment of a bus division, and none of it was expended by the American Automobile Association in the interest of the passenger-car division of the association.

The CHAIRMAN. That was not my question, but I am glad to have the information.

Senator KING. What do you do with that $800,000 that you collect?

Mr. HENRY. We spend it in the interest of the motorists throughout the Nation. We appear before Federal and State legislatures in the interest of legislation to benefit the motorist; we coordinate the services of our clubs, arrange for the exchange of courtesies to tourists, conduct safety campaigns, publish maps, tour books, and a magazine, and in a collective way do for motorists and their local

motor clubs what they can not do for themselves as individuals or local units.

Senator WALSH. You maintain bureaus of information, do you not?

Mr. HENRY. We maintain bureaus of information in 1,047 cities in the United States. In fact, we have a transportation system. We furnish touring information for our members all over the country.

I do not know what Senator Couzens had in mind. I had not heard any reference that we were subsidized by the National Chamber of Commerce, but there is no truth in it. We are appearing next month before a committee in Congress in direct opposition to the National Automobile Chamber of Commerce. That would certainly answer any such criticism that has been made of the American Automobile Association.

Senator COUZENS. I just stated that there was a witness before us yesterday, representing individual motor-car users, I think from Philadelphia, who stated that some of these associations were subsidized by the manufacturers. We asked him for more specific information, and he hesitated about giving it, and then consented to say that the American Automobile Association was one of the associations that was subsidized by the manufacturers.

Mr. HENRY. If it comes to a question of the American Automobile Association being on trial, we are perfectly willing to introduce any testimony this committee might desire.

Senator KING. You make a categorical denial of that charge, other than the contribution to the bus interests?

Mr. HENRY. Absolutely.

Senator BARKLEY. What is the bill you just referred to, where you expect to appear in opposition to the Automobile Chamber of Commerce?

Mr. HENRY. It is in connection with the regulation of the bus interests of the country.

Mr. Chairman and gentlemen of the committee, I appear before you as president of the American Automobile Association. This is an automobile owners' organization having 1,047 affiliated motor clubs with members in every State in the Union. Our organization is chartered for service, not for profit. We pay no dividends. Our officers draw no salaries, nor receive any form of remuneration for their work for our association.

Our association is supported by dues paid by member clubs. These clubs in turn are supported by the dues paid by their members who are car owners. The national association as well as the local clubs function as units entirely independent of the automobile industry. I want to stress that very strongly. The policies of the local motor clubs are determined by the automobile owners who are members. The policies of the national association are determined by delegates sent to our annual meetings with instructions as to how they shall vote upon questions of general importance. We feel, therefore, in presenting to you the views of our association, that we express the views of the car owners of the country.

Some months ago I appeared before the House Ways and Means Committee to urge that that committee recommend to the House of Representatives that the 3 per cent hang-over war excise tax on passenger automobiles be repealed under the present tax-reduction

program. The committee yielded partially to our request by recommending that the tax be cut to 1½ per cent. After full discussion of the matter in the House, however, that body voted to repeal the tax in its entirety.

When the bill came to your committee, you decided to withhold your recommendations to the Senate until the Treasury Department could more accurately estimate the probable returns on income earned in the calendar year 1927. The Treasury Department has made its report which indicates that there will be no important loss in revenue, but contends that the expenses of the Government will increase to the point where tax reduction must be held within the limit of approximately $200,000,000. The House bill reduces taxes in the amount of $290,000,000 a year.

The CHAIRMAN. That is hardly correct, that there will be no loss in revenue.

Mr. HENRY. At the time they did not contend there would be a loss in revenue. Since that time you will find they have reversed their position.

The question which your honorable committee is facing is whether or not you will recommend to the Senate a cut of $290,000,000 or abide by the Treasury recommendation of a cut of not more than $200,000,000. From our standpoint, the big question involved is the retention or elimination of the automobile tax, which the Treasury Department insists should be retained.

Among the arguments which the Treasury Department has used to justify its position for the retention of the automobile tax are the following:

(*a*) That the movement to repeal the automobile tax is not popular.
(*b*) That the automobile tax should be retained because it furnishes a broad base on which to place a permanent sales tax;
(*c*) That the automobile is a luxury;
(*d*) That the repeal of the automobile tax may result in a deficit in the national revenue; and
(*e*) That Federal aid on roads must be made dependent on the continuation of the automobile tax.

Most of these arguments were specific or implied in statements by Mr. Mills and others for the retention of the tax. Let me take them up in order:

When Mr. Mills made the point that the demand for the repeal of the tax comes from the car manufacturers and not from the car owners, he overlooked the fact that such national bodies representative of owners as the National Grange, the American Farm Bureau Federation, the American Automobile Association, and the United States Chamber of Commerce, have constantly urged the repeal of the tax on the ground that it imposes an unjust burden on one class of citizens and an unjust discrimination on one form of transportation.

As a partial answer to the Treasury's statement that the movement to repeal the automobile tax is not popular, I ask your permission to place in the record a number of telegrams I have received within the past day or two from organizations and persons who, learning that I was to appear before this committee to-day, sent in their views on the matter. I will read two or three of these telegrams, which are typical of the rest of them. I might state there have been over two or three hundred of them.

The CHAIRMAN. I think I have received perhaps more than you have.

Mr. HENRY. I do not doubt that at all, sir.

This is from Senator Fess's home State, the State of Ohio, and is from the president of the State association:

Organized motorists in Ohio wish to voice their plea to the Senate Finance Committee for the early elimination of the war excise tax on automobiles. Automobile owners have already paid over a billion dollars war tax. We strongly oppose retaining this tax.

All these telegrams are practically the same.

Senator WALSH. What reply do you make to those telegrams?

Mr. HENRY. We made no replies to them.

With two exceptions, all of you gentlemen were members of the Senate at the time the 1926 tax reduction bill was considered. After mature deliberation, this committee recommended to the Senate that it vote to retain the 3 per cent tax on passenger automobiles and replace in the revenue bill a 2 per cent tax on automobile truck chassis and bodies above a certain value, the House having already voted to repeal the truck tax. You took that recommendation to the Senate but were overwhelmingly defeated. By a vote of 55 to 12, the Senate rejected the proposal for the reinstatement of the truck tax. Not only that, but the Senate on an amendment offered by Senator King and very ably supported by Senators Simmons, Couzens, Harrison, and Edge of this committee, voted to repeal the 3 per cent tax on passenger cars.

Senator WALSH. Did Senator King do that?

Mr. HENRY. That is in the record.

Now, let me ask you in all frankness what caused the Senate to reject your recommendation and then vote to repeal the automobile tax? Does it stand to reason, gentlemen, that the Senate did so because a majority of the automobile owners were perfectly satisfied to pay the tax and no interest whatever in its repeal? That argument is further borne out by the chairman of this committee, who says he has received a considerably larger number of telegrams than I have received, which would be a very large number.

Senator WALSH. Senator King, during your absence, the statement was made that you offered an amendment in the Senate to repeal the excise tax.

Senator KING. I offered a bill at the last session to repeal the tax.

Senator WALSH. I thought by your argument this morning that you had a different view of it.

Senator KING. I made no argument, Senator. If it should develop I was right then, I might assume a different position. I will not vote for any bill that will create a deficit. So far as taxing automobiles and other articles is concerned, I should do it rather than create a deficit.

Senator WALSH. I think you were right two years ago.

Senator KING. I thought I was right then, and I am not sure that I am right now. If I am convinced that I am right now, I shall reverse the position I took then. These bills are not fixtures. There is nothing static in a tax law.

Senator SHORTRIDGE. Mr. Henry, you realize, do you not, that to take off this tax would create a loss of about $65,000,000 or $66,000,000?

Mr. HENRY. Yes; I do. I had that in mind. And since you have brought up that question, I might also state that the owners of motor cars demand that tax be removed regardless of any other taxation the Senate might consider.

Senator SHORTRIDGE. Whether there be a deficit or no deficit?

Mr. HENRY. I did not say that. The motor car owners have always paid all the taxes necessary to pay, and will continue to pay them, but first of all we insist this is of paramount importance and should come off.

The CHAIRMAN. And so do the admission tax people. I wish it were possible to take them all off.

Senator HARRISON. There is a surplus in the Treasury.

The CHAIRMAN. Yes.

Senator SHORTRIDGE. Due to the economy of the present administration.

Mr. HENRY. The reasons which actuated the Senate two years ago and which are reflected in the position taken by the House in this session are more insistent and compelling to-day than they were at any time since the war excise tax was first placed on automobiles.

A survey conducted by our association recently indicates that automobile taxes are being increased at a terrific rate. It was found that in 1927 State motor vehicle taxes increased three times faster than motor vehicle registrations. I am going to ask your permission to file with the committee a map and detailed tabulation of the figures covered in our survey, which briefly show that 23,238,000 motor vehicles were registered and that motorists paid, in the form of registration fees and gasoline taxes, $552,629,000. During the same period motorists paid $60,555,000 in the Federal excise tax, $15,000,000 in municipal taxes, and $125,000,000 in personal property taxes, making a grand total of $753,184,000.

The facts disclosed by our survey show to a greater extent than ever before the heavy proportion of taxes that the motorists are bearing, and afford a timely warning to the Federal Government to get out of a taxing field which is already over-exploited. In my opinion the figures should clinch the argument for the immediate repeal of the Federal excise tax.

Senator SHORTRIDGE. The increase of city and local municipal and State taxes on automobiles went toward the improvement of highways and streets and roadways.

Mr. HENRY. That is not altogether true, sir.

Senator SHORTRIDGE. The greater percentage of it.

Mr. HENRY. Texas has taken 1 per cent of its tax for the school program. Georgia has retired some railroad bonds with it, and Lord knows what has happened in other States. Some of it goes into the general fund.

Senator BARKLEY. The ad valorem tax on automobiles goes into the general fund. I think only the license tax and gasoline tax goes to the support of roads.

Mr. HENRY. We have insisted that all gasoline taxes must be expended on roads. In most States we have been successful.

I am told that a few Senators are not sure how they will stand on the automobile-tax question because they have not received a sufficiently large number of requests from individual car owners to convince them that their constituents want the automobile tax re-

pealed. I should like to ask those who have put the question in this way whether or not they voted for or against decreases in the rates of income tax and increased personal exemptions on the basis of requests from individuals. When they voted to take the war excise tax off of diamond rings, silk stockings, fur coats, and other articles of personal adornment, did they do so only after a deluge of personal requests? I dare say that neither they nor you had many direct requests, but you recognized the desire of the people of this country to get rid of permanent sales taxes. You yielded to the apparent national demand and did not wait until your file cabinets bursted with stereotyped letters signed by individuals. You thought first of the principle involved, and have consistently applied the principle that there should not be a permanent sales tax to the point that the taxes imposed during the war may be found on only two manufactured products, namely, automobiles and pistols. It is indeed humiliating that the motor-car owners of this country must be thrown into the same bull pen with gunmen.

The specious reasoning of the Treasury Department with respect to the classification of the automobile as a luxury and the recommendation that it be made the object of a permanent sales tax because it is spread over a broad base, indicates to me that the department will avail itself of any excuse it finds for denying relief to motor-car purchasers. Only a few years ago the department insisted that because the automobile was a luxury the tax should be retained. Later the vehicle evolved into a semi-luxury. When the ridiculous nature of this argument was brought home, the Treasury sought new reasons why the tax should be retained and to-day argues against repeal on the ground that the tax has a "broad base."

Before discussing the "broad base" that the automobile tax affords, I want to read to you gentlemen a paragraph from a letter sent by one of your colleagues on the committee to the president of one of our important State motoring organizations. I would ask that you note particularly his description of the automobile when he says:

> I realize the general desire for the repeal of the tax on pleasure automobiles, yet I thing that Congress did pretty well in 1926 in repealing the tax on trucks and reducing the pleasure automobile tax from 5 per cent to 3 per cent. If it is possible to abolish it entirely this year, I shall be very happy.

It is hardly conceivable that a member of your committee, a United States Senator, will at this stage of the development of automotive transportation in this country, sponsor the retention of this tax on the ground that it is a tax on pleasure vehicles. To hold such a view he must shut his eyes on progress and refuse to recognize the fact that 5,000,000 automobiles are owned by farmers, that 90 per cent of all passenger cars are used more or less for business purposes, that nearly 200,000 automobiles are used constantly by doctors, that hundreds of thousands of suburban residents are wholly dependent on their passenger automobiles for transportation, and that automobiles travel seven times as many passenger-miles as do steam passenger trains.

With respect to the distribution to the Federal-automobile tax over a broad base, I concede that the tax falls upon a large number of persons, but I do not concede that more people are reached by the automobile tax than would be reached by the continuation of the

tax on railroads, telegraph, and telephone companies and innumerable manufactured articles. Would not such products as cameras, toilet soap, carpets, rugs, trunks, traveling bags, purses, men's and women's hats, shoes, neckties, silk socks and stockings, shirts, underwear, pajamas, petticoats, perfumes, and a myriad of pills and tablets form bases of taxation broader than the 4,000,000 passenger cars now sold annually? If it is necessary to tax transportation or to put a sales tax on manufactured products would it not be more equitable to place a general sales tax, or a general transportation tax, on one and all alike and not single out the motor-car purchasers as the objects of special and unwarranted discrimination? The relief heretofore given those who paid war taxes on transportation and manufactured products, has had the full approval of the Treasury Department. Why the Treasury has not prior to this time insisted that the Federal-tax system be spread over a broad base, is one of the puzzling questions that remains unanswered. Is broad base the real reason for its insistence in this tax, or is the Treasury actuated by such motives as were reflected by Mr. Mellon when in his testimony before the House Ways and Means Committee he said, "the automobile is one of the railroads chief competitors."

Senator SHORTRIDGE. That was true, was it not?

Mr. HENRY. That they are competitors?

Senator SHORTRIDGE. Yes.

Mr. HENRY. Yes: but why is it the province of the Secretary of the Treasury to bring that forward?

Senator SHORTRIDGE. I am not talking about his position, but that was and is a fact.

Mr. HENRY. If it is a fact, then let the railroads be the first to ask for relief. The Treasury Department has no business bringing it forward.

The motoring organizations of this country are fully aware of the devious and subtle methods that have been employed by the Treasury Department in this session of Congress to confuse the issue before you and defeat the large demands of motor-car owners for tax relief. We resent most emphatically the veiled threat that has been passed on to us through official channels that unless we surrender arms in this fight the country will run the risk of losing Federal-aid appropriations for good roads.

The methods that have been employed to confuse the issues of tax repeal and the continuation of Federal aid are, in my opinion, positively ridiculous. Federal aid is an established policy of this Government and there is no reason whatever why the issues of tax repeal and Federal aid should not be considered upon their individual merits and as distinct policies. It is ludicrous that the Budget Bureau, or any other administrative or executive agency of this Government, should be permitted to dictate the policy that Congress shall pursue with reference to the continuation of road appropriations.

Senator SHORTRIDGE. Nobody is dictating. Pardon me. I do not want to interrupt you.

Mr. HENRY. That is all right.

Senator SHORTRIDGE. You are imputing to the Treasury Department the motive of dictation.

Mr. HENRY. But the statement came baldly from the Director of the Budget that the President of the United States was going to see to it that Federal aid was discontinued if this tax was taken off; and that is what we resent.

Senator SHORTRIDGE. He might have suggested that it might become necessary.

Senator WALSH. The Treasury Department was pretty severe in its statements.

Senator SHORTRIDGE. I understand, but the Government must have revenue. I suppose the thought is that unless they get the revenue certain appropriations can not be made.

Senator BARKLEY. That is a matter for Congress to determine.

Senator SHORTRIDGE. Yes.

Senator KING. Being a Democrat and at time a rather severe critic of the administration, I want to advise you that under the law it is the duty of the Budget Bureau to make recommendations to Congress and to outline to Congress their plan to meet the expenses of the operation of the Government, and they come here and submit a message to Congress and submit their Budget. The President and the Budget Bureau have a right to make recommendations. That is not dictating to Congress. It is their duty to do it. They prepare a budget and Congress may or may not approve of their recommendations. So I do not think you are warranted in your criticism of the President because of the recommendations which he may make—the financial policy which he may advocate. He would be derelict in his duty if he did not prepare the Budget and submit it to Congress.

Mr. HENRY. If you will let me finish the sentence, it will probably cover your objection.

Senator WALSH. It is not the duty of the Budget Bureau to tell Congress what tax to repeal.

Senator KING. The President has a right to make recommendations.

Senator WALSH. I am speaking of the Budget.

Mr. HENRY. In the opinion of laymen it is silly that these agencies should be permitted to object to beneficial legislation by passing down the line the word that it would be inconsistent with the administration's financial policy to continue the Federal road appropriations if the excise tax should be repealed. I do not believe the veiled threat made has had the desired effect upon Members of Congress.

The CHAIRMAN. It is not a threat. In every single solitary bill sent down there for a report, if it is objected to on the ground that the revenues of the Government will not permit it, those identical words are used. Not on this bill alone, but every bill that is sent to them, even small claims of $1,500 or $1,000 or any amount. I think you are taking the wrong attitude in saying that is a threat.

Senator HARRISON. The language speaks for itself. It was a threat. They were using the big stick.

The CHAIRMAN. It is not a threat at all.

Mr. HENRY. The statement of the Treasury Department speaks for itself.

Senator SHORTRIDGE. I never understood it to be a threat.

Senator HARRISON. You do not accept it as that.

Senator SHORTRIDGE. If it were a threat, it would not affect me or frighten me in any way.

Senator HARRISON. Of course not.

Senator CURTIS. Mr. Chairman, can we not go on with this hearing and get rid of it? These side remarks do not help out.

The CHAIRMAN. Proceed with your statement, Mr. Henry.

Mr. HENRY. In presenting its story to you, the Treasury Department has emphasized the danger of a deficit in the national revenue. We would be the last people to appear before your committee who would recommend that any such danger be incurred, but in touching upon the matter I humbly submit that the former estimates of the Treasury Department do not inspire any large amount of confidence on the part of the American taxpayer in the accuracy of the Treasury Department's statement that $200,000,000 is the limit within which taxes may be safely reduced. In this connection, I would call your special attention to the recent hearings on revenue revision before the House Ways and Means Committee in which an illuminating analysis of the Treasury's errors in estimating probable surplus was made by one who is universally recognized as one of the ablest financial experts in the United States to-day, namely, Representative Garner, of Texas. On pages 30 and 31 of the hearings, you will find an unchallenged statement made by Congressman Garner in Mr. Mellon's presence to the effect that, since 1924, the total error made by the Treasury in estimating the probable surplus of Federal income amounted to $981,000,000. If we may base our judgment on the past experience with Treasury estimates, it seems reasonable that the surplus for 1929 and succeeding years will be a great deal larger than the Treasury is willing to admit.

In conclusion, gentlemen of the committee, I respectfully submit that you should approach the question of the immediate repeal of this tax with a most sympathetic attitude and for the following urgent reasons:

First. The automobile tax has yielded a total revenue of more than $1,100,000,000, every cent of it borne by the consumers.

Second. The automobile tax is a special war excise tax, levied to meet the emergency expenses incident to our participation in the World War.

Third. The automobile tax discriminates grossly against the purchasers of new automobiles.

Fourth. The automobile tax is in principle a transportation tax, and to retain it when all other transportation taxes have been repealed is a further mark of discrimination.

Fifth. The automobile furnishes no broader basis for a permanent excise tax than do many other products and commodities of a less essential nature.

Sixth. The automobile tax, based on new-car purchases, does not distribute the annual burden of Federal taxation equitably among all motor-car owners.

Seventh. The automobile tax is not comparable with any other tax now levied by the Federal Government except the tax on pis-

tols, because these are the only special war-excise taxes now remaining.

Eighth. The automobile tax is a needless supersurtax on a class of citizens who are now paying more than a fair share of State and local taxes.

Ninth. The automobile tax is not needed at this time as a means of raising revenue for the Federal Government.

Tenth. The automobile tax is a war-time levy and should be repealed as a major item in the present tax-reduction program.

In this connection, before leaving, I wish to say that the automobile owners, as I said before, think they are entitled to the repeal of this tax, regardless of the reduction of any other form of taxation this committee might recommend.

Senator KING. May I ask you one question?

Mr. HENRY. Yes, sir.

Senator KING. This is with reference to the question propounded to you by Senator Couzens about the subsidy. Your organization publishes a magazine?

Mr. HENRY. Yes, sir.

Senator KING. And you carry advertisements in that magazine at a very great cost to the advertisers, and the manufacturers pay you a good many thousand dollars annually for advertising?

Mr. HENRY. If the manufacturers think the medium is a proper exploiting of their wares, they buy the space at a very reasonable rate per page.

Senator KING. But they do?

Mr. HENRY. They buy it.

Senator KING. How much do you receive from the manufacturers?

Mr. HENRY. I could not answer that question. There are probably 20 pages of advertising from different manufacturers in the American Motorist and probably less than 20 per cent is from automobile manufacturers.

Senator KING. Your receipts are between $50,000 and $60,000 a year, are they not?

Mr. HENRY. I imagine that would be a fair estimate.

Senator HARRISON. What is the circulation of the American Motorist?

Mr. HENRY. About 150,000.

Senator SHORTRIDGE. You think the repeal of this tax would inure to the benefit of the purchasers of automobiles, do you?

Mr. HENRY. Absolutely.

Senator SHORTRIDGE. Do you think the manufacturers would bring that about?

Senator WALSH. Senator, that was all gone over before you came in. They have agreed to take that off.

Senator SHORTRIDGE. They have agreed to?

Senator WALSH. Yes.

Senator SHORTRIDGE. Agreed with whom?

Senator WALSH. As they did when we reduced it from 5 to 3 per cent.

Senator SHORTRIDGE. I heard what was presented yesterday. Senator Reed submitted some figures.

Senator WALSH. We spent a long time on it this morning. It is in the record.

The CHAIRMAN. It is in the record of this morning.

Senator SHORTRIDGE. Of course, I assume that was their theory in supporting the argument.

The CHAIRMAN. Yes.

Motor vehicle registrations, registration receipts, and gasoline-tax collections, by States, for the calendar year 1927

State	Total motor vehicles registered	Total receipts from registration and gasoline tax [1]	Average tax per motor vehicle [1]
Alabama	241,984	$8,368,510.90	$34.58
Arizona	81,047	1,881,675.02	23.21
Arkansas	206,568	8,001,008.28	39.21
California	1,693,195	28,622,523.22	16.90
Colorado	268,026	4,758,031.53	17.75
Connecticut	282,264	[2] 9,805,000.00	34.73
Delaware	46,797	1,500,518.69	32.06
Florida	397,360	16,672,713.52	41.95
Georgia	500,507	11,683,258.97	38.84
Idaho	102,546	3,163,156.38	30.84
Illinois	1,438,985	21,008,792.64	14.53
Indiana	812,594	15,450,447.94	19.03
Iowa	702,401	17,620,069.21	25.08
Kansas	701,901	10,622,577.00	19.96
Kentucky	285,099	9,612,818.08	33.71
Louisiana	255,000	[2] 7,230,341.00	28.35
Maine	158,438	4,545,857.02	28.68
Maryland	271,145	7,157,308.65	26.39
Massachusetts	821,107	12,689,745.47	15.45
Michigan	11,156,344	31,025,367.12	26.83
Minnesota	636,682	15,415,268.48	23.83
Mississippi	227,103	6,904,702.63	30.40
Missouri	682,419	14,487,278.44	21.21
Montana	112,201	2,553,631.00	22.67
Nebraska	373,912	7,376,807.75	19.73
Nevada	25,776	696,911.67	27.03
New Hampshire	156,600	[2] 2,900,000.00	30.20
New Jersey	720,408	17,061,726.10	23.68
New Mexico	60,345	1,913,094.33	31.70
New York	[1] 1,889,429	[1] 31,742,545.47	16.71
North Carolina	[1] 431,282	[1] 14,786,682.39	34.28
North Dakota	100,701	[2] 2,845,442.35	17.70
Ohio	1,570,118	30,540,991.99	19.44
Oklahoma	484,771	12,947,849.71	26.70
Oregon	245,705	10,187,877.03	41.46
Pennsylvania	1,583,763	42,212,552.92	27.28
Rhode Island	117,186	2,937,372.95	25.06
South Carolina	199,629	[2] 7,139,936.59	35.76
South Dakota	169,552	4,564,126.00	26.91
Tennessee	294,767	8,171,711.97	27.74
Texas	1,115,869	30,215,000.00	27.07
Utah	93,974	2,119,316.02	22.55
Vermont	79,413	2,784,194.03	35.05
Virginia	326,187	12,375,650.13	37.93
Washington	384,583	9,886,535.50	25.45
West Virginia	237,210	7,641,569.38	32.21
Wisconsin	698,399	15,736,552.86	22.53
Wyoming	52,222	1,278,169.01	24.47
District of Columbia	125,289	1,368,591.02	10.92
Total	23,238,332	552,629,828.16	23.78

[1] This column includes only gasoline taxes and registration receipts. It does not include Federal or personal-property taxes.

[2] Approximated.

Automobile registrations, registration fees, etc., and total receipts from gasoline taxes (less refunds), 1927

State	Number of passenger cars registered	Number of trucks registered	Total receipts from motor vehicle registration fees, licenses, and permits	Total receipts from gasoline taxes (less refunds, etc.)
Alabama	219,078	31,906	$2,735,170.32	$5,633,340.53
Arizona	70,639	10,408	492,845.12	1,388,829.90
Arkansas	174,524	32,044	3,662,271.76	4,338,736.52
California	1,479,411	213,784	8,796,347.68	19,826,175.54
Colorado	245,798	22,288	1,639,657.92	3,118,373.51
Connecticut	238,643	43,620	[1] 6,805,000.00	[1] 3,000,000.00
Delaware	38,057	8,760	846,289.00	654,229.69
Florida	335,693	61,697	5,692,128.02	10,980,585.50
Georgia	262,502	38,005	3,712,978.42	7,970,280.55
Idaho	91,779	10,767	1,404,099.32	1,669,057.06
Illinois	1,254,121	184,504	14,829,593.29	6,168,099.35
Indiana	696,457	116,137	5,430,805.64	10,039,642.30
Iowa	648,083	54,318	10,371,698.77	7,248,370.44
Kansas	447,273	54,628	4,990,192.60	5,032,385.00
Kentucky	255,370	29,729	4,316,848.77	5,295,969.31
Louisiana	[1] 216,000	[1] 39,000	[1] 4,125,000.00	[1] 3,105,341.00
Maine	132,824	25,614	2,529,654.12	[1] 2,016,202.90
Maryland	260,158	10,987	2,987,911.69	[1] 4,169,396.96
Massachusetts	724,359	96,748	12,689,315.47	----------
Michigan	999,915	156,429	16,866,996.06	14,158,371.06
Minnesota	565,401	81,281	10,240,388.77	5,174,879.71
Mississippi	204,362	22,710	2,160,060.00	4,744,702.63
Missouri	610,303	72,116	8,272,346.25	6,234,902.19
Montana	94,290	17,911	1,143,337.00	1,410,294.00
Nebraska	342,377	31,555	3,749,552.84	3,636,254.71
Nevada	20,414	5,362	229,769.27	467,142.40
New Hampshire	84,009	12,090	[1] 1,009,000.00	[1] 1,300,000.00
New Jersey	595,644	125,364	12,963,540.72	4,097,985.38
New Mexico	58,697	1,648	528,193.02	1,384,901.31
New York	[1] 1,578,625	[1] 320,801	[1] 31,743,545.47	----------
North Carolina	[1] 391,123	[1] 40,159	[1] 6,000,000.00	[1] 8,786,682.39
North Dakota	144,830	15,871	1,595,442.35	[1] 1,250,000.00
Ohio	1,372,621	197,797	10,646,226.99	19,894,675.00
Oklahoma	437,776	46,995	5,719,849.71	7,197,000.00
Oregon	221,715	20,990	6,527,310.93	3,660,536.10
Pennsylvania	1,365,826	217,937	25,916,220.45	17,296,332.47
Rhode Island	98,332	18,754	2,021,394.04	915,958.91
South Carolina	179,568	29,061	2,115,421.75	[1] 5,024,514.84
South Dakota	153,019	16,533	2,491,981.60	2,072,145.00
Tennessee	269,046	25,481	3,765,775.33	4,405,936.64
Texas	1,001,153	114,746	15,655,009.00	14,590,000.00
Utah	80,730	13,214	672,408.35	1,446,912.67
Vermont	73,194	6,219	1,878,949.90	905,244.13
Virginia	286,341	39,853	5,235,953.21	7,139,706.92
Washington	326,667	57,916	6,092,837.59	3,803,697.91
West Virginia	269,281	27,929	3,967,211.68	3,671,357.70
Wisconsin	629,995	88,494	9,736,532.86	6,000,000.00
Wyoming	45,805	6,416	525,806.75	752,362.26
District of Columbia	111,636	14,253	310,741.00	1,057,850.02
Total	20,316,500	2,921,832	298,520,595.65	234,109,262.51

[1] Approximated.

STATEMENT OF ROY D. CHAPIN, PRESIDENT OF THE NATIONAL AUTOMOBILE CHAMBER OF COMMERCE

The CHAIRMAN. You may state your name and occupation.

Mr. CHAPIN. My name is Roy D. Chapin. I am president of the National Automobile Chamber of Commerce, and I appear before you at the request of its board of directors, to present the unanimous petition of the motor-car manufacturers of America for a repeal of the remaining motor vehicle excise taxes. I also represent, at their request, the rubber industry, the Motor and Accessory Manufacturers, and the Automotive Equipment Association. Their particular interest in this situation is that whereas two years ago you saw

fit to remove completely the tax on tires and parts, at the same time to-day they are paying that tax, because every tire and every part that goes into a new car has to pay a 3 per cent tax in the final sale of the car. So you have not yet completely removed the tax.

The CHAIRMAN. Who pays the tax?

Mr. CHAPIN. They pay it through us.

The CHAIRMAN. You pay the 3 per cent. The amount they bill you is for the parts and the rubber. That is all. You pay a tax on it, but they pay no tax.

Mr. CHAPIN. They pay no tax, but it is still charged.

The CHAIRMAN. You both paid it before.

Mr. CHAPIN. The public still pays it.

The CHAIRMAN. That is what I mean.

Mr. CHAPIN. I should like first to answer the question that was asked of the last witness, whether or not the manufacturers charge the excise tax on their invoices.

Every manufacturer in America charges an excise tax of 3 per cent on his invoice, and it is passed on.

Senator HARRISON. Do they charge more than they actually pay? It was charged here by one of the officials of the Treasury Department that one concern paid erroneously around $20,000,000.

Senator COUZENS. I think the Senator is in error. He was speaking in respect to the freight.

Senator HARRISON. The service charge.

Senator COUZENS. Yes.

Senator HARRISON. Do they do that in the service charge? Do they collect that much erroneously?

Mr. CHAPIN. I do not think any erroneous charges are made.

Senator HARRISON. Do they charge more than they actually have to pay out?

Mr. CHAPIN. The tax of 3 per cent is always charged, and the dealer himself, not the manufacturer, but the dealer, charges in addition a handling charge and freight for delivery of a motor car, which is a portion of his cost of selling.

Senator MCLEAN. Do they charge more for freight than the freight costs?

Mr. CHAPIN. As far as I know, Senator, that is not done by anybody.

The CHAIRMAN. Now, you are speaking of the dealer. Senator Harrison has reference to the manufacturer billing cars f. o. b. Detroit and then charging freight, whatever it may be. If it is to Salt Lake City, they would charge the freight rate from Detroit to Salt Lake City. And if it were assembled in Ogden and shipped down from Ogden to Salt Lake—I do not say it is—but if it were, they charge the full freight from Detroit to Salt Lake City just the same.

Mr. CHAPIN. You are getting to the question of assembling, which is a question for the dealers. The dealers themselves will be represented here this morning to discuss what charges they put on.

The CHAIRMAN. You know whether the manufacturer does it or not, do you not?

Mr. CHAPIN. The manufacturer charges first the tax, which appears definitely on his invoice. He does not charge the freight,

except in instances where he himself pays the freight because he has an assembling plant. There are very few of these.

The CHAIRMAN. They sell all the automobiles f. o. b. Detroit, do they not?

Mr. CHAPIN. Yes, sir. All advertising carries the statement that it is f. o. b. Detroit, f. o. b. Kenosha, f. o. b. Indianapolis, f. o. b. Cleveland, or wherever it may be manufactured.

The CHAIRMAN. Then the amount of freight that would be paid from Detroit on a car is charged as a part of the cost of that car?

Mr. CHAPIN. Always.

The CHAIRMAN. Always?

Mr. CHAPIN. Always; by all dealers.

The CHAIRMAN. By all dealers and by all manufacturers?

Mr. CHAPIN. The manufacturer himself does not pay the freight.

The CHAIRMAN. I do not say he does, but does he charge it?

Mr. CHAPIN. No. he does not charge it; the dealer charges it.

The CHAIRMAN. He charges that amount on the cost of the car, does he not?

Mr. CHAPIN. No, sir. The dealer pays the freight at his end. The manufacturer does not pay it.

Senator COUZENS. I think I may clear the matter up, if you will permit me.

The CHAIRMAN. Certainly.

Senator COUZENS. The Hudson Motor Car Co., for example, has nothing to do with the freight. They assemble all their cars. Is that correct?

Mr. CHAPIN. Yes, sir.

Senator COUZENS. They have no interest in the freight. The dealer pays the freight and fixes the freight charge. In the case of the Chevrolet or some of the General Motors cars or the Ford Motor Co., they ship from the manufacturing plant to their assembling plants. For instance, to serve Washington they have an assembling plant at Kearny, N. J., and Chester, Pa. Any man who buys a car in Washington may go to one of these plants and drive his car to Washington. He then charges, as in the case of the invoice I showed the chairman this morning, a freight charge which would have been, as I understand it, the freight charge if it had been shipped direct by rail all the way from Detroit to Washington.

The CHAIRMAN. That is right.

Senator COUZENS. But that only applies to those concerns that have assembling plants in various parts of the country, and does not apply to any of the rest of the industry, such as the Packard, the Hudson, the Essex, or any other company that has no assembling plant.

Senator REED of Pennsylvania. The fact remains that they charge freight they do not pay.

Senator COUZENS. They charge freight they do not pay the railroads. If you have a plant that costs $2,000,000 a year in Chester, and another plant in Kearny at $2,000,000 those have to be compensated for.

Senator REED of Pennsylvania. Of course.

Senator COUZENS. That is the reason they charge the consumer in Washington the freight as though it had been shipped direct from

Detroit to Washington. Otherwise, all the cost of maintaining these assembling plants would have to be added to the price. The man in Washington pays the same as the man in Detroit who has no freight charge.

Mr. CHAPIN. I might say that if it were more profitable to assemble all over the country, my own company would have these plants. The reason we do not have any is because of the additional cost of manufacture outside of our own factory.

The CHAIRMAN. If the statement is true as to your particular business, it certainly is not true as to Ford. The statement shows that he made on that plan of selling f. o. b. Detroit some $24,000,000 a year. His assembling plants certainly did not cost him that amount of money.

Senator COUZENS. That has nothing to do with this legislatiton.

The CHAIRMAN. It has something to do with whether the tax is taken off or not.

Senator REED of Pennsylvania. It has something to do with the ultimate consumer getting the benefit of a reduction.

The CHAIRMAN. Yes.

Senator REED of Pennsylvania. A typical case is that of the Packard Motor Co., of New York, which sold their model 443, 8, sedan, f. o. b. Detroit, for $3,750. The quotation of dealers in New York is $3,984, the addition of $234 being divided as follows: Tax, $78.75; extra tire and tube, $54.50; transportation, $100.75. In checking up the records of that company, the actual cost of transportation of that car from Detroit to New York was $61. The company has profited to the extent of $39.75 in freight charges, even if they brought the car from Detroit to New York, and if they assembled it in New York, presumably they made a further saving.

Now, if that is they way they construct their bills, what chance has the ultimate purchaser of the car got to have any advantage of any reduction in this tax?

Mr. CHAPIN. I will answer that immediately. As I say, the industry is unanimous, and that includes the Ford Co., which does not happen to be a member of our organization, in the statement that the minute this tax bill is signed taking off the automobile tax just that moment throughout the United States the delivered prices of all motor cars will be reduced by the amount of the tax.

Senator KING. But they have been reduced during the past year, according to the advertisements, without any diminution in the tax.

Mr. CHAPIN. I am talking about the dealers' prices. The list price on motor cars in all advertising is given as f. o. b. the factory.

Senator KING. Because of the keen competition greater reductions have been promised. Have not some of these reductions been promised regardless of the tax, and will they not be made whether there is any tax or not?

Mr. CHAPIN. That is purely a competitive situation. I presume my own company has had as much to do with price-cutting as any company. We have always lowered the price at every opportunity, and have done it intentionally, because we believed it good business.

Senator REED of Pennsylvania. Is the Armleder Motor Co., of Cincinnati, a member of your association?

Mr. CHAPIN. No, sir.

Senator REED of Pennsylvania. They manufacture trucks?

Mr. CHAPIN. I believe they do.

Senator REED of Pennsylvania. It is reported to me that prior to the repeal of the tax on trucks in the 1926 act their quoted price was $3,000 plus $90 for tax; that immediately after the tax was repealed their quotation on the same truck was raised to $3,090 f. o. b. Cincinnati. Do you know of many cases like that?

Mr. CHAPIN. There are practically no cases like that, but you must take this for granted: That the cost of manufacturing of motor cars will sometimes go up and down with individual companies.

Senator REED of Pennsylvania. The coincidence in this case is that it went up the amount of the tax two days after the tax was repealed.

Mr. CHAPIN. They evidently found they could not make money.

Senator REED of Pennsylvania. It has been suggested that they figured the purchaser had always paid $3,090, and would be willing to do it in the future.

Mr. CHAPIN. All companies raise and lower their prices without reference to any other company. If there is any one thing that proves there is no combination in restraint of trade in the motor industry it is the variation in prices. On the very day some companies will lower prices other companies will raise prices.

Senator EDGE. Let me see if I get this correctly. Do I understand that, should the tax be eliminated entirely or in part, immediately upon that becoming a law all the motor companies in this association will publicly announce that their present prices for cars, f. o. b. the place of manufacture, plus, of course, the freight rate from that place of manufacture to point of delivery, will be reduced in an amount equivalent to the amount of the lowered tax?

Mr. CHAPIN. Not the list prices. These never include the war tax. All advertising states that the war tax is extra. I refer to the dealer's price.

Senator EDGE. When you say the "list price," that is the price that is advertised, is it not?

Mr. CHAPIN. The f. o. b. Detroit price, which does not include the war tax, as you will notice. I want to make that very plain. We do not try to deceive anybody. We always make it evident in our advertising that the buyer of the car pays that tax, and he would anyway. He pays all taxes in the cost of anything he buys. He has to. Our method of operation would be this: The minute this bill is signed taking this tax off, every manufacturer will get in touch with his distributing organization and dealers throughout the country, and the dealer's price will be lowered by the amount of the tax.

I can say very frankly that we have a precedent for this. Two years ago you reduced the tax on passenger cars from 5 to 3 per cent. That was made effective not on the date of the passage of the bill, but was made effective a month after the signature of the bill. What was the result? The result was a tremendous hardship upon the automobile industry, because business almost stopped. Almost every manufacturer in the business out of his own treasury contributed the amount of the tax for that month, and instructed the dealers to reduce the car by the amount of the tax immediately and

not wait the full month. I do not know how much money it cost the industry, but it was a great deal.

The CHAIRMAN. I would like to see all the excise taxes removed from this bill, there is no doubt about that, but evidently from the amount we can reduce the tax that can not be done. It is the duty of the committee to decide what is best to be done to relieve those who are the most needy, and, therefore, we want to hear you on that point, as well as others who pay the excise tax.

Senator McLEAN. Before you leave the point you were just discussing, suppose the tax is $50. If we should repeal that tax you would not charge it? Naturally, you would not add the tax?

Mr. CHAPIN. We could not.

Senator McLEAN. But do you propose to reduce the price another $50?

Mr. CHAPIN. No, sir. The dealer's price on the car, which includes that $50, would be lowered $50.

Senator McLEAN. Naturally, you would not charge the tax after the law is repealed.

Mr. CHAPIN. No, sir. I understand that point has been brought up, and I want to make it clear that that will automatically come off the day that law is signed removing this tax.

Senator EDGE. Your list price does not now include the tax, does it?

Mr. CHAPIN. It never has, and we make that clear to the public.

Senator HARRISON. That is a charge that could not be made against any of the automobile manufacturers except those that have the assembling plants. Is that not true?

Mr. CHAPIN. Yes, sir. My own answer to that would be the fact that while we are probably the third or fourth largest manufacturer in the world, we have no assembling plant in this country.

Senator HARRISON. How many companies have assembling plants?

Mr. CHAPIN. I think not over two, possibly three.

Senator HARRISON. General Motors, and Ford, and what other concerns?

Mr. CHAPIN. No other one that I know of.

The CHAIRMAN. Do not the Packard people have them?

Mr. CHAPIN. No, sir.

Senator HARRISON. If there is anything in the charge, it could only be charged against those two concerns?

Mr. CHAPIN. As far as I know, Ford and Cheverolet are the only two manufacturers, making the lowest priced cars in the greatest quantity, who have found they can afford to run assembling plants.

Senator HARRISON. Is Ford or General Motors represented here?

Mr. CHAPIN. General Motors is.

Senator WALSH. Of course, they have to pay freight charges on the parts shipped from the central factory to the assembling plant.

Mr. CHAPIN. Yes, sir. And the cost of manufacture, when you get into a small assembling plant, is very much greater than in the case of your own plant, where you will turn out 1,500 or 2,000 or more cars a day. It is no fun running an assembling plant. I can state that. They simply do this: They do help business in the particular section in which they are located. We would all like to have them, but we can not profitably operate them.

Senator McLEAN. Just how do they help the industry?

Mr. CHAPIN. They give a good deal of employment to the particular section in which they are located. They buy quite a lot of materials.

The CHAIRMAN. Can you express the view of the automobile association in this respect: Would you prefer the 3 per cent tax to be taken off from automobiles entirely, and if that be done, one-half of 1 per cent increase over what we intended to increase the corporation tax?

Mr. CHAPIN. I can answer that very readily. We talked to President Coolidge some time this last fall. The President asked us that very question, and our answer was this, as given by Mr. Erskine, president of the Studebaker Co., and the industry will stand back of it. His answer was that our first interest is for the purchaser of our own product. We believe he is entitled to every protection we can give him, and I think the reputation of the motor industry is pretty good with the people for being fair with them and giving them the lowest possible price on our product. We feel that primarily the motor tax should be removed, and we believe also you are going to find it possible to lower the corporation tax.

The CHAIRMAN. That is not what I asked you. Which would you prefer?

Mr. CHAPIN. We prefer the elimination of the motor tax.

Senator EDGE. The elimination of the motor tax?

Mr. CHAPIN. Yes, sir.

Senator KING. And an increase in the corporation tax?

Mr. CHAPIN. That is the province of you gentlemen.

Senator KING. If the alternative should be presented to you, you would prefer the elimination of the motor tax?

Mr. CHAPIN. For the benefit of 22,000,000 car owners in this country; yes, sir.

Senator KING. Let me ask you one question in the light of the suggestion made by Senator Reed. Do you think the manufacturers have been absolutely accurate in the charges which they have made for freight? The case to which Senator Reed called attention indicates that they have billed the purchaser thirty-odd dollars more for freight charges than they actually paid.

Mr. CHAPIN. The answer to that is that the bill for transportation charges included what is known as handling, which includes the expense of taking the car out and putting it in shape for delivery. There is a customary charge for this by every dealer in the United States.

Senator KING. What is that average charge for so-called handling and service?

Mr. CHAPIN. I have no idea. It would probably vary from $6 to $30 or $40, depending on the size of the car.

Senator KING. Can you conceive of a charge of $40 for a so-called service and handling that is legitimate and honest?

Mr. CHAPIN. Well, Senator, my best answer to you is that the competition in the automobile business is very keen, and if there is anything in the world that every dealer and every manufacturer is vitally concerned in, it is delivering their cars at the lowest

possible price which will permit them to keep business going steadily.

Senator KING. Competition is not so great or keen as to materially affect the earnings of General Motors and Mr. Ford and perhaps others. Their earnings were stupendous, almost greater than any industry in the United States. If competition is so keen as you have indicated, how do you account for the enormous earnings of those companies?

Mr. CHAPIN. I do not think Mr. Ford has made any statement of his past year's earnings.

Senator KING. Well, you know the situation of Mr. Ford. I do not think that is a fair answer to my question. You do not mean to say Mr. Ford's earnings in the past have not been great, do you?

Mr. CHAPIN. I am speaking of the past year.

Senator KING. But eliminating the past year, when he was changing the tin lizzie to a superior kind of car, what do you say?

Mr. CHAPIN. He went through the same trouble that every manufacturer has gone through. There is no guarantee that any one car is going to be successful year after year, and if you go back through the history of the automobile business you will find the mortalities among the manufacturers have been as great as those in any other industry. There is no reasonable presumption that any company will make money year after year. The only reason the so-called stupendous earnings that you mentioned have come about is because of the tremendous volume this industry enjoys, due to the fact that the manufacturers everywhere in the country have adopted methods of manufacturing that have been copied more than any other industry's methods, not only in this country, but throughout the world.

Senator KING. You do not mean to deny that the automobile industry in the United States has made enormous profits, do you?

Mr. CHAPIN. I think it has, and it is quite entitled to them, because it has shown the way to all industries as to a better method of manufacturing. If you will divide the total profits of any company by the number of cars turned out I do not think you would criticize their earnings in any instance.

Senator KING. I do criticize the enormous profits that some have made.

Mr. CHAPIN. If you divide it by the total number of cars, you will find it is not very much.

Senator KING. What were the earnings of General Motors this last year?

Mr. CHAPIN. I could not say.

Senator HARRISON. The question was asked you whether or not, if you had to determine whether you would get an elimination of the tax on automobiles or take a reduction in the corporation tax, and your answer was that first you would take the deduction in the tax on automobiles.

Mr. CHAPIN. Yes, sir.

Senator HARRISON. And then take as much reduction as you could get in the corporation tax?

Mr. CHAPIN. Yes, sir.

Senator HARRISON. To eliminate the tax on automobiles it would amount to about $66,000,000, would it not?

Mr. CHAPIN. Just about that amount.

Senator HARRISON. Under the estimate of the Treasury you would still have about $124,000,000 to reduce the corporation tax and some other tax, would you not?

Mr. CHAPIN. Yes, sir; under their present figures, I believe.

Senator BARKLEY. If the Treasury's figures are wrong again, we might reduce the corporation tax still more.

Mr. CHAPIN. Every time there has been a reduction of war-time taxes the representatives of our industry have come before committees of Congress in opposition to the motor excise tax. The record of these hearings constitute a complete discussion of the issues. This is particularly true of the appearance made by Mr. George M. Graham, at the hearings before the Ways and Means Committee of the House of Representatives, on November 7, 1927. As a matter of saving your time, I would suggest now that your committee can obtain a clear view of the whole question by reference to the printed report of those proceedings. Mr. Graham made a complete presentation and it is all a matter of record.

The CHAIRMAN. We have that record.

Mr. CHAPIN. That we have been able to make our case, I think, is best demonstrated by the several votes which Congress has taken on this matter.

Thus, in 1924, you reduced by 50 per cent the tax on tires, parts, and accessories and entirely exempted from taxation motor-truck chassis with a wholesale valuation of $1,000 or less, as well as truck bodies having a wholesale value of less than $200.

Senator BARKLEY. The other day Mr. Mills of the Treasury Department suggested that when that tax was removed from automobile parts the manufacturers of all those parts went right on collecting the same amount from the public that they did before. Do you know whether that is true or not?

Mr. CHAPIN. I do not know whether that is true or not. It might be true in a few cases, but I could not tell what individual companies are doing in isolated instances. The handling of parts is something that is very difficult, because it involves changing costs every day. You know what a car costs, but to-day you may build enough parts to last for a year, and the cost of parts varies greatly in every plant.

Senator BARKLEY. It would be much more easy to apply that reduction to a part than a whole car, would it not?

Mr. CHAPIN. No, sir, Senator; it would not.

In February, 1926, you eliminated the tax on trucks, tires, parts, and accessories. One month later the tax on motor cycles and on passenger cars, including busses, was reduced from 5 to 3 per cent.

As a result of the hearings last November, the Ways and Means Committee voted in this session to report out a 50 per cent reduction in the passenger-car taxes. Later, when the House considered the subject that body voted to entirely repeal the motor taxes.

In the light of the past attitude of the Senate and the present vote by the House, we feel that a prolonged discussion now would simply serve to take the time of a committee which is already fully posted.

In the interval since the House voted, however, statements have been made by the Undersecretary of the Treasury, Mr. Ogden Mills, on behalf of the Secretary which we feel should be answered in fairness to ourselves and to our customers, the owners of 20,000,000 passenger-motor vehicles now in operation in the United States.

In his statement before the members of the Ways and Means Committee, Mr. Mills stamped the automobile as a "semiluxury" and recommended that these taxes should be continued as a permanent phase of a peace-time program. He also stated that it would be inequitable to the railroads if the motor tax were repealed.

Evidently Mr. Mills did not find that his argument respecting the car as a "semiluxury" or as a rail competitor fell on fruitful ground, because he makes no further reference to it in his talk before your committee. But he does recommend to you continuance of the tax and also says the demand for its repeal—

does not come from the automobile purchasers but from the manufacturers and dealers who have organized an intensive propaganda and of necessity do not look upon our tax problems as a whole, but concentrate their attention on the one tax which they believe affects their own interests.

In this statement, as in others which he has made during the course of consideration of these taxes, Mr. Mills has either failed to familiarize himself with the position of the motor industry or he has ignored it. Yet, Mr. Mills has been a member of the Ways and Means Committee and has heard our position stated in detail repeatedly.

It is true that the manufacturers believe that this tax should be repealed; but it is not true that it is the one tax which they believe affects their own interests.

Our plea for the repeal of the motor excise tax is and has been based primarily on the question of fairness.

If we were considering simply our immediate interests, we would ignore the excise taxes which we pass on to the consumer and would ask for relief first from the corporation tax which we do pay.

But we hold that as manufacturers we have a responsibility to our customers and we believe that that responsibility should come first.

We have no objection now nor have we ever had any objection to paying any tax as an industry which all industries are called upon to pay.

But we protest the continuation of any tax which singles out the user of the commodity which we sell for a discriminatory levy.

We protest it more because the whole trend in Congress since the conclusion of the war has been to repeal these excise taxes when and as revenue needs permitted, until to-day automabiles are left alone in a category with pistols.

Senator REED of Pennsylvania. Oh, no; tobacco.

Mr. CHAPIN. I refer to war-excise taxes. The tobacco tax was on before the war.

The CHAIRMAN. They were all increased.

Mr. CHAPIN. When Mr. Mills says that we are alone in the effort to have these taxes removed he ignores the farm and motor user organizations who are here and who can speak for themselves.

When he says that the manufacturers have organized an intensive propaganda, he states a fact which has been generally known for years and which we so far from concealing have stated to the Congress and to the public as frankly and directly as we are capable of doing.

He fails to tell you, however, that in conversation with the Secretary of the Treasury representatives of the industry, three of whom are present here to-day, as well as Members of Congress were told two years ago that the Treasury had no objection to the removal of these taxes when and as revenue needs permitted. It was not until Mr. Mills's appearance before the Ways and Means Committee, last November, that the industry had any intimation of the change in the attitude of the Treasury Department.

Senator KING. Was there any change in their attitude? Was not the attitude of the Treasury Department that they had no objection to the removal of the excise tax, when and as the needs of the Treasury justified it, and their contention now is that the condition of the Treasury is such that it would not justify the removal of this tax? Is there any inconsistency about it?

Mr. CHAPIN. Yes, sir; in the statement before the Ways and Means Committee of the House of Representatives, it was specifically said by the Treasury Department that they believed this war excise tax should be a permanent tax upon motor vehicles.

Senator KING. Upon some theory that the situation of the country and increasing the appropriations by Congress demanded that some fixed source of revenue should be established. I suppose that was the argument.

Mr. CHAPIN. It was a complete reversal upon the part of the Treasury Department.

Senator REED of Pennsylvania. I notice the annual report of the Secretary of the Treasury for the last year recommended against the removal of this tax.

Mr. CHAPIN. They wanted to keep it on permanently.

Senator REED of Pennsylvania. Yes. That same recommendation was made in the annual report of last year.

Mr. CHAPIN. With reference to the railroad situation, I was curious to see just what the attitude of the railroad executives might be, so I wrote the presidents of all the leading roads. Unanimously they have advised me they have no objection to the removal of our tax and in 12 instances said they believed it should be repealed. I think that answers that question very completely.

The attitude of the railroad presidents is the more interesting because it reflects the viewpoint of transportation men interested in providing the public with efficient transportation at low cost.

We submit that the motor vehicle to-day forms one of our greatest transportation resources. Yet, while Congress repealed the tax on the use of railroad transportation shortly after the close of the war, the tax still remains on highway transport.

Mr. Mills has attempted to further becloud the issue by saying that the users should contribute to roads, and in a letter written by the director of the Bureau of the Budget and filed with the Senate Committee on Post Offices and Post Roads, we find this comment

made on Senator Phipps's bill providing for the authorization for Federal aid appropriations:

I have to advise that if the existing Federal tax on automobiles is repealed, the proposed legislation would be in conflict with the financial program of the President.

Yet it is a fact, as you gentlemen know, that there is no relation between Federal aid and the motor excise tax. Federal aid was established in 1916 as a basic policy of our Government, and installed at that time. The excise tax was not imposed until the war, and would not have been imposed then if it had not been for the war.

Mr. Mills has utterly ignored the fact that the motor users of the country are to-day paying about $700,000,000 in special and personal property taxes to the States and municipalities exclusive of the war excise taxes. This sum is more than enough to meet the current costs of all highway improvement, yet everybody receives a return from highway improvement.

To date, the Federal Government has actually spent about $600,000,000 for Federal highway aid, yet it has collected in these war excise taxes alone more than $1,000,000,000 from motor users. So we have a credit of at least $400,000,000.

Senator CURTIS. Yes, but you have to pay it in the other tax. You could not fairly limit yourself to one tax.

Mr. CHAPIN. We pay for more than we have ever gotten back.

Senator CURTIS. Everybody else has. None of us gets back what we pay out for taxes.

Senator REED of Pennsylvania. Somebody has got to pay for that war.

Mr. CHAPIN. Finally, the Federal Government has a very direct interest in highway improvement. Without highways our national defense, our Postal Service, our interstate commerce would suffer an irreparable damage. The Constitution states specifically that roads are a matter of general welfare.

By what conceivable stretch of the imagination, then, can Federal aid be predicated upon continuance of motor excise taxes?

Mr. Chairman and members of the Finance Committee, there is but one other point which we would like to impress upon you.

The whole policy of the motor industry since its organization has been a consistent and persistent effort to drive down the cost of cars to the users while maintaining quality.

How successful we have been every man here to-day who is a car user has reason to know.

The dollar buys more in the motor car to-day in respect to the 1913 dollar than it will buy of any other commodity.

Senator KING. What do you say as to the quality of cars to-day compared with the quality 10 years ago?

Mr. CHAPIN. Far greater, much better.

The CHAIRMAN. I think your statement is a little too broad when you say it will buy more in the automobile industry than any other commodity manufactured.

Mr. CHAPIN. Statistics that have been brought together by different organizations demonstrate that point.

The CHAIRMAN. I can tell you a number of others.

Senator HARRISON. What are they?

Senator SMOOT. One is the sugar industry that you have always wanted to bill.

Mr. CHAPIN. Nothing has been left undone on our part to offer greater values to the public. Whole factories have been scrapped to make way for improved machinery. Research laboratories have been constantly maintained to find ways and means of cutting costs.

In our effort to provide modern transportation to the American public at low cost we have gone far afield to search out new methods, both of production and operation.

Inevitably, we come to some barriers which we alone can not break down. One of these is the discriminatory motor-excise tax.

The motor-excise tax no longer has any justification other than that it is easy to collect.

We ask you to repeal it, not for our relief, but for the relief of the men and women who buy the vehicles which we sell, and who will receive the full amount of the reduction.

Senator REED of Pennsylvania. Mr. Chairman, I will have to ask to be excused to go to another committee. I would like to say that I do not think there is anything to be criticized in the large profits that are made by these companies, because I think they have earned them. I think they have given the public a return for what the public has given them. But I do feel that in respect to a semiluxury, as the pleasure automobile is, there is as much justification for a tax as there is on tobacco. The tax on tobacco, in many cases, is 40 per cent of the sales price to the customer.

Mr. CHAPIN. It is a long argument between luxury, semiluxury, and necessity. I can simply suggest that if you stop using all motor cars in this country to-day you would have the most serious upset in business that ever happened in America.

Senator REED of Pennsylvania. I quite believe that.

Mr. CHAPIN. In other words, the motor car has become such a necessity that everything we do is bound up in its use.

Senator REED of Pennsylvania. But the roads on Sunday are not filled with autom biles that are driving as a matter of necessity.

Senator EDGE. I would not call it altogether a luxury.

Senator REED of Pennsylvania. I did not. I said "semiluxury."

Senator BARKLEY. Before the automobile came along, a horse and buggy on a moon-light night was considered a luxury.

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

(Whereupon at 12 noon, a recess was taken until 2 p. m.)

AFTER RECESS

The committee resumed at 2 o'clock p. m., in its committee room in the Capitol, Senator Reed Smoot presiding.

The CHAIRMAN. The committee will come to order, and we will proceed with our hearings.

Senator Robinson, I believe you have a gentleman who desires to be heard.

Senator ROBINSON of Indiana. I do, Mr. Chairman, and I wish to say that I proposed an amendment to H. R. 1, which reads as follows:

On page 19, line 4, insert the following after the word "business":

or attending meetings of trade or business organizations of which the taxpayer is a member.

That would permit physicians in going to and from clinics and State and national conventions and the like to make deductions for the expense incurred in going back and forth and at the place of meeting, in the interest of science, the preservation of health, and all that sort of thing. Doctor Woodward is here. He is the head of the organization and I should like to introduce him to the committee. He can tell the committee much more than I can about this matter.

The CHAIRMAN. Very well, the committee will be glad to hear Doctor Woodward. But I will just say that in the case of every revenue bill we have had under consideration this same subject matter has been up.

Senator ROBINSON of Indiana. Yes; and I think the revenue bill has been wrong up to date because it did not take care of it.

The CHAIRMAN. Very well. The committee will be glad to hear Doctor Woodward.

STATEMENT OF DR. WILLIAM C. WOODWARD, EXECUTIVE SECRETARY BUREAU OF LEGAL MEDICINE AND LEGISLATION, AMERICAN MEDICAL ASSOCIATION, CHICAGO, ILL.

Doctor WOODWARD. Mr. Chairman and gentlemen of the committee, the purpose of this amendment is to clarify the revenue act so as to procure for physicians the same right of deduction that is now accorded to all other professional and business men and to corporations.

The CHAIRMAN. Do not say "to clarify," but to amend.

Doctor WOODWARD. Well, we would like you to amend the bill, if you will. We are not asking for any difference in rate, or anything of that sort.

The CHAIRMAN. I understand that.

Doctor WOODWARD. The revenue act as it now stands authorizes the deduction of "traveling expenses, including the entire amount expended for meals and lodging while away from home in the pursuit of a trade or business." That appears in paragraph 1, subsection (a) of section 214. The Commissioner of Internal Revenue, however, denies to physicians the right to deduct traveling expenses incurred in attending meetings of physicians, surgeons, and their professional organizations.

On June 26, 1922, the Commissioner of Internal Revenue promulgated a ruling as follows:

Amounts expended by a physician for railroad and Pullman fares and hotel bills in attending a medical convention are not ordinary and necessary expenses incurred in the pursuit of his profession and do not constitute allowable deductions in his return.

That ruling was promulgated without a hearing and without an investigation. It places physicians of the country in a class by themselves. The matter was fought out in the case of ministers, and the Board of Tax Appeals authorized ministers to deduct similar expenses. It is alleged in various letters that have been written that there is an obligation on the part of ministers to attend their meet-

ings. However, no such rule or showing of any such obligation was presented by the minister's attorney in the course of the hearing. That a minister is under such an obligation I have no doubt, but it is the same moral obligation that all professional men are under to keep themselves abreast of their calling. And in his very arguments and briefs you will find that the minister's counsel refers to the fact that the case is a case of interest to professional men, and especially to ministers; but he does not limit his plea to the claims of ministers.

Senator WATSON. You think that doctors of medicine and doctors of divinity ought to be on the same plane.

Doctor WOODWARD. With respect to tax deductions, if you please, yes.

The CHAIRMAN. But not as to fees, however.

Doctor WOODWARD. A closer comparison, however, may arise in the case of chemists. A professor at the University of Pittsburgh was denied the right to make deductions. He carried the case to the Board of Tax Appeals, and the board decided that chemists, in this case a professor in the University of Pittsburgh, might deduct traveling expenses incurred in attending various professional meetings. Now, Mr. Chairman, it is alleged in various statements and letters I have seen that that particular professor was under some obligation to attend meetings, but there is nothing in the record to show that he was under any more obligation to attend the meeting than any other professional man is under similar obligations. Moreover, if you will refer to the record in that case you will find that counsel for the chemist argued substantially in favor of physicians, referring by way of illustration to physicians and surgeons.

You will find, too——

Senator WATSON. Mr. Chairman, what difference would this make in the revenue returns?

The CHAIRMAN. We have not an estimate on it.

Senator WATSON. Doctor Woodward, have you had anybody to make an estimate of the difference your proposed change would make in the revenues of the Government?

Doctor WOODWARD. It is impossible to say under this ruling because no one knows to what extent persons other than physicians are now denied the right to make deductions on this account. My impression is that they are denied that permission very, very seldom, because we got few responses to letters we wrote asking people to join with us in the movement.

There is nothing to indicate that the collectors of internal revenue here, there, and elsewhere can not permit a deduction in the case of anyone save a physician; but in the case of the physician there is a hard and fast rule that a deduction may not be made for this purpose. So far as the medical profession is concerned the total amount involved is probably $100,000 a year. I have figured that out rather carefully. We are interested to a considerable extent, of course, in our own organization, and we figure that our own members in attending our single annual meeting are mulcted of as much as $20,000 to $25,000 a year because of this ruling.

Mr. Chairman and gentlemen of the committee, all that we ask is that the physicians of the country be placed on absolutely the same plane as other people are.

The CHAIRMAN. They are on the same plane now as are attorneys.

Doctor WOODWARD. But there is no ruling as to them.

Senator ROBINSON of Indiana. There is a different ruling as to physicians, placing them in a class all to themselves in this matter.

The CHAIRMAN. Do you mean to tell this committee that attorneys can go to a gathering and deduct their expenses?

Senator ROBINSON of Indiana. I mean to say that they probably do it in many cases, and because there is no particular ruling applying to their profession.

Doctor WOODWARD. There has been no definite ruling made on the subject of attorneys at law, but there has been a definite and distinct ruling made in the case of physicians, and therefore the collectors of internal revenue are on notice as to physicians.

The CHAIRMAN. There is no necessity for making a ruling on a matter until a case comes up to the department. But the department would not permit it if they had the case raised. Do you gentlemen here present who are connected with the automobile industry, get your expenses deducted for such trips?

A VOICE. No.

The CHAIRMAN. You never tried to deduct your expenses on such trips, did you?

Another VOICE. No; except while traveling on corporation business.

The CHAIRMAN. I mean while traveling on a trip of this kind, your own personal expenses.

The VOICE. No.

Senator ROBINSON of Indiana. I should like to read this ruling from the Treasury Department.

The CHAIRMAN. I am not talking about the ruling.

Senator ROBINSON of Indiana. As showing discriminations against physicians, and physicians only:

The bureau has not made any general ruling in regard to deductibility of traveling expenses incurred by business men, tradesmen, laboring men, and professional men other than physicians.

The CHAIRMAN. But that is the only one that has come there. You can not cite a case against the others because no case has been presented there. And nobody has come to ask us since 1922 except physicians.

Senator ROBINSON of Indiana. In the Silverman case that was done, and——

The CHAIRMAN. He was a professor of chemistry. He was not a chemist like we have out here in the mines in Utah, some of whom come here every year to a convention.

Senator ROBINSON of Indiana. What difference does it make in principle?

The CHAIRMAN. That is what the Internal Revenue Bureau has decided.

Doctor WOODWARD. Here is the statement made in the Silverman case in the course of the argument before the Board of Tax Appeals:

The moment a corporation enters into this situation and sends its officers anywhere it is treated as an ordinary cost of corporation business.

Now, we see no reason why the physician should not be allowed to support himself and to pay his own expenses when a corporation can pay the expense of its own particular persons.

Senator WATSON. What class of persons attending meetings of that kind have their expenses paid by corporations?

Doctor WOODWARD. Well, for instance, some physicians do when they are connected with corporations. But this particular case to which I have referred was that of a chemist and it refers to chemists, engineers, and others.

The CHAIRMAN. He was a professor of chemistry and did nothing else.

Doctor WOODWARD. But we will draw a parallel between the physician and the business man. In the case of Julius Forstman, docket No. 2521, Board of Tax Appeals, Forstman was allowed by the corporation by which he was employed $18,000 a year to cover entertainment and traveling expenses. The expenses were incurred in the interest of the company by entertainment in his home and elsewhere, and in traveling, for the purpose of buying and selling merchandise and in keeping in touch with the fashions of the United States and in foreign countries.

Now, there was no question asked as to the deductibility of those expenses. In the body of the decision the Board of Tax Appeals says:

> The commissioner does not contend that expenses incurred by petitioner in traveling and entertainment on behalf of the company are not deductible.

Now, we certainly feel that if a man can travel in the United States and abroad for the purpose of keeping in touch with fashions and ordinary styles, if you will, that a physician ought to be permitted to travel for the purpose of keeping in touch with science and the art of medicine, which is, after all, for the benefit of the people. The deduction in the Forstman case had reference, by the way, to a commercial organization. These deductions in which we are interested have reference to organizations that are not profit-making organizations.

The whole policy of the Government has been to support and to encourage organizations of this sort. But here when a physician is willing to give his time and money for the support of the activities of these very organizations, the ruling of the Commissioner of Internal Revenue comes along and says, "If you do, we shall tax you for doing it." That is the long and the short of the situation.

The CHAIRMAN. The physician who goes to a convention goes to learn what he can from the addresses that may be made, and to meet and talk with other physicians and get their views; to discuss what fees they should charge, and really what can be accomplished by way of new processes and inventions or new ideas that are promulgated or are under investigation. That is what they are there for.

Doctor WOODWARD. Of course, to keep himself abreast of the best that is in his profession, for the benefit of his patients and the public.

The CHAIRMAN. For himself, too.

Doctor WOODWARD. Here is a ruling promulgated by the Commissioner of Internal Revenue in reference to corporations, and we can see no reason why they are permitted to have the benefit of these

deductions and physicians are denied such benefit. You will find in a bulletin issued by the Chamber of Commerce of the United State, General No. 806, dated December 31, 1926, the following:

Deductions with respect to chambers of commerce: In response to a request from the National Chamber of Commerce for a ruling, the Bureau of Internal Revenue has held that traveling expenses paid by a corporation sending an officer or employee to a convention, of either the Chamber of Commerce of the United States or the International Chamber of Commerce, are deductible as business expenses by the corporation. The presumption when a sole proprietorship or partnership sends one of the members to such a convention that the expenses are incurred for the pleasure of the individual rather than for the business of the firm does not apply with respect to corporations, the bureau has ruled.

The CHAIRMAN. That is true.

Doctor WOODWARD. It is certainly illogical when it says that a gentleman sent to such a meeting at the expense of a corporation goes less for his own pleasure than for the benefit of the corporation. If there is any difference at all, it might be expected that the man who goes at samebody else's expense is much more apt to indulge in side entertainment than the man who goes at his own expenses, the professional man, the physician, if you will—who goes to fit himself to carry on his profession.

I think there is clearly shown an injustice against the physician in the statement of the commissioner that he has issued no such ruling with respect to any other group. If that is a fair ruling let him issue it against other business and professional men who similarly attend conventions, meetings, or other gatherings, or else rescind this ruling which has been made to apply to medical men. Unless that is done, the 94,000 medical men whom I represent will continue to think that they are being grossly discriminated against.

Senator SHORTRIDGE. Let me see if I understand the situation: In the case of a representative of the chamber of commerce who goes, we will say, from San Francisco to New York, and incurs certain expenses, does he under the ruling have his expenses deducted?

Doctor WOODWARD. Yes, sir.

The CHAIRMAN. Not to him.

Senator SHORTRIDGE. To the chamber of commerce. But if a member of the medical profession of California proceeds, we will say, to Philadelphia to attend a national gathering of physicians and surgeons, his expenses are not deductible, is that the way I understand it?

Doctor WOODWARD. No; they are not deductible according to the ruling made by the Commissioner of Internal Revenue.

The CHAIRMAN. Senator Shortridge, the only mistake you make in the comparison, is about the chamber of commerce. It does not pay any tax at all. No chamber of commerce in the United States pays a tax.

Doctor WOODWARD. But corporations, members thereof, do pay taxes?

The CHAIRMAN. But a chamber of commerce is not a corporation in that sense at least.

Doctor WOODWARD. But the Chamber of Commerce of the United States is a representative body.

The CHAIRMAN. They are exempt. They do not pay any tax.

Doctor WOODWARD. But the corporations that are represented at those meetings do pay taxes.

The CHAIRMAN. And therefore, even if they did pay the expenses of representatives, the chamber of commerce would not have anything from which to deduct those expenses.

Doctor WOODWARD. But the corporations represented in it do pay the expenses of their representatives.

Senator SHORTRIDGE. Is not there a preference given to representatives of commercial bodies and representatives of educational bodies over other organizations, such as an organized body of physicians and surgeons?

The CHAIRMAN. The law provides, and has always provided, that a corporation that pays money out of the profits of the institution to send a man on the business of the institution shall have that payment deducted from their profits.

Senator EDGE. That is, any corporation organized for profit?

The CHAIRMAN. Yes.

Senator SHORTRIDGE. How about this organization of physicians? Take the case I have suggested of the physician going from San Francisco to Philadelphia to attend a gathering, may his expenses be deducted from his income-tax return?

The CHAIRMAN. The only question involved is this: The department ruled that a physician doing business in Washington, or anywhere else, can have any kind of exemption on anything else, the same as a merchant can have engaged in business. But if he goes to a convention of physicians, his expenses for that trip are not deductible from his net income. That is the ruling, and it would be the same way as to the automobile association. They can not deduct it. If one of these automobile association men sitting here in the room should go to a convention, and they are having conventions almost all the time, such expenses are not deductible.

Senator WATSON. Well, Mr. Chairman, you better not put it into their heads or they may be asking for it next thing you know.

Doctor WOODWARD. I doubt if there is one present who does not deduct such expenses.

The CHAIRMAN. If they did that deduction would not be allowed.

Senator ROBINSON of Indiana. Here is an answer I should like to make to the question propounded by Senator Shortridge: That in any other profession or business the taxpayer can make deductions and they can be ruled on by the local collector of internal revenue. But with reference to physicians and surgeons, and with reference to them alone, the Commissioner of Internal Revenue has promulgated a ruling that they may not even attempt to make a deduction.

Senator SHORTRIDGE. Why is that so?

The CHAIRMAN. Because that is the only case that has ever come up for a ruling.

Senator ROBINSON of Indiana. These cases are coming up all the time.

The CHAIRMAN. Yes, as to physicians. This is the wording of the law:

All ordinary and necessary expenses paid or incurred during the taxable year in carrying out any trade or business.

In the case of a physician going to a convention it is the ruling that it is not an ordinary or necessary expense.

Senator SHORTRIDGE. But why should it not fall into the same category? Why, for instance, in the case of a physician proceeding from San Francisco to Philadelphia, there to meet others engaged in the same profession or calling, as in the case of a merchant, why should not such expenses be considered ordinary and necessary expenses?

Senator ROBINSON of Indiana. That is just the point we make.

Doctor WOODWARD. That is our contention—that we should be treated in the same way.

Senator EDGE. It would seem to me that there is a discrimination here. Now, take the corporation——

The CHAIRMAN. The corporation is entirely different.

Senator SHORTRIDGE. Well, but they have individuals who own them and who represent them.

The CHAIRMAN. Well, it is the corporation that is first taxed, and the stockholders who own the corporation, on which we impose a tax at the present time of 13½ per cent on its net income, then after that money is distributed to the individual we tax it again.

Senator SHORTRIDGE. The gentleman seems to have a substantial grievance here.

Senator WATSON. It would certainly seem to.

Senator EDGE. That is the way it appears to me.

Senator SHORTRIDGE. Are they misinformed in regard to the whole matter, Mr. Chairman?

The CHAIRMAN. Why, it is a case that they want this credit. And they are not different from any other people. Everybody wants as far as possible to pay a light tax. We have now less than 4,000,000 taxpayers in the United States, taking into account corporations, associations, individuals, and every class.

Senator SHORTRIDGE. Then, it would seem that the people are rather prejudiced against paying taxes.

The CHAIRMAN. Oh, yes; more or less so.

Doctor WOODWARD. We merely want to be put in the same position that other people are placed.

Senator EDGE. The question that appeals to me is: Is there a discrimination here?

Senator SHORTRIDGE. That seems to be the important point.

Doctor WOODWARD. Let me read the language of an official interpretation by the Bureau of Internal Revenue.

The CHAIRMAN. Physicans and surgeons, gentlemen of the committee, are not the only ones who do not have such expenses deducted.

Senator ROBINSON of Indiana. Engineers and chemists get the benefit of such deductions, and some lawyers get it.

The CHAIRMAN. Well, they say they do not, and these representatives of the automobile association here say they do not get any such deductions. And I am quite sure that if the matter were put up to the Bureau of Internal Revenue you would find that members of organizations similarly situated would not be given the privilege of a deduction.

Senator ROBINSON of Indiana. But, Mr. Chairman, here is the peculiar situation affecting physicians and surgeons: Owing to this

ruling promulgated by the Commissioner of Internal Revenue, when a physician or surgeon seeks to get such a deduction from the local collector of internal revenue it is not allowed. In other words, as to the physician and surgeon there is a definite ruling and the local collector of internal revenue does not allow such a deduction. But in other matters the local collector of internal revenue uses his judgment about it.

The CHAIRMAN. But they all come here in the end. Let me ask the representative of the department: Do you know of any attorney ever getting any allowance here for expenses incurred in attending some convention, held, we will say, in Philadelphia or anywhere else?

Mr. ALVORD. No.

Doctor WOODWARD. I feel quite sure that many attorneys do, and perhaps the gentleman does not know anything about it.

The CHAIRMAN. He knows about the returns.

Doctor WOODWARD. He does not know about the case of the individual attorney.

The CHAIRMAN. But he is an attorney himself.

Doctor WOODWARD. May I read from a ruling by the Bureau of Internal Revenue. This was their own interpretation of the act of 1918, when the provision for traveling expenses with reference to deductions was narrower than it is now. In the income tax primer issued by the Bureau of Internal Revenue, revised March 1, 1919, they answered this question:

What constitutes an item allowable as a deduction as a business expense? The physician may claim as deductions the cost of medicines and medical supplies used by him in the practice of his profession; the expenses paid in the operation and repair of an automobile used in the making of professional calls, dues to medical societies and subscriptions to medical journals, the expense of attending medical conventions.

That was in force when the revenue act of 1921 was passed. In other words, they ruled that expenses incurred while attending a medical convention were ordinary and necessary expenses of the physician's business. That interpretation was placed, too, on that very same phrase by the rules and regulations section of the Bureau of Internal Rvenue when in response to an inquiry from a physician in Ohio as to whether he might or might not deduct those expenses a letter was prepared in the Bureau of Internal Revenue to be sent to him telling him he might do so in view of the income-tax rulings. When that letter was given to the Commissioner of Internal Revenue for signature it occurred to him that there might be some question about it despite the previous practice and the official rulings, and therefore it was sent to the solicitor. The solicitor, without any inquiry into the custom and rulings of the bureau, cited a ruling by the Attorney General, which held that a corporation could not deduct gifts to the American Red Cross, and therefore that doctors can not deduct traveling expenses. That is the long and short of it.

Doctors are willing to give their time and their money, but they do not believe that they should be taxed for doing so.

Senator WATSON. Do you mean to say that that is the reason he assigned for so holding. Why, there is no analogy there at all. There must be some mistake about that.

Doctor WOODWARD. Senator Watson, he based it on a ruling by the Attorney General, in which he undertakes to define ordinary and necessary expenses under that section of the law, and it has no relation at all to traveling expenses. It has no relation to physicians.

Senator SHORTRIDGE. Pardon me a moment right there, but let me ask: Under the ruling of the bureau as it now stands do I understand that a physician attending a convention or gathering of the members of his profession can not deduct his traveling expenses?

Doctor WOODWARD. Yes; because the collector of internal revenue who complies with the law, or rather with the ruling made by the Commissioner of Internal Revenue, will not permit him to do it.

Senator SHORTRIDGE. Whereas in the case of a commercial man traveling on a directly commercial errand he may deduct?

Doctor WOODWARD. Men who go on commercial errands may do it.

The CHAIRMAN. But he goes for the company he represents. He does not pay it himself, but the corporation pays it out of its own income. And the man himself does not get the deduction; the corporation does.

Senator REED of Pennsylvania. But suppose he is an individual owner of a store.

Senator SHORTRIDGE. Yes; or a member of a copartnership.

Senator EDGE. Doctor Woodward, when you referred a moment ago to an opinion in the case of a corporation, not being permitted to take credit for a contribution to the Red Cross, did you say simultaneously with that the old ruling by the commissioner was reversed?

Doctor WOODWARD. Not simultaneously.

Senator EDGE. Well now, as I understand it, at that same time, corporations were permitted to continue to make deductions.

Doctor WOODWARD. Yes, sir; as to traveling expenses, as I understand it; but as to physicians, the ruling was based on that opinion.

Senator EDGE. And at the same time did they continue to permit corporations to have credit?

Doctor WOODWARD. To make deductions?

Senator EDGE. Yes.

Doctor WOODWARD. They apparently do, from the ruling.

Senator EDGE. I am like Senator Watson, I can not see the slightest relationship between saying that a Red Cross contribution is not deductible and saying that the expenses of a physician or surgeon attending a medical or surgical convention can not be deducted. The whole thing looks like a Chinese puzzle to me.

Senator WATSON. It is far afield so far as logic is concerned.

Senator MCLEAN. Doctor Woodward, you have State conventions of medical men, where they have a meeting only of doctors in the State?

Doctor WOODWARD. Yes; or invited guests, and then we have national conventions. I represent the national body, the American Medical Association.

Senator MCLEAN. And you want this privilege to cover both State and national conventions?

Doctor WOODWARD. It ought to cover all professional men alike. All professional men ought to be placed on the same basis. We are not here asking any special privilege of any kind, but simply asking that we shall not be singled out as an exception to the rule and denied

the right to deduct expenses to medical conventions, while other people attending conventions are allowed to take deductions.

Before I take my seat I should like to suggest this for the consideration of the committee: The merchant who is in business in San Francisco can go to New York to buy a bill of goods, and he can deduct traveling expenses incident to that purchase. But the physician who is practicing in San Francisco and who wishes to go to New York to attend a convention in order to replenish his stock of goods, to add to his knowledge and skill, is not allowed to deduct those expenses.

Senator SHORTRIDGE. Is that the situation now?

Doctor WOODWARD. Yes, sir.

Senator MCLEAN. Then I would suggest to the physician attending such a convention, that he better go for the purpose of buying a box of pills.

Senator REED of Pennsylvania. And the merchant charges off depreciation, but the doctor can not do that.

Senator EDGE. Suppose a lawyer is attending a meeting of the American Bar Association, does he come under that provision allowing a deduction for expenses?

Doctor WOODWARD. It depends upon the views of the local collector. There is no special ruling apply to attorneys at law, and the individual lawyer does what he feels like is proper, and so does the local collector of internal revenue.

The CHAIRMAN. All right, Doctor Woodward, we thank you.

Senator ROBINSON of Indiana. May I offer this brief and memorandum for your record?

The CHAIRMAN. Yes; they may be made a part of the record.

(The brief and memorandum referred to are here made a part of the record, as follows:)

[Revenue reduction bill, Seventieth Congress, first session. H. R. 1]

A Brief in Support of an Amendment to Section 23, Proposed by Senator Robinson of Indiana, to Relieve Physicians from Discrimination with Respect to the Deductibility of Traveling Expenses and to Establish and Maintain Uniformity with Respect to the Deduction of Such Expenses. Submitted on Behalf of the American Medical Association

STATEMENT OF THE CASE

1. The revenue act of 1926 authorizes the deduction of traveling expenses by all individual taxpayers alike. The deduction of traveling expenses by individual taxpayers is authorized by the following provisions of the revenue act of 1926:

SEC. 214. (*a*) In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business. * * *

The phrase "trade or business," where it appears above, has been uniformly construed as covering the professions. Under any other construction, professional men would be taxed on gross incomes, while men engaged in trade and business, as those words are ordinarily used, would be taxed on only net income.

II. The Commissioner of Internal Revenue denies the right of physicians to deduct traveling expenses incurred in attending meetings of their professional organizations, although other taxpayers are allowed to deduct similar expenses. The Commissioner of Internal Revenue, on June 26, 1922, published the following ruling, to which he has adhered ever since and to which he still adheres:

"Amounts expended by a physician for railroad and Pullman fares and hotel bills in attending a medical convention are not ordinary and necessary expenses incurred in pursuit of his profession and do not constitute allowable deductions in his return." (Internal Revenue Bulletin, No. 26, p. 7, June 26, 1922.)

The commissioner has not promulgated a corresponding rule with respect to any group of taxpayers other than physicians. (Bureau of Internal Revenue Files: IT:E:RR:HRC.)

The ruling of the Commissioner of Internal Revenue denying the deductibility of traveling expenses incurred by physicians in attending meetings of medical organizations was based on an inquiry by a physician as to how he should make out his income-tax return. When the ruling was made there was outstanding a ruling by the Bureau of Internal Revenue which held that such expenses were ordinary and necessary expenses and were therefore deductible (Income Tax Primer (revised March 1, 1919), prepared by the Bureau of Internal Revenue, p. 15). That earlier ruling was made under the revenue act of 1918, which did not specifically recognize traveling expenses as deductible. But under the revenue act of 1921 and all subsequent revenue acts, which have specifically included traveling expenses among the ordinary and necessary expenses that are deductible, the commissioner has denied the deductibility of the very same expenses. No explanation has ever been given of this reversal of opinion.

The ruling of the commissioner is a guide not only for taxpayers in making out their returns but also for the officers and employees of the Bureau of Internal Revenue who audit such returns. Any such officer or employee is apparently bound by that ruling to disallow any credit taken by a physician for traveling expenses incurred in attending any medical meeting, at any time and under any circumstances. Appeal to the Commissioner of Internal Revenue from any such disallowance is obviously hopeless, for the commissioner has closed the case in advance so far as he is concerned, by his ruling set forth above.

III. While the revenue act of 1926 authorizes appeals to the Board of Tax Appeals and to the courts, the relief thus afforded is impracticable in the present situation. A taxpayer aggrieved by a ruling of the Commissioner of Internal Revenue has a right of appeal to the Board of Tax Appeals and to the courts. The remedy, however, is here an impracticable one. The amount of taxes involved is considerable as related to any group of taxpayers like the medical profession, but unfortunately such a group has no right of appeal as a whole. In the case of any individual taxpayer, however, the amount involved is so small in proportion to his entire income that he finds it easier to submit to an unjust and unlawful exaction of taxes rather than to match his limited resources against all of the resources of the Treasury Department to test the issue; his right of appeal is of no practical value.

Moreover, the details of individual cases vary so widely that there is no certainty that a decision of the Board of Tax Appeals or of the courts in any particular case would be applied by the Commissioner of Internal Revenue in any other case. As evidence of the inadequacy of such precedents, the refusal of the Commissioner to follow the decision of the Board of Tax Appeals in the Appeal of Alexander Silverman (6 B. T. A. 1328) may be pointed out. The board decided in that case that a chemist was entitled to deduct traveling expenses incurred in attending professional meetings. The commissioner was able, however, to find in the decision of the board qualifications and limitations that in his judgment justify him in refusing to follow the case in determining the deductibility of similar traveling expenses incurred by physicians. A copy of the decision in the Silverman case is appended.

IV. Senator Robinson of Indiana has proposed an amendment to the pending revenue reduction bill, H. R. 1, designed to relieve physicians of the discrimination from which they now suffer with respect to the deductibility of traveling expenses and to prevent similar discrimination in the future with respect to any taxpaying group. To discontinue the discrimination now practiced against physicians and to prevent similar discrimination against any other group of taxpayers, Senator Arthur R. Robinson, of Indiana, proposed, February 1, 1928, an amendment to the pending revenue reduction bill, H. R. 1, as follows:

On page 19, line 4, insert the following after the word "business": "or in attending meetings of trades or business organizations of which the taxpayer is a member:"

If Senator Robinson's amendment is adopted, deductions of traveling expenses will be authorized as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.—In computing net income there shall be allowed as deductions:

(*a*) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business or in attending meetings of trades or business organizations of which the taxpayer is a member.

Senator Robinson's amendment is limited in its terms to attendance at "meetings of trades or business organizations." It is understood, however, that these terms are broad enough to cover meetings of professional organizations. Certainly the phrase "trade or business" has heretofore been construed as including the professions, and under that construction physicians and other professional men have been allowed to deduct rent, the expenses of heating and lighting their offices, salaries of assistants, the cost of necessary professional supplies, etc. In any event, with the purpose of the amendment to afford relief to professional men so clearly before Congress, it may be presumed that if the present phraseology does not accomplish that purpose, the phraseology of the bill will be amended so as to do so before the bill is enacted.

ARGUMENT

I. The ruling of the Commissioner of Internal Revenue denying the deductibility of traveling expenses incurred by physicians in attending medical meetings has no support whatever in the opinion of the Attorney General on which the commissioner relies as a precedent. The opinion of the Attorney General stated is utterly irrelevant.

In support of his ruling that holds that traveling expenses incurred by a physician in attending a medical meeting are not deductible, the Commissioner of Internal Revenue cites a decision by Attorney General Palmer, May 19, 1919. (31 Opinions of the Attorney General, 617.) In that opinion, the Attorney General held that under the revenue act of 1918 a corporation was not entitled to deduct contributions to religious, charitable, scientific, or educational corporations or associations. No question was before the Attorney General concerning deductions by individuals as taxpayers. No question was before him as to the deduction of traveling expenses by either individual taxpayers or by corporations. In the course of his opinion, however, the Attorney General said:

"It is also evident that the ordinary and necessary expenses contemplated by paragraph 1 of section 214 and 234 (of the revenue act of 1918), allowing deduction of ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business in the case of both individuals and corporations, were not intended to include all necessary expenses because the two immediately succeeding paragraphs provide for deducting interest and taxes, both of which will be recognized as necessary expenses; also the provision in regard to allowance for salaries, compensation, rentals, etc., indicates that all of the expenses, which are contemplated under the terms used in paragraph 1 of these two sections, are expenses incurred directly in the maintenance and operation of the business, and not all of those which may be beneficial or even necessary in the broader sense."

Certainly the Attorney General's comments neither require the commissioner to deny, nor justify him in denying, the deductibility of any traveling expenses whatever without knowledge of all the circumstances under which those expenses were incurred. Deductibility is a mixed question of law and fact, and the taxpayer is entitled to a fair judgment. He gets no such judgment under the rule laid down. His case is judged before the event.

II. The deductibility of traveling expenses incurred in attending meetings has been admitted by the Commissioner of Internal Revenue and the Board of Tax Appeals in the cases of professional men other than physicians. Apparently the deduction of similar expenses by men engaged in the trades and in business generally is commonly permitted. The Commissioner of Internal Revenue can not lawfully deny the deductibility of such expenses in similar cases simply because the taxpayer is a physician, nor can he by rule create a presumption of nondeductibility in the case of a physician that does not apply equally in the case of all other taxpayers.

The Commissioner of Internal Revenue admits the correctness of a ruling by the Board of Tax Appeals that traveling expenses incident to attending a professional meeting are deductible when incurred by a minister (Appeal of Marion D. Shutter, 2. B. T. A. 23, 4 Internal Revenue Bulletin, No. 33, p. 1, August 17, 1925) and a chemist (Appeal of Alexander Silverman, 6 B. T. A. 1328, 6 Internal Revenue Bulletin, No. 37, p. 1, September 12, 1927). The commissioner has admitted also the deductibility of traveling expenses incurred by an engineer in attending a meeting of a committee of an organization of which the engineer was a member (unpublished memorandum of the Solicitor of the Bureau of Internal Revenue, May 13, 1922, Sol. I:I:20-5-3-72). And prior to the commissioner's ruling of June 26, 1922, the Bureau of Internal Revenue officially admitted the deductibility of expenses incurred by physicians in attending professional meetings. (Income Tax Primer, revised March 1, 1919, prepared by the Bureau of Internal Revenue, p. 15.) No reported case has been found in which any business man, or a taxpayer engaged in agriculture or in any of the mechanic arts, who has attended a meeting of a business or trade organization on his own account has been denied the right to deduct traveling expenses incident to such attendance. In cerain cases the commissioner has authorized corporations to deduct traveling expenses incurred in attending, through their representatives, conventions of representatives of like organizations. (Bulletin of Chamber of Commerce of United States, General No. 806, p. 2529, December 31, 1926.)

With respect to no group of taxpayers other than physicians has the commissioner ever issued a rule that declares in substances that no member of the group can at any time, anywhere, and under any conditions attend a meeting of a professional, business, or trade organization of which he is a member under conditions that will make the expenses of such a.tendance deductible. (Bureau of Internal Revenue files: IT:E:RR:HRC.) No justification or excuse has ever been given for the promulgation of the rule denying to physicians, and to no other class whatsoever, the deductibility of traveling expenses incurred in attending professional meetings. Under the circumstances set forth above it is obvious that legislation should be enacted to prevent the continuance of such discrimination and to prevent similar discrimination against any other taxpaying group.

The Commissioner of Internal Revenue has endeavored to support his denial of the deductibility of physicians' traveling expenses by a decision of the Board of Tax Appeals in the case of a physician, Everett S. Lain (3 B. T. A. 1157), April 3, 1926, four years after the commissioner promulgated his ruling. Doctor Lain was a member of a medical partnership that sought to enlarge its practice by having the partners attend professional meetings so as to enlarge the professional acquaintance of the partners. It was on that basis that the right to deduct traveling expenses was claimed, and it is difficult to see why that claim was not allowed. The decision was probably influenced by the fact that Doctor Lain submitted his case without argument, while it was argued by counsel for the Government. The decision of the board affords no clue to the theory on which it held that the expenses incurred by Doctor Lain and the partnership were not deductible. It is impossible, therefore, to determine what precedent, if any, this case establishes.

III. Public interests demand that every physician keep abreast of the science and art of medicine. Attendance at meetings of medical organizations is an important means to that end. Attendance, therefore, should be encouraged and not penalized by taxation. Congress has recognized that fact by exempting from taxation and otherwise favoring medical organizations not organized for profit. The ruling of the Commissioner of Internal Revenue that in effect taxes attendance at meetings of such organizations is inconsistent with that principle.

The physician attends medical meetings so that he may enlarge his knowledge of the science and art of medicine and pass along to his fellow physicians the benefit of his own experience in the practice of his profession. His attendance, while of immediate value to himself and to his fellow physicians, is ultimately of value to his patients and to the general public. To deny to him the right to deduct as an expense of his profession the cost of such attendance is in effect to tax him on the cost of attendance and therefore to discourage attendance.

The public value of organizations for scientific, literary, or educational purposes, not authorized for profit, is recognized by their exemption from taxation (revenue act of 1926, sec. 231), by the fact that contributions or gifts to them

are deductible in the computation of the Federal income tax of the donor (revenue act of 1926, sec. 214, subsec. (a), par. 10), and by the admitted deductibility of dues paid by the members, as ordinary and necessary expenses (Regulations 69, Income Tax, revenue act of 1926, art. 105). It seems inconsistent with such recognition to penalize by taxation the members who attend meetings, in order to profit by them and to give their knowledge, skill, experience, ability, and energy to promote the activities of such organizations.

The Commissioner of Internal Revenue advances the hypothesis that the professional men whose traveling expenses he admits were deductible, a minister and a chemist, were under some "duty" to attend the meetings to which their claims of deductions related, while physicians who attend meetings of medical organizations are not and can not be under any such duty. The hypothesis finds, however, no support in the records of the cases cited. Neither the minister nor the chemist proved any rule or order of any superior authority requiring attendance or showed that he would have been penalized if he had not attended. The duty of attendance in each case was the same moral duty as the duty of every member of such an organization to support its activities and to profit by the advantages it offers.

The Secretary of the Treasury, January 17, 1928, wrote to a correspondent who inquired concerning the situation, that—

"If a member of the medican profession is compelled by the rules of his organization to attend its conferences, then, there is reason to believe that the Board of Tax Appeals, in view of its other decisions, would recognize the expenses incurred as properly deductible from gross income."

But why should a physician be compelled to appeal to the Board of Tax Appeals and then to prove a rule of his organization compelling his attendance at its meetings? The cost of the appeal would ordinarily exceed the money saved the taxpayer. The allowance or rejection of claims for deductions of traveling expenses in all cases other than those of physicians seems to rest primary in the sound discretion of the officers and employees of the Bureau of Internal Revenue, without any specific instructions from the commissioner. Why, then, has he issued his mandate establishing a different rule for the medical profession?

CONCLUSION

The medical profession asks only that it be placed on the same footing as all other taxpayers with respect to the deductibility of traveling expenses incurred in attending meetings of professional, trades, and business organizations. It asks that the special rule of the Commissioner of Internal Revenue be abrogated by legislation, and that the promulgation of any similar rule in the future be prevented in like manner. In support of its claim of the right to deduct traveling expenses incurred in attending meetings of medical organizations, the medical profession submits the argument in favor of similar attendance with respect to another professional group, as set forth by the Board of Tax Appeals in the appeal of Alexander Silverman (6 B. T. A. 1328), in support of its findings that the traveling expenses of a chemist, incurred in attending meetings of chemical organizations, are deductible. The board said:

"As the head of the department of chemistry, it was expected of and incumbent on him as such to keep abreast of his particular field of work and in touch with other scientists in the same field, which was done among other ways by the preparation and publication of papers, by the reading of technical periodicals, and by the attendance at such conventions where consideration of subjects of a scientific nature were presented and discussed.

"The petitioner attended like conventions prior to 1921, did so attend in 1921 and has since so attended, such action on his part being expected and necessary, as it was of others similarly employed at the university, for the purpose of keeping thoroughly informed in his field of work and in touch with other scientists, and in order to advance the interests of the university, though his contract of employment does not specifically make mention of any such activities and there was no provision made for repayment to him of expenses so incurred."

The Commissioner of Internal Revenue has acquiesced in the decision quoted above (6 Internal Revenue Bulletin, No. 37, p. 1, September 12, 1927). He expressly declined, however, to apply it as a precedent to the medical profession (telegram of assistant commissioner, September 30, 1927). It is for that reason and because of the inadequacy of relief through the Board of Tax

Appeals and the courts that this appeal is made to Congress for remedial legislation.

Respectfully submitted.

WILLIAM C. WOODWARD,
Executive Secretary Bureau of Legal Medicine and Legislation,
American Medical Association.

UNITED STATES BOARD OF TAX APPEALS

[6 B. T. A. 1328]

(Alexander Silverman, Petitioner *v.* Commissioner of Internal Revenue, Respondent. Docket No. 10389. Promulgated May 12, 1927)

Amounts expended by petitioner, a professor of chemistry and a member of the faculty of the University of Pittsburgh, in connection with the carrying on of his profession, in attending scientific meetings and conventions, constitute an ordinary and necessary business expense.

S. Leo Rushlander, Esq., and A. E. James, Esq., for the petitioner.

D. D. Shepard, Esq., for the respondent.

This proceeding results from the determination of a deficiency in income tax for the year 1921 of $55.88 by reason of disallowance of a deduction of $558.75 claimed by petitioner as ordinary and necessary business expense for the taxable year in carrying on his duties as a professor of chemistry and a member of the faculty of the University of Pittsburgh. The facts are found as stipulated.

FINDINGS OF FACT

The petitioner is a resident of Pittsburgh, Pa. He keeps his accounts on the basis of actual receipts and disbursements. Prior to and during the year 1921 he was at the head of the department of chemistry of the University of Pittsburgh, with the title of professor of chemistry, and has for the past 21 years been a member of the faculty of that university.

As the head of the department of chemistry, it was expected of and incumbent on him as such to keep abreast in his particular field of work and in touch with other scientists in the same field, which was done among other ways by the preparation and publication of papers, by the reading of technical periodicals and by the attendance at such conventions where consideration of subjects of a scientific nature were presented and discussed.

The petitioner attended like conventions prior to 1921, did so attend in 1921, and has since so attended, such action on his part being expected and necessary as it was of others similarly employed at the university, for the purpose of keeping thoroughly informed in his field of work and in touch with other scientists, and in order to advance the interests of the university, though his contract of employment does not specifically make mention of any such activities, and there was no provision made for repayment to him of expenses so incurred.

In the taxable year mentioned petitioner, for the purposes and objects mentioned, attended the American Ceramic Society at Columbus, Ohio; the American Chemical Society at Rochester, N. Y., and a meeting of the same society in New York City, and, in so doing, incurred and paid reasonable and actual expenses for hotel rooms, meals, and railroad fare to and from said conventions, the sum of $558.75, no part of which sum has been repaid him by the university, nor by any person, society, or organization whatever. Each of the three trips mentioned occupied a week, and petitioner was in attendance the full length of each convention, and for each convention prepared and delivered a paper or papers. By reason of the fact that petitioner was a member of the council of the American Chemical Society, he was in attendance prior to the general convention season.

OPINION

Littleton. The board has held that expenditures of the character and made under circumstances involved in this proceeding are deductible as ordinary and necessary business expense. M. D. Shutter, 2 B. T. A. 23.) We have also

held that expenditures made by a professional cartoonist for periodicals and other current literature and in attending political conventions, when properly proved, were proper deductions as ordinary and necessary business expense. (J. N. Darling, 4 B. T. A. 449.)

The board is of the opinion from the facts in this proceeding that the petitioner is entitled to the deduction claimed.

Judgment will be entered on 15 days' notice, under rule 50.

MEMORANDUM RELATIVE TO DISCRIMINATION AGAINST PHYSICIANS UNDER SUBSECTION 1 OF SECTION 214 (A) OF THE REVENUE ACT OF 1926, WITH RESPECT TO THE DEDUCTIBILITY OF EXPENSES INCURRED IN THE PURSUIT OF THEIR PROFESSION, PREPARED BY THE BUREAU OF LEGAL MEDICINE AND LEGISLATION, AMERICAN MEDICAL ASSOCIATION

I. Subsection 1 of section 214 (a) of the revenue act of 1926 authorizes individuals, in computing their income taxes, to deduct "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." It specifically authorizes the deduction of "traveling expenses (including the entire amount expended for meals and lodgings) while away from home in the pursuit of a trade or business." It is applicable to all individual taxpayers alike, without discrimination. The Commissioner of Internal Revenue, in applying this section, however, discriminates among various groups of professional men, to the detriment of the medical profession. It is of this discrimination that the medical profession complains.

II. Under the provisions of the revenue act of 1926, stated above, the Commissioner of Internal Revenue allows a professional man who happens to be a chemist or a minister, in computing his income taxes, to deduct traveling expenses incurred in attending meetings held by professional organizations Under a similar provision of an earlier act, referred to below, he allowed an engineer to make similar deductions. If the professional man happens to be a physician, the Commissioner of Internal Revenue denies to him the right to deduct such traveling expenses. This denial is in the face of a previous affirmative ruling by the Commissioner of Internal Revenue that expenses incurred by a physician in attending professional meetings were ordinary and necessary expenses of his profession and were deductible. The reversal of the commissioner's ruling with respect to this matter was made without hearing, without argument, and without discoverable cause. The discrimination against physicians, and in favor of chemists, ministers, and engineers was made without inquiry into the practices of these several professional groups with respect to attendance at meetings of organizations of their respective professions. The action of the commissioner, therefore, does not represent a reasoned determination of a debatable matter, based on an inquiry into the law and the facts, a knowledge of both of which was and is necessary to a determination of it, and to such a reasoned determination of the issue the taxpayer is lawfully entitled. The discrimination practiced by the commissioner is, in the judgment of the medical profession, therefore, arbitrary, unjust, oppressive, and unlawful.

III. In theory, the law provides a remedy through the courts whereby the taxpayer can obtain relief from the commissioner's action. The remedy, however, is impracticable. For, while the sum of which the medical profession is mulcted by the commissioner's ruling is in the aggregate large, in the case of the individual physician it is relatively small, and the cost in time, energy, and money of pursuing the remedy provided is so great as to lead the physician to pay what he regards as an unjust exaction by the Commissioner of Internal Revenue rather than to contest the issue in the courts. It is for this reason that an appeal is made to Congress for a revision of the language of the revenue act of 1926 that will prevent hereafter such a discrimination against the profession that is now practiced under the present language.

IV. The Commissioner of Internal Revenue cites in support of his denial of the deductibility of a physician's traveling expenses the appeal of Everett S. Lain (3 B. T. A. 1157), decided April 3, 1926. In that case the taxpayer was a physician. He was a member of a partnership that to a large extent secured its patients through acquaintances in the medical profession, such acquaintances being made by the partners by attending meetings and conventions of medical societies. The commissioner refused to allow the deduction of expenses incurred through such attendance in 1920 and 1921, although at the very time when the appellant incurred the disallowed expenses for attend-

ing meetings in 1920 the official Income Tax Primer issued by the Bureau of Internal Revenue for the information and assistance of taxpayers, page 15, expressly provided that "a physician may claim as deductions * * * the expenses of attending medical conventions." Doctor Lain appealed in his individual capacity. The case was submitted without argument on his behalf and was decided against him, the reason for the decision not being stated.

But to cite this case in justification of the commissioner's ruling against the deductibility of any traveling expenses whatsoever incurred by any physician in the United States attending a medical meeting is at most to exculpate the commissioner from responsibility for the discrimination of which the medical profession now complains. It neither explains nor justifies the discrimination.

V. The Commissioner of Internal Revenue acquiesced in the decision of the Board of Tax Appeals in the appeal of Marion D. Shutter (2 B. T. A. 23), decided June 10, 1925, in which a minister was allowed to deduct traveling expenses incurred in attending a general convention of the denomination to which he was an adherent. Recently an effort seems to have been made by the Commissioner of Internal Revenue to distinguish between the case of this minister and the case of a physician on the ground that it was the duty of the minister to attend the convention. While some claim was made on behalf of the appellant in this case to the effect that he was under "obligation" to attend the convention, the Board of Tax Appeals declared merely that "his attendance at such convention was essential to his standing and position in the church." No evidence was submitted to show that he would have been disciplined or dismissed had he not attended the convention. The obligation on the part of a physician to attend medical meetings is apparently of as much binding force as was the obligation on the part of a minister to attend in this case.

VI. The commissioner has acquiesced also in the decision of the Board of Tax Appeals in appeal of Alexander Silverman (6 B. T. A. 1328), decided May 12, 1927, thereby admitting the deductibility of traveling expenses by a chemist in attending professional meetings. The Board of Tax Appeals found that it was expected of and incumbent on the appellant, as head of the department of chemistry of the University of Pittsburgh, "to keep abreast in his particular field of work and in touch with other scientists in the same field, which was done among other ways * * * by the attendance at such conventions where consideration of subjects of a scientific nature were presented and discussed." The board found that such attendance on the part of the appellant was "expected and necessary, as it was of others similarly employed at the University, for the purpose of keeping thoroughly informed in his field of work and in touch with other scientists, and in order to advance the interests of the University, though his contract of employment does not specifically make mention of any such activities and there was no provision made for repayment to him of expenses so incurred." The board said:

"The board has held that expenditures of the character and made under under circumstances involved in this proceeding are deductible as ordinary and necessary business expense. (M. D. Shutter, 2 B. T. A. 23.) We have also held that expenditures made by a professional cartoonist for periodicals and other current literature and in attending political conventions, when properly proved, were proper deductions as ordinary and necessary business expense. (J. N. Darling, 4 B. T. A. 449.)"

In response to an inquiry addressed to the Commissioner of Internal Revenue, Mr. C. R. Nash, assistant to the commissioner, replied, under date of September 30, 1927:

"Decision Board Tax Appeals in appeal of Alexander Silverman is not precedent for allowing expenditures incurred by members of medical associations in attending conventions as deductions in computing net income."

VII. The Commissioner of Internal Revenue ruled that attendance by an engineer at a meeting of a committee of a professional organization of which he was a member was an ordinary and necessary expense of the practice of his profession and was therefore deductible. (See Bureau of Internal Revenue, SOL: I: I: 20-5-3-72, dated May 13, 1922.) An effort was made to discriminate between the case of an engineer and the case of a physician in that the engineer's expenses were said to be "in fact directly connected with such membership and activity inasmuch as the taxpayer was required as an officer of a technical society to attend the meetings of the committee." But it did not appear, however, that he would have been disciplined or removed had he not attended the meetings of the committee, or that he was in any way liable to a

penalty if he did not maintain his membership in the organization. He was no more required to attend the committee meeting than is a physician required to attend a meeting of his medical organization.

VIII. The Commissioner of Internal Revenue has held that a corporation can attend, through a representative or representatives, meetings of organizations. (See Bulletin of the Chamber of Commerce of the United States, General, No. 806, December 31, 1926, page 2529.) No evidence is required to show that the corporation incurring such expenses is under any obligation whatsoever to be so represented, and no limit is placed on the number of persons whom it can designate to attend the convention. The discrimination that permits a corporation to deduct traveling expenses incurred in attending meetings of which it is a member and yet denies the same right to a physician is made notwithstanding the fact that individual taxpayers are expressly authorized to deduct traveling expenses while away from home in the pursuit of a trade or business, while no such specific provision is made for the deduction of traveling expenses by corporations.

IX. The discrimination of which physicians now complain placed a burden primarily on the physician. The burden falls, however, ultimately on the medical organizations with which those physicians are identified, for it discourages attendance at the meetings of such organizations, and it is therefore contrary to the policy of the Government as expressed in the revenue act of 1926 and other revenue acts with respect to organizations of this character. Such organizations are practically always scientific organizations, not for profit. No part of the net earnings of such organizations, in so far as they may be said to have net earnings, inures to the benefit of any private shareholder or individual. The policy of the Government as expressed in the revenue act is to encourage the activities of such organizations by exempting them from taxation. (See sec. 231, revenue act of 1926.) Dues paid by physicians for the support of such organizations are deductible as ordinary and necessary expenses of carrying on the practice of medicine. (See sec. 214(a), par. (1), revenue act of 1926, and article 105, Regulations 69, Bureau of Internal Revenue.) In furtherance of this policy to promote the activities of such organizations, contibutions, or gifts made in furtherance of their purposes may be deducted by the donor in computing his net income tax. (See sec. 214 (a), par. (10), art. 251, revenue act of 1926.) With the policy of the Government to promote these organizations and their activities so clearly expressed in the revenue act itself, it is certainly a remarkable anomaly to find the act construed so as to tax the several members of such organizations who are willing to give up their time and money in attending meetings to carry on the work of the organizations for the privilege of so doing.

In view of the facts stated above it seems clear that Congress, when it passed the revenue act of 1926, did not intend to discriminate against physicians in the matter of the deduction of traveling expenses incurred in attending professional meetings. If the language of the act justifies such discrimination—and such a discrimination has been and is being made by the Commissioner of Internal Revenue—then the language of the act would seem not to express properly the intent of Congress. It is believed by the medical profession that the language of the act, as interpreted by the Commissioner of Internal Revenue, does not express the intent of Congress, that Congress intended no discrimination against the medical profession. For that reason an appeal is being made to Congress in the hope that in the forthcoming revenue legislation the language will be so clear that there will be no possibility of a continuation of the discrimination that is now being made.

The CHAIRMAN. Mr. Wyvell, you may come around to the table. We are anxious to conclude this matter this afternoon.

STATEMENT OF MANTON M. WYVELL, ESQ., ATTORNEY AT LAW, WASHINGTON, D. C.

Mr. WYVELL. Mr. Chairman and members of the committee, I am going to be very brief.

The CHAIRMAN. We want to get through with this matter this afternoon if possible.

Mr. WYVELL. I wish to state that I represent the American-La France & Foamite Corporation, which is the chief manufacturer of fire-fighting apparatus in this country. I am going to tell you briefly what happenend to the fire-fighting appar us manufacturers when they came to deal with the Internal Revenue Bureau in connection with the excise taxes imposed by the various acts.

The CHAIRMAN. Do you mean with reference to fire engines?

Mr. WYVELL. Fire engines and all sort of fire-fighting apparatus. It was the contention of the manufacturers of fire-fighting apparatus from the outset that in no sense was fire-fighting apparatus an automobile within the meaning of the excise-tax laws. The industry so stated its position to the Internal Revenue Bureau. The Internal Revenue Bureau apparently had no firm decision with respect to how it should deal with the matter. The first ruling that came out was made in January, 1918, interpreting the 1917 tax act. That ruling held that that portion of the apparatus, namely the engine, although self-propelled, was manufactured for the primary purpose of pumping water onto a fire, was not an automobile, and, therefore, not subject to tax, but that practically all other apparatus was.

The CHAIRMAN. That is, that that portion of your machine was not taxable.

Mr. WYVELL. That that particular machine was not taxable, the pumping engine, although it was self-propelled. The next ruling came out in May, 1918. Under that ruling the Internal Revenue Bureau stated that articles sold to a political subdivision, that is, cities or villages, were not subject to a tax at all; and therefore it followed that practically no apparatus made and sold by fire-fighting manufacturers was taxable, for the reason that except for the small portion sold to private individuals or corporations it is all sold to governmental bodies: Over 90 per cent of the fire-fighting apparatus is sold to cities and villages, so that perhaps 95 per cent of such apparatus is not subject to a tax at all. That ruling was made in May, 1918.

Then in May, 1919, the ruling was affirmed, so that for a period of approximately 14 months the bureau held that practically no tax was due from this industry.

In July, 1919, the bureau squarely reversed itself and held that it was subject to a tax, and spelled out a reason that although apparatus was sold to cities, the tax being one on manufactures, they were subject to the tax.

Senator SHORTRIDGE. Including fire engines too?

Mr. WYVELL. Well, I will come to that a little bit later.

Senator SHORTRIDGE. All right. Pardon me.

Mr. WYVELL. Nothing was said in that ruling with respect to engines. Then in October, 1919, another ruling was made, and I will just briefly read a portion of it, and it is pertinent:

> A self-propelled fire engine, if designed to carry only such persons as are necessary to drive it and to operate the pumping engine, is not taxable.

That apparently exempted the pumping engine again. But that only lasted for a short time, and a few months later we were advised that the whole subject was undergoing further consideration. So that for a few months the industry was in suspense as to what was taxable.

A ruling came down in 1920 reversing all previous rulings, and holding that fire-fighting apparatus was subject to the tax, placing it under the classification of automobile trucks, but whereas the industry had been taxed at 5 per cent it was now taxed at 3 per cent.

Senator SHORTRIDGE. And that included the engine.

Mr. WYVELL. Yes, sir; they did not exempt the engine at that time. They held that everything of every kind and nature was subject to the tax. You can readily see the confusion thrown around this proposition. The companies had been for 14 months not subject to the tax, and then suddenly, in the midst of the depression of 1920, they are called upon to pay enormous sums to the Government. And the Government was quite harsh with them and demanded that it be promptly paid. The companies were embarrassed to pay it, but finally did pay it.

The American-La France brought suit to determine the question, and that suit came on and was tried, and finally went to the Circuit Court of Appeals in New York. It was the American-La France Fire Engine Co., as it was then called, that brought the suit, and the Circuit Court of Appeals in New York unanimously held that it was not the intention of the Congress to tax fire-fighting apparatus; that fire-fighting apparatus was not an automobile, that its use of the streets was merely incidental and occasional, being self-propelled only for the purpose of getting to a fire and putting it out. That decision was unanimous, that it was not subject to any tax whatever. The bureau accepted that ruling and began to return the money collected on proper application.

Senator SHORTRIDGE. What year was that?

Mr. WYVELL. In 1925. That decision came down in April, 1925. In the brief which I am going to furnish you—and I will be glad to hand a copy to each member of the committee—reference is made to that decision.

Senator SHORTRIDGE. Has the bureau followed that ruling?

Mr. WYVELL. The bureau has been following that ruling. Now, our particular situation is this, and we are up to this point now, that the tax was illegal and the Government had no right to the money, any more than it had the right to tax shoes or chairs or anything else. They took the company's money.

And, unfortunately, due to the confusion created by the bureau itself, this company and some other companies were a few days too late in getting their claims for refunds in, and we are asking the committee for an amendment to permit the industry to receive back the money to which it is entitled and which the Government took without color of right whatever.

The CHAIRMAN. Oh, that is a claim, and you will have to have a special bill introduced to cover that.

Mr. WYVELL. Mr. Chairman, may I submit that this was the bill under which the money was taken from us——

The CHAIRMAN. Well, this is not a claim bill.

Mr. WYVELL. May I make this suggestion?

The CHAIRMAN. It is usual, and there is not a session of Congress but what claim bills are introduced and passed.

Mr. WYVELL. But if we attempted to make this a claim as such in a claim bill, you would have to deal with perhaps 12 fire engine companies, because to some extent they are all in the same boat. It was the general bill that took our money away from us, and I think it is only proper that this matter of refund should be dealt with in the same bill.

Senator WATSON. It was a ruling under the bill.

Senator McLEAN. How much money did it involve?

Mr. WYVELL. A total of approximately $1,400,000 was collected under this ruling. All of it has been paid back except approximately $200,000. Not more than that is involved irrespective of interest.

Senator SHORTRIDGE. Relief would be by way of a separate bill.

The CHAIRMAN. That is all as I understand.

Senator HARRISON. If the matter is so palpably wrong and the failure of the return of the money was not the fault of these people, I do not see why we can not write it into this proposition.

The CHAIRMAN. This is the third revenue bill, and I do not remember that we ever made claims a part of a revenue bill.

Senator HARRISON. And I do not recall a similar case.

The CHAIRMAN. Oh, yes; there was one here only yesterday.

Senator HARRISON. Is the Treasury Department recommending that this payment be made?

Senator McLEAN. As I understand it, the statute of limitations have run against it.

Mr. WYVELL. Yes; only 12 days. I have communicated with Mr. Alvord. He knows my position in the matter.

Mr. ALVORD. The Treasury Department has taken the position that a refund of money after the statute of limitations has run should be covered by a separate bill in each case where the Congress wants to cover it.

Senator HARRISON. If I understand from the statement made here there are some companies that paid the money and then got it back.

Mr. WYVELL. Well, some companies got their money back, and some companies did not because they were too late in filing application, in this case by 12 days, and we did not get it back.

Mr. ALVORD. They were treated the same as all other taxpayers.

Senator REED of Pennsylvania. Some of them let the statute of limitations run and some did not.

Senator WATSON. Yes; but it is a great wrong and ought to be rectified.

Mr. WYVELL. You see, this was a monthly proposition. It was not as simple as filing them once a year. And I will say that we got a part of our money back, I may say the greater part of our money back. But due to this confusion in the Internal Revenue Bureau itself, we were confused and did not get some claims filed in time. We asked the Government to pay the money back, and they said no, the statute had run.

The CHAIRMAN. All right.

Mr. WYVELL. I wish this memorandum to be made a part of my remarks.

(The memorandum referred to is here made a part of the record, as follows:)

AMERICAN-LA FRANCE & FOAMITE CORPORATION,
New York, April 11, 1928.

MEMORANDUM FILED WITH THE COMMITTEE ON FINANCE OF THE SENATE RELATING TO A PROPOSED AMENDMENT PERMITTING REFUNDS OF EXCISE TAXES ERRONEOUSLY AND ILLEGALLY COLLECTED BY THE TREASURY DEPARTMENT ON THE THEORY THAT FIRE-FIGHTING APPARATUS AND APPLIANCES CONSTITUTED AUTOMOBILES

From 1917 to April, 1925, inclusive, the Internal Revenue Bureau erroneously and illegally collected from manufacturers of self-propelled fire-fighting apparatus approximately $1,400,000 upon the erroneous theory that fire-fighting apparatus constituted automobiles in the revenue act of 1917, the revenue act of 1918, the revenue act of 1921, and the revenue act of 1924.

The United States Court of Appeals, second circuit, in the case of the American-La France Fire Engine Co. *v.* Riordan, collector (6 Fed. Rep., 2d series, p. 964), held that it was not the intent of Congress to tax fire-fighting apparatus, and, therefore, that fire-fighting apparatus was not included within the excise-tax laws imposing taxes upon automobiles, automobile trucks, and automobile accessories. The Internal Revenue Bureau accepted the opinion of the circuit court of appeals as good law and returned to the various manufacturers of fire-fighting apparatus about $1,200,000, leaving about $200,000 not returned for the reasons stated below:

The Internal Revenue Bureau dealt with fire-fighting apparatus in a series of rulings confusing and wholly inconsistent with each other. The American-La France Fire Engine Co., of Elmira, N. Y., is the largest manufacturer of fire-fighting apparatus, and in January, 1918, The Treasury Department ruled that a self-propelled pumping engine, being the instrument which actually pumps the water through the hose and on the fire, was not an automobile, but that other fire-fighting apparatus should be classed as automobiles or automobile accessories and taxed at 5 per cent. In May, 1918, the Commissioner of Internal Revenue, by regulations 44, article 7, announced that article sold to a State or political subdivision thereof for use in carrying on its governmental operations were not subject to excise taxes. Approximately 90 per cent of the fire-fighting apparatus manufactured by the American-La France Fire Engine Co. and other fire engine companies is sold to municipalities, and while this ruling was in force the Internal Revenue Bureau collected taxes only on fire-fighting apparatus sold to individuals, firms, or private corporations, and thereafter the Government in some instances refunded to the American-La France Fire Engine Co. taxes paid under former rulings. Under date of May 5, 1919, regulations 47, construing the revenue act of 1918, was announced, and article 10 of regulations 47 repeated the regulations that articles sold to a State or municipal subdivision thereof by a manufacturer for use in carrying on its governmental operations were not subject to the tax.

In the month of July, 1919, the Commissioner of Internal Revenue promulgated Treasury Decision No. 2897, which reversed the above-mentioned regulations and decisions in regard to sales to States and municipalities, and further provided that such reversal should have a retroactive effect. That thereafter and by Treasury Decision No. 2930, issued October 7, 1919, the Treasury Department again apparently ruled that pumping engines and perhaps other kinds of fire-fighting apparatus were not subject to the excise tax, but this ruling was so confusing that its meaning was doubtful. A sentence in said ruling reads as follows:

"A self-propolled fire engine, if designed to carry only such persons as are necessary to drive it and to operate the pumping engine, is not taxable."

This ruling was formally published as article 11 of regulations 47. Such fire-fighting apparatus as was allowed at be taxable was taxed as a pleasure automobile at 5 per cent.

These rulings necessarily resulted in the greatest confusion with respect to what taxes, if any, would be demanded. Conferences were held by representatives of the American-La France Fire Engine Co. with Treasury officials concerning the situation. Then later the Treasury Department notified the American-La France Fire Engine Co. that they were still uncertain with respect to the tax liability of fire-fighting apparatus and that the whole situation would be reviewed in an additional ruling. In the meantime they were informed that the

Internal Revenue Bureau would accept claims in abatement with respect to excise taxes claimed and not paid due to the existing confusion.

Thereafter and by Treasury Decision No. 2989 issued March 3, 1920, the Internal Revenue Bureau reversed and modified the above ruling, to wit, Treasury Decision 2930, and promulgated articles 11, 12, and 13 of regulations 47, and ruled therein that all fire-fighting apparatus of every kind and nature should be regarded as automobile trucks and should be taxable at 3 per cent instead of 5 per cent as in the case of ordinary automobiles. This ruling was made retroactive, and the American-LaFrance Fire Engine Co. was informed that they must now pay excise taxes at the rate of 3 per cent (3%) with respect to all sales, whether made to a city, county, State, person, or corporation, and with respect to every kind of fire-fighting apparatus, including pumping engines.

The foregoing shows the confused condition in the Treasury Department relating to the collection of excise taxes on fire-fighting apparatus.

This ruling, to wit, articles 11, 12, and 13 of regulations 47, very seriously affected the finances of all manufacturers of fire-fighting apparatus. The Internal Revenue Bureau, using the ruling as authority, suddenly called for excise taxes now claimed to be due for previous years and months and for periods of time when according to Internal Revenue Bureau rulings no taxes were due, and with respect to certain kinds of fire-fighting apparatus, which had not heretofore been taxed. Moreover, this ruling came in a period of great depression and it was very hard to raise money. The result was that some of the smaller manufacturers of fire-fighting apparatus were forced to the wall.

The American-La France Fire Engine Co. was suddenly called upon to pay approximately $340,000 of alleged back excise taxes, when all the time it had been trying to observe Treasury rulings, and it found itself in a very distressing situation. It was only by the curtailment of expenses, the rapid cutting down of inventories, and by resorting very largely to the point of exhaustion of its credit at the banks that the American-La France Fire Engine Co. was able to pay these alleged taxes, which afterwards the United States courts held to be illegally collected.

Each time a tax was paid by the American-La France Fire Engine Co. it protested the tax under oath upon the ground that fire-fighting apparatus could not be regarded as automobiles, and that it was not the intention of Congress to include fire-fighting apparatus when it provided for the excise tax upon automobiles, automobile trucks, and automobile accessories.

Thereupon the American-La France Fire Engine Co. brought a suit in the Circuit Court of the United States, Western District of New York, to recover sums paid as excise taxes during three of the preceding months. The suit was carried to the Circuit Court of Appeals, Second Circuit, and by decision No. 159, decided April 6, 1925, the circuit court of appeals held that fire-fighting apparatus could not be classed as automobiles or automobile trucks within the meaning of any of the excise tax laws previously enacted; and that Congress did not intend to tax fire-fighting apparatus, since fire-fighting apparatus was used solely for the purpose of extinguishing fires, and that such apparatus was purchased almost entirely by municipalities or for State purposes.

Thereupon the Treasury Department accepted the above-mentioned decision of the Circuit Court of Appeals, Second Circuit, and proceeded to make refunds with respect to claims filed by the American-LaFrance Fire Engine Co., and other fire-engine companies covering taxes paid by them.

Due to the confusion explained above which necessarily resulted from the action of the Government in promulgating retroactive, conflicting, and inconsistent rulings with respect to fire-fighting apparatus, the American-LaFrance Fire Engine Co. was about 15 days too late in filing refund claims with respect to certain payments of approximately $150,000 made in 1920 and as these claims were not filed within the period of limitation then existing, the Government refused to return to the American-LaFrance Fire Engine Co. approximately $150,000 of the sums which the Government had erroneously and illegally collected despite the protests duly and emphatically made. It is submitted, therefore, that since the Government illegally collected the above money, when no part of it was due or owing, that in all fairness provision should now be made for the return to the American LaFrance Fire Engine Co. of the sums to which it is entitled.

It is probable that other manufacturers of fire-fighting apparatus are entitled to the return of not exceeding $50,000 by reason of similar situations. If the amendment herein suggested should be adopted, the total amount which the Government would be called upon to refund will not exceed $200,000.

Accordingly the manufacturers of fire-fighting apparatus respectfully request that the attached amendment be enacted in the pending revenue bill, and that it be placed in the bill after line 14 of page 188 of House Resolution 1 now before the Committee on Finance of the Senate.

Respectfully submitted.

——— ———, *President.*

At the end of line 14, page 188, of the bill to reduce and equalize taxes and provide revenue, and for other purposes, insert the following:

"(d) Where, prior to the enactment of this act, the Secretary of the Treasury has illegally collected excise taxes upon the sale of self-propelled fire fighting apparatus erroneously taxed as automobiles, automobile trucks, automobile wagons, or parts or accessories thereof under the revenue act of 1916, the revenue act of 1917, or the revenue act of 1918, there shall be refunded to the manufacturer, producer, or importer by whom said taxes were respectively paid the sums so paid with interest from the date of payment upon the allowance by the Commissioner of Internal Revenue of refund or credit claims therefor, and such claims for refund shall be considered and passed upon by the Commissioner of Internal Revenue if the same shall have been filed before the passage of this act or within one year thereafter and notwithstanding any period of limitation that might otherwise be applicable thereto."

The CHAIRMAN. We will now hear Mr. Griffith.

STATEMENT OF WARREN E. GRIFFITH, VICE PRESIDENT OF THE NATIONAL AUTOMOBILE DEALERS' ASSOCIATION, TOLEDO, OHIO

Mr. GRIFFITH. I am the head of a committee that is here in the interest of the removal of the war tax on motor cars, and I am accompanied here by Mr. C. E. Fisher, president of the Uppercu-Cadillac Corporation of New Jersey, Newark, N. J.; Mr. Edward J. Foley, president of the Foley-Chevrolet Co., Newark, N. J.; Mr. Harter B. Hull, president of the Harter B. Hull Co., of Baltimore, representing the Dodge cars.

The case for the dealers was presented in detail before the Ways and Means Committee of the House of Representatives last fall, and I think that unless there are some questions about details of that presentation, I will eliminate that in the interest of your time.

The CHAIRMAN. Yes; it is fully given here in the hearings held by the Ways and Means Committee.

Mr. GRIFFITH. The information was given quite fully before the Ways and Means Committee of the House and appear in their hearings.

The CHAIRMAN. If there is anything additional that you desire to say we shall be glad to listen to you.

Mr. GRIFFITH. I want to put myself and also the other members of the committee at the service of the Finance Committee of the Senate in answering any questions that may have arisen here pertaining to this subject since the hearings before the Ways and Means Committee of the House. I understand that there are a number of questions that have come up.

The CHAIRMAN. The only question in the minds of the most of the Senators is whether we can afford to do it. I think the most of

them would like to take all these excise taxes off. But that is the only question.

Mr. GRIFFITH. The point that we would like to make is the same as the manufacturers would make and the owners would make, Mr. Chairman, and that is the fact that it is a very representative group, perhaps permeating more largely into the population of the United States than you think, and that the tax is really paid in a very large number of cases by people who would be benefited tremendously by not having to pay it, and that the expense of collecting the tax is a tremendous burden on the automobile dealers, who are really tax collectors for the Government.

When you recall that a 60-days' supply of new automobiles is constantly on hand on the floors of the dealers of this country, about 600,000 automobiles, with $10,000,000 in taxes, which automatically go into the capital structure of those dealers, which cost $1,000,000 to $1,500,000 to carry, and upon which there can possibly be no profit, it becomes a burden upon a group of merchandisers who can not well stand additional burdens.

Senator REED of Pennsylvania. Think of what we are doing to the tobacconists.

Mr. GRIFFITH. How is that?

Senator REED of Pennsylvania. Think of what we are doing to the tobacconists, where we are charging 40 per cent in some cases on the selling price of cigarettes.

Mr. GRIFFITH. Senator Reed, I should really hate to be put in the category with tobacco.

Senator SHORTRIDGE. Who pays the tax now?

Mr. GRIFFITH. The purchaser.

Senator SHORTRIDGE. Do the dealers pay the tax?

Mr. GRIFFITH. Yes; the dealer pays the tax and collects it.

Senator WATSON. He collects the tax?

Mr. GRIFFITH. Yes.

Senator SHORTRIDGE. But who is it that ultimately pays the 3 per cent tax?

Mr. GRIFFITH. The man who buys the automobile.

Senator SHORTRIDGE. Not the manufacturer?

Mr. GRIFFITH. No, sir.

Senator SHORTRIDGE. And not the dealer?

Mr. GRIFFITH. No, sir; except for the time being.

Senator SHORTRIDGE. But the purchaser of the machine pays the tax.

Mr. GRIFFITH. Yes, sir.

Senator REED of Pennsylvania. Who pays it to the Government?

Mr. GRIFFITH. The manufacturer.

Senator HARRISON. You would rather be put in the category of the chewing-gum people, whose tax has been lifted, I take it.

Mr. GRIFFITH. That is a little better than tobacco.

Senator SHORTRIDGE. Well, I question that, and so does the Senator from Mississippi.

Mr. GRIFFITH. Another matter which I should like to bring up quite definitely here is, that should the committee recommend the removal of the war tax, because that is what it is, and I think you will, you were committed in principle, both branches of the Congress were committed in principle two years ago to the rebate of the

tax on motor cars already on the floors of dealers and already paid for to the Government. As was pointed out this morning by Mr. Chapin, immediately upon the signing of the bill which would remove the war tax from automobiles the public will get the benefit of it in its entirety. Now then, it should not be that the dealer would have to pay that overlapping tax, because he would immediately have to give the purchaser the benefit of it.

The CHAIRMAN. We can provide for 60 days' time.

Mr. GRIFFITH. I understand, but at the time the bill came out of the House, Mr. Chairman, the original recommendation of the Ways and Means Committee on the 1½ per cent compromise it was left in as it applied to the rebate of tax so that it was not taken care of there.

The CHAIRMAN. In the last bill we provided that there would be a floor tax, and that could be provided for again.

Mr. GRIFFITH. Are there any other questions?

The CHAIRMAN. I think we understand the situation pretty thoroughly.

Mr. GRIFFITH. All right, I thank you.

(The witness left the stand.)

The CHAIRMAN. We will now hear from Mr. Frederic Brenckman.

STATEMENT OF FREDERIC BRENCKMAN, WASHINGTON REPRESENTATIVE OF THE NATIONAL GRANGE, WASHINGTON, D. C.

Senator SHORTRIDGE. I believe you represent a farmers' organization?

Mr. BRENCKMAN. Yes, sir; the oldest one in existence. It is 61 years old.

Senator REED of Pennsylvania. Do the farmers want the tax taken off of Rolls-Royces?

Mr. BRENCKMAN. I will tell you briefly what the policy of the National Grange is with reference to Federal taxation as outlined at our last annual meeting, which was held at Cleveland, Ohio, last November: The policy of the National Grange may be stated in this way, that we are in favor of debt retirement rather than tax reduction. And we come to that conclusion by virtue of the fact that the interest on the national debt at this time is over $600,000,000 a year, which is just about as much as it cost to run the Government all told back in 1910.

The CHAIRMAN. And a few years ago it was a billion dollars.

Mr. BRENCKMAN. Yes, sir.

The CHAIRMAN. And we have saved that much of the taxes anyhow.

Mr. BRENCKMAN. We feel that rather than reduce the taxes it would be well to get rid of the national debt, and the interest charge just now is about what it cost to run the Government 15 years ago. However, in outlining a policy it was very distinctly stated that if there is to be any tax reduction in the judgment of the Congress, that we are in favor of a complete repeal of the war-time tax on automobiles, and for the reason that we consider this tax discriminatory, unjust, and——

The CHAIRMAN. As to the admission tax it is the same way, is it not?

Mr. BRENCKMAN. Well, I am not prepared to say about that. But we are especially opposed to the permanent imposition of this automobile tax as a sales tax. The National Grange has always been opposed to the idea of a sales tax. Now, looking at it from the standpoint of the farmer——

The CHAIRMAN. I wish I could take you for about half an hour over to my office. I think I could show you how foolish your attitude is on that proposition.

Mr. BRENCKMAN. From one-fifth to one-fourth of all the automobiles in the United States are owned by farmers, and the farmer is peculiarly hard hit along this line. In the first place he has a road tax to pay, and in the strictly rural districts the maintenance of roads falls very largely on farm property. Even in our State of Pennsylvania, Senator Reed, we have 70,000 or 80,000 dirt roads, and the farmers largely maintain those roads. There is very little help from the State. So first there is the road tax, and then in practically every State I suppose the farmer pays a license fee or a registration fee on his car. And then there is the driver's license fee. And then there is the gasoline tax, and if we add the war-time automobile tax the farmer pays in most cases five taxes on his automobile.

We do not take the position that the automobile is a luxury. It has been said occasionally that the automobile is a luxury, and the attitude of some people is that the farmer ought to have an automobile because it is a luxury. But the automobile is a necessity for the farmer. He has need for it. In the first place, it would be very difficult for the farmer to get over the roads to-day if he would try to go back to the horse and buggy, because he would be passed by vehicles going faster than the horse can travel, and would be crowded off the road. We feel that the farmer needs the automobile, and we do not think that the Government is justified in continuing this war-time tax when practically every war-time tax has been removed. Now, that is the attitude of the National Grange.

Senator HARRISON. That is especially true of trucks, because the farmers have to have trucks.

Mr. BRENCKMAN. Yes, sir; trucks are very necessary and helpful.

The CHAIRMAN. But tracks are free now.

Senator HARRISON. There is no tax on trucks now?

The CHAIRMAN. No; none whatever.

Senator HARRISON. Well, the farmers have been able to win that much.

Senator REED of Pennsylvania. Mr. Brenckman, just a question or two: We know that in the last analysis it is the ultimate consumer that pays every tax.

Mr. BRENCKMAN. Yes, but this tax is particularly shifted onto the ultimate consumer because it is so arranged. There is not any chance for the ultimate consumer to escape it in any way at all.

Senator REED of Pennsylvania. The income taxes, and especially those of corporations, are all in the last analysis borne by the ultimate consumer. Every time a farmer buys a pair of shoes he is helping to pay the income tax of the shoe manufacturer. Is it not for the best interests of the farmer that we get these taxes down?

Mr. BRENCKMAN. The income tax?

Senator REED of Pennsylvania. Yes.

Mr. BRENCKMAN. Of course, we realize that somebody has got to pay the taxes, and our theory is that ability to pay ought to be considered in levying taxes.

Senator REED of Pennsylvania. I think we all agree with you in that. And when it comes to the income tax, the Government, of course, has applied that theory, and it is the individual who pays that tax. But your corporation income taxes, whether paid by railroads or by manufacturers or what not, are—the most of them, at least—paid by people who are selling to the population of the United States as a whole. For that very reason I have felt all along that a reduction of these taxes might lower the costs of goods that are bought by the community.

Mr. BRENCKMAN. That is probably true.

Senator REED of Pennsylvania. And that that would be reflected probably just as much in the farmer's budget by the end of the year as would the 3 per cent tax on the passenger automobile that he buys occasionally.

Senator WATSON. But the tax on an automobile is, of course, a direct tax, and one that he feels, because he pays it when he buys the car.

Mr. BRENCKMAN. That is the position of the National Grange.

The CHAIRMAN. Very well. We thank you, Mr. Brenckman.

(The witness left the table.)

The CHAIRMAN. Mr. McKenna.

STATEMENT OF ROYAL T. McKENNA, GENERAL COUNSEL OF THE MOTOR AND ACCESSORY MANUFACTURERS ASSOCIATION, NEW YORK CITY

Mr. MCKENNA. Mr. Chairman and gentlemen of the committee, my name is Royal T. McKenna. I am general counsel of the Motor and Accessory Manufacturers Association and also represent the Automotive Equipment Association.

I appear here in opposition to the provisions of section 424. What I have to say is embodied in a memorandum, which I will hand to the reporter; and, as I have also furnished copies of that memorandum to each member of the committee, I will not make any further argument on the point.

The CHAIRMAN. We will make that a part of the record.

(The memorandum above referred to is as follows:)

For ready reference in connection with the discussion of the provisions of section 424 of the new revenue bill, the following memorandum is furnished you:

Both the limitations on the appropriations for refunding taxes illegally collected provided in Public, No. 660, Sixty-ninth Congress, and H. R. 5800, Seventieth Congress, and subdivisions (b) and (c) of section 424 of H. R. 1, are in direct conflict with section 3220, which section authorizes the Commissioner of Internal Revenue to "refund and pay back all taxes erroneously or illegally collected." So long as section 3220 remains on the statute books it is a serious injustice and discrimination to withhold refund of taxes illegally collected from one class of manufacturers, while refunds are being made, daily, to all other classes of taxpayers from whom illegal collections have been made.

With regard to the question of whether or not the taxpayers at whom this discriminatory and confiscatory legislation is aimed can be legally required, as provided in subdivision (c) of section 424, to pass on to the consumer the amount of any excise tax refunded to them by the Government, attention is

respectfully invited to the decision of the Court of Appeals of the District of Columbia in the case of Heckman & Co. (Inc.) *v.* I. S. Dawes & Son Co. (Inc.) (decided April 5, 1926), in which it was held that the tax was paid by the manufacturer for himself, and not for the purchaser, and that the purchaser had no right of recovery, even though he had reimbursed the manufacturer for the amount of the tax.

Subdivision (a) of section 424, which provides that no refund shall be made except in pursuance to a judgment of a court in an action duly begun prior to February 28, 1927, is unconstitutional, in that it retroactively deprives citizens of rights granted under section 3226 of the Revised Statutes, which section provides that suit for recovery of taxes illegally collected may be instituted at any time within two years after the rejection of a claim for refund. In connection with the question of the constitutionality of subdivision (a) attention is invited to the decision of the Supreme Court of the United States in the case of Wheeler *v.* Jackson (137 U. S. 245, 255), in which Mr. Justice Harlan, speaking for the court, said:

"It is the settled doctrine of this court that the legislature may prescribe a limitation for the bringing of suits where none previously existed, as well as shorten the time within which suits to enforce existing causes of action may be commenced, provided in each case, a reasonable time, taking all the circumstances into consideration, be given by the new law for commencement of suit before the bar takes effect."

Also, in the case of Sohn *v.* Waterson (17 Wallace 596, 597), Mr. Justice Bradley, speaking for the court, said:

"When a statute declares generally that no action, or no action of a certain class, shall be brought except within a certain limited time after it shall have accrued, the language of the statute would make it apply to past transactions as well as to those arising in the future. But if an action accrued more than the limited time before the statute was passed a literal interpretation of the statute would have the effect of barring such action at once. It will be presumed that such was not the intent of the legislature. Such an intent would be unconstitutional."

There were pending in the office of the Commissioner of Internal Revenue on February 28, 1927, numerous claims on which no action had been taken by the commissioner, and on which no suits could have been instituted by the taxpayers prior to that date, on account of the limitations of section 3226, Revised Statutes. This section provides that no suit may "be begun before the expiration of six months from the date of filing such claim, unless the commissioner renders a decision thereon within that time."

From a mere reading of this section you will note that suit could not have been brought on any claim filed subsequent to August 28, 1926, unless such claim had already been declined by the commissioner. As a matter of fact, numerous claims filed in the period from August 28, 1926, to February 28, 1927, had not been declined on the latter date, and there are to-day pending in the department numerous claims, filed within the statutory period, which have not been declined.

Regardless of any contention that may be made as to the validity of the proposed section 424 (a), it is submitted that, as a matter of equity and fair dealing, opportunity should be afforded the taxpayer to bring suit for taxes alleged, and in some cases admitted by the commissioner, to have been illegally collected, and upon rendition of judgment by the court such judgment should be paid.

If the provisions of section 424, as enacted by the House, are not entirely eliminated, the least that should be done is to set the date before which suits may be commenced at six months after the enactment of this act (see Public, No. 804, 69th Cong., approved March 4, 1927, which fixes the period within which the Government might bring suit to collect amounts due in the operation of railroads under Federal control) and eliminate the words "directly or indirectly" from subdivision (b).

I am authorized to say that the Automotive Equipment Association, with principal offices in Chicago, Ill., subscribe to the statements and contentions hereinbefore made.

Respectfully,

ROYAL T. MCKENNA, *General Counsel.*

The CHAIRMAN. Mr. Austin, we will hear from you now. Will you please give your name and address to the reporter?

STATEMENT OF J. B. AUSTIN, CULVER CITY, CALIF.

Mr. AUSTIN. Mr. Chairman and gentleman of the committee, our troubles are administrative more than financial. While the law exempts tickets sold for 75 cents, when they buy, as is customary in the circus, reserved seats, the department has ruled that the two transactions form one transaction, and, therefore, when a person buys a reserved seat an entire 14 cents accrues on the accommodation.

Senator SHORTRIDGE. Please make that plain.

Mr. AUSTIN. The law states, "Tickets sold for less than 75 cents." An age-old custom with the circus is to buy a ticket outside and an added reserved seat inside. There is no tax on the general admission, but when a customer elects a buy a reserved seat inside, the department has ruled that the entire tax accrues on the transaction.

We ask that whatever exemption is made on the admission tax that it be exempted like the income tax is; say, for instance, the established price is $1.50, exemption $1, and tax 5 cents. We ask that the exemption be passed on to the circus business in which, up to the present time, we have never received a nickel.

Senator SHORTRIDGE. Do I understand that you can buy a general admission ticket for 75 cents with no tax?

Mr. AUSTIN. No tax.

Senator SHORTRIDGE. But going inside the main tent if you wish to buy a reserved seat——

Mr. AUSTIN. Then there is a tax of 14 cents that accrues.

Senator REED of Pennsylvania. They take it from the customer gradually instead of doing as the theaters do?

Mr. AUSTIN. Yes, sir.

The CHAIRMAN. What do you charge for a reserved seat?

Mr. AUSTIN. Seventy-five cents. Now, gentlemen, our situation has been further complicated by the various States passing admission tax laws. South Carolina has one and last week Mississippi passed one. That makes 28 cents as accrued now under the State and the Federal taxes, which is absolutely prohibitive.

Senator REED of Pennsylvania. That circus tax is practically a sales tax, is it not?

Mr. AUSTIN. No, sir; we pay all kinds of licenses in addition.

Senator REED of Pennsylvania. No; but I mean this tax that is imposed on the price of the ticket is practically a sales tax?

Mr. AUSTIN. Yes, sir.

Senator REED of Pennsylvania. You say that Mississippi has just adopted that?

Mr. AUSTIN. Just last Friday; and South Carolina had already done so. Now, gentlemen, we think this: The 75 cents saving has been passed on to other forms of amusement, and in hundreds and hundreds of towns the people have no other form of amusement except the picture shows. They naturally get it into their heads that the tax has been left off, and along comes the circus and announces that it is still on and they look upon us as they formerly did. We feel that in justice to our business we should have this exemption. We know that you are going to exempt something, and whatever that is we think it should be exempted right down the line. The form now reads: "Established price $1.50, tax 14 cents, balance $1.34." We think it should read: "Established price $1.50, exemp-

tion 75 cents, tax 7 cents." We know that the admission taxes are going to stay on, to a certain extent, and we think we are entitled to our share of it in keeping with the other business.

Senator HARRISON. Mr. Austin, here is a Mississippian in sympathy with you.

Mr. AUSTIN. Gentlemen, the idea is this: The circus business now is psychological. No one comes until the psychological moment, at 8 o'clock. Ninety per cent of our patrons come in automobiles. The people come to see the big show now. We sell all our tickets in 20 minutes, and we must make arrangements for even change. So we just had to make that arrangement. Whatever exemption you gentlemen decide on later, if we got that portion of it we would be perfectly satisfied.

Senator REED of Pennsylvania. You mean to exempt the first dollar of admission tax instead of those under one dollar?

Mr. AUSTIN. Yes; if anyone wanted to occupy the high-priced seats they would pay on the added accommodation. It would place all in our business on an equal footing. In the small towns, where there is nothing but the picture show, we come along with a tax hung up and they say, "Well, there isn't any tax; the tax is off."

Senator REED of Pennsylvania. You absorb the tax out of your $1.50 now, do you not?

Mr. AUSTIN. In some cases, and in some cases we add it. The feeling is such in small towns that we can not add it, but in cities they understand that. They are broken into that. We have to carry two sets of tax.

The CHAIRMAN. Mr. Brokmeyer.

STATEMENT OF EUGENE C. BROKMEYER, GENERAL COUNSEL FOR THE NATIONAL ASSOCIATION OF RETAIL DRUGGISTS, WASHINGTON, D. C.

Mr. BROKMEYER. Mr. Chairman and gentlemen of the committee, my name if Eugene C. Brokmeyer, and I am general counsel for the National Association of Retail Druggists. We had the honor in December to ask this committee to consider the suggestion that the registration tax on retail druggists who are called on to dispense narcotic drugs in aid of the sick be reduced from $6 a year to $1 a year, because for many years, until the war, the tax on retailers and wholesalers and manufacturers and physicians was $1 a year. Originally it was made that way simply to give the Government control over the supervision of the manufacture and distribution of narcotic drugs, which was eminently proper, it having been the duty of the Congress, of course, to effect the International Opium Convention.

The tax was increased to $6, and in 1926 it was reduced to $3 on physicians, which we think was very fair and considerate, considering that they are practicing medicine.

Senator WATSON. Was it $6 on doctors and physicians, too, during the war?

Mr. BROKMEYER. Yes, sir.

The CHAIRMAN. It is only $1 now on physicians?

Mr. BROKMEYER. It is only $1 now, and we ask that we be placed on terms of equality with physicians, because we are partners, so

to speak, and as your worthy chairman will bear me out the physician prescribes and we compound the narcotic prescription and furnish it to the sick.

However, I read a very interesting and very persuasive statement from the Secretary of the Treasury to a Senator, and in principle I concur with the view of the Treasury Department, that it might be dangerous to make too much of a reduction in this tax, because you might weaken the identity of the Harrison Act as a revenue measure, and the Supreme Court only yesterday said that that is a very material point in determining the constitutionality of the Harrison Act.

We are in sympathy with that view, but we come with this amended application, if I may be permitted to put it in that way; we ask you, if you can see your way clear, to reduce the tax from $6 to $3 a year.

It makes this difference: There are some 5,300 retail druggists in the country; and $3 a year saving to them would amount to $150,000 a year.

Senator SHORTRIDGE. About how much revenue has the law yielded at $6?

Mr. BROKMEYER. At $6 it would be six times 53,000, or approximately something over $300,000.

If you could see your way clear to reducing it from $6 to $3, you would still save for the Treasury $160,000, which would be still a substantialy yield from a revenue point of view.

Senator SHORTRIDGE. But $6 a year would not strike one as being a very heavy burden. That is only 50 cents a month.

Mr. BROKMEYER. I would ask the same question if I were in your place, Senator, and if I did not know that the retail druggist is a man that makes his living by selling postage stamps and dealing in small-priced articles. As he pays some 30 or 40 different kinds of tax, Federal, State, and local, every two or three dollars counts.

Senator SHORTRIDGE. Yes; that is true.

Mr. BROKMEYER. So I will leave that in your hands.

The CHAIRMAN. Senator, that is all who are here to be heard to-day, and we will adjourn now until 10 o'clock to-morrow morning.

(Whereupon, at 3.10 o'clock p. m., the committee adjourned to meet at 10 o'clock a. m., Thursday, April 12, 1928.)

REVENUE ACT OF 1928

THURSDAY, APRIL 12, 1928

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

The committee met, pursuant to adjournment, at 10 o'clock a. m., in the committee room, Senate Office Building, Senator Reed Smoot presiding.

Present: Senators Smooth (chairman), McLean, Curtis, Reed of Pennsylvania, Shortridge, Edge, Simmons, King, Harrison, Walsh of Massachusetts.

The CHAIRMAN. If the committee will come to order, we will proceed with the hearing. I believe Mr. MacChesney is the first witness.

STATEMENT OF NATHAN WILLIAM MacCHESNEY, CHICAGO, ILL., GENERAL COUNSEL FOR THE NATIONAL ASSOCIATION OF REAL ESTATE BOARDS

The CHAIRMMAN. You may give your name and address.

Mr. MACCHESNEY. My name is Nathan William MacChesney, of Chicago, Ill. I am general counsel for the National Association of Real Estate Boards.

The CHAIRMAN. You have already submitted a brief, have you not?

Mr. MACCHESNEY. I have already submitted briefs, which are before the committee and have sent copies individually to the members of the Senate committee, which attempt to cover the particular matters in H. R. 1 in which we are vitally interested.

Originally, when I appeared before the House Ways and Means Committee, we had a program which covered some 16 or 17 points, as a result of numerous tax conferences with representatives of some 650 real-estate boards. As a result of the hearing and the general sentiment, as far as we could sense it, there were certain items in that program which we have dropped out, and we are coming before you to-day with the program reduced to five points, which we believe to be the most essential out of the several hundred which were originally submitted to our national association, and only 5 points out of the 16 or 17 points which were argued before the House Ways and Means Committee. In addition, I desire to be heard very briefly with reference to two or three matters which were put into H. R. 1 and which, therefore, we did not consider before the House Ways and Means Committee in connection with the revenue act of 1926.

In order to save the time of the committee I am going to briefly refer to the principal points we wish to bring before you. I have filed what I designate as a brief or "third memorandum," covering these points, with a letter of transmittal, which will be found on pages 1 to 5 of the brief, together with a single-sheet summary for the benefit of the committee which outlines the contents of the brief.

The CHAIRMAN. Just put the summary in the record at this point.

(The document referred to is as follows:)

NATIONAL ASSOCIATION OF REAL ESTATE BOARDS,
OFFICE OF THE GENERAL COUNSEL,
30 North La Salle Street, Chicago, Ill.

To the honorable committee on Finance of the Senate:

The National Association of Real Estate Boards, through its general counsel, has filed with your committee under date of March 31, 1928, a detailed brief comprising the amendments to the revenue act of 1926 and H. R. 1 necessary to the real-estate business and interests, of which this is a summary.

A. CAPITAL GAINS

(1) Realty as capital assets:

(*a*) *Rule as to investor.*—The profit on the sale of realty should be considered as a capital gain regardless of the length of time it has been held where it has been acquired as an investment in fact, whether by an ordinary investor, a broker, or an operator.

(*b*) *Rule as to real-estate dealer.*—The profit on the sale of realty should be held to be capital gain where the property has been held by the taxpayer, regardless of his business or the purpose for which it was acquired, for more than two years.

(2) Capital gain rate formerly fixed with reference to bracket in income tax with maximum that of corporation tax, and proposed act should be adjusted on same principle:

In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain or sustains a capital net loss the tax upon the capital net gain should not exceed 6½ per cent and not more than 6½ per cent of the capital net loss should be deducted.

B. COMMISSIONS FOR OBTAINING LONG-TERM LEASES

Commissions paid by either the lessor or lessee for obtaining a long-term lease should be considered as expenses deductible in the year in which they become a definite liability, instead of being considered capital expenditures to be amortized over the period of the lease.

C. SUBDIVISION PROPERTY

1. *Deferred-payment sales not on installment plan.*—The statute or regulations should contain such an explicit definition of the term "fair market value" as to remove from the realm of individual opinion the determination of the question as to whether or not obligations of purchasers have a fair market value. (See Brief, p. 22.)

2. *Installment sales.*—Section 212 (d) of the revenue act of 1926 should be amended so as to remove the 25 per cent initial-payment limitation on installment sales. (See Brief, p. 32.)

3. *Subdivision—not lot—basis in subdivisions.*—Subdivisions rather than individual lot should be considered as the basis for determining profits. (See Brief, p. 35.)

4. *Syndicates and trusts.*—If capital is employed under the form of a trust, agreement, contract, or other financing method for the purpose of purchasing, subdividing and/or selling real property under which it is provided for periodic distribution of net proceeds of sale (or where in fact such proceeds have been distributed) and which also provides for and/or contemplates complete liquidation in due course of business (or where in fact such liquidation has taken place) the income shall be taxable only to the beneficiary of the trust agree-

ment or other instrument and there shall be no taxable gain until distribution shall have been made. Distributions as and when received by the taxpayer may be applied against and reduce the investment and in that event there shall be no taxable gain to him until such investment shall have been returned. (See Brief, p. 38.)

D. DIVIDENDS OUT OF SURPLUS ACCUMULATED PRIOR TO MARCH 1, 1913

The policy of exempting from tax, distributions by corporations out of earnings or profits accumulated and increase in value accrued prior to March 1, 1913, which has obtained since 1916, should be continued. (See brief, p. 53.)

E. COMPULSORY DISTRIBUTION BY PERSONAL HOLDING COMPANIES

There should be no distinction between a personal holding company as defined in section 104 (b) (1) of H. R. 1 and other corporations. There should be no limitation upon the right of the corporation to accumulate profits in any taxable year other than the reasonable needs of the business. (See brief, p. 57.)

Complete program of national association.—There are presented here five major points, the first three of which were a part of the original program of the national association for tax reduction and the last two of which were made necessary by reason of new provisions introduced in the bill by the House of Representatives. The full program of the national association for tax reduction consists of 15 points of which 7 are not now being urged before this committee, though we believe them worthy of consideration. The national association is desirous of holding the measure of relief already given by the House of Representatives in the bill now before you, on the following points of our program, which are discussed in detail in the supplemental brief filed with the committee under date of April 10, 1928:

PARTIAL RELIEF CONTAINED IN H. R. 1 IN THE SENATE

(1) *Cooperative apartments.*—The owners or lessees of apartment buildings operated altogether on the cooperative plan are given the right to deduct in their individual income returns the sums of money paid to the corporation on account of taxes and interest.

(2) *Installment sales.*—The seller of real estate may return the profit on the installment basis if the amount of payments received in the first year do not exceed 40 per cent of the selling price. Heretofore this limit was 25 per cent. We think the rule should be the same as it is for personal property.

(3) *Real estate boards.*—Real estate boards were included with business leagues, chambers of commerce, and boards of trade as exempt from tax if not organized for profit and if no part of the net earnings insures to the benefit of any shareholder.

We urge consideration and study of the full program as outlined in the brief, and we hope the program here set out will receive your favorable action.

Respectfully submitted.

NATHAN WILLIAM MACCHESNEY,
General Counsel.

Of counsel:
MACCHESNEY, EVANS & ROBINSON
(NATHAN WILLIAM MACCHESNEY AND HARRY E. SMOOT, *Of Counsel*),
30 North LaSalle Street, Chicago.
MACCHESNEY & WHITEFORD,
815 Fifteenth Street NW., Washington, D. C.

Mr. MACCHESNEY. The first of the points which I wish to discuss is the question of capital gain. Originally, when the capital-gain section was put in, there was considerable discussion about it and its relation to the income tax law then pending. It was finally fixed on a basis which is described by Mr. Montgomery as a normal tax of 8 per cent plus a surtax of 4½ per cent, making a total tax of 12½ per cent. Originally, when the bill was introduced, it was fixed at 15 per cent, but was modified to 12½ per cent on the theory that it

was unfair to individuals in the sale of capital assets as compared with a corporation, and the 12½ per cent was arrived at as a maximum, because that was the corporation tax rate and had a definite relationship to the normal and surtax in effect at that time.

Our contention with reference to capital gain now is that, if the taxpayer is to be given the same advantage under the revision of the present act that he had under the act at the time the 12½ per cent went in, it must be adjusted, because if, as a matter of fact, he is still charged on the capital gain a rate of 12½ cents with a lower normal and surtax rate, you are in effect postponing the advantage to the average taxpayer. I cover this rather completely in the brief (pp. 6 and 11–18) with some illustrations which I would be glad to have you look at, showing that under the act when it was passed a man who had an income of $27,500 (brief, p. 15) found it to his advantage to take advantage of the 12½ per cent rate, whereas a man who now has a capital gain income gets no advantage from the 12½ cent rate until he has an annual income of $65,000, greatly limiting the number of people who are given the benefit of that provision, which we think was not the intention, because it is generally conceded that the capital-gain tax is an unusual tax. It is not in effect in other countries. It is not strictly an income tax, though it has been held by the court to be within the law. It is generally felt that capital gain, representing an accumulation of profits over a series of years, should be at a lower rate therefore. You can raise it in either one of two ways. You can actually raise it, or by lowering the other rates you can destroy the relationship, because 12½ per cent now is higher than it was when it was passed in relation to both normal and surtax rates as well as to the corporation tax. That is the essence of the argument.

Our other point is that the capital gain tax, as administered and now written, is a very great hardship upon the particular interests we represent. Take, for instance, the matter of a home, or the matter of a building which is compelled to be sold, and a man takes a profit from it. He can not take advantage of it unless he has held it more than two years. We have statistics tending to show that about 100,000 homes change hands yearly in the country, and if a man is compelled by moving, if he gets another position, if he is elected to Congress and wants to sell his house in Chicago and buy a new one in Washington, he can not tell when that is going to happen.

We are not asking this committee that a man who is in the subdivision business, subdividing lots, should be given the benefit of the capital gain tax on property of the kind he sells; but we are saying that a man who buys a piece of property as an investment in fact should have the advantage of the capital gain section at any time it becomes necessary to sell that property. The most outstanding example of that in the case of a real-estate dealer, for instance, is that of a man who buys his own home to live in it, and he is in a totally different kind of business. In that case it is evident that that is an investment from any standpoint. It was not bought for the purpose of his business, and when he sells it he ought not to be compelled to pay a tax at the peak of his income but should be allowed to treat it as a capital gain. We are asking that the two years limit with ref-

erence to investors in fact, whether in real estate business or not, be removed. (See p. 1, summary.)

Then we are also asking that, so far as the real-estate dealers are concerned, where they have held the property for more than two years it should automatically become a capital asset to which the capital gain section should be applicable. We say that because real estate is not subject to inventory, as other classes of property, such as securities are, where gains and losses can be taken currently. I would not be disposed to quarrel with a period higher than two years. Perhaps three or even four years would more fully protect the Government and meet our contention.

Our contention is that in the ordinary building enterprise, if a man puts up a building for sale, is a real-estate dealer, and he holds it two years, he has lost money on it, because the universal experience is that a man who erects a building for sale and can not sell it in the current year, he has made a failure of the enterprise. It may be in certain classes of subdivision where improvements had to be put on them, that the period of sale is extended into the second year, and that is why I suggest the three-year period. But if a subdivider has to carry his land, after putting it on the market, for more than three years, the accumulation of interest and charges means that the enterprise has been a failure, as far as a profitable enterprise is concerned. It has become a capital asset, willy nilly, and therefore he should not be compelled to pay on it as though it were a current asset. (See p. 1 summary, and pp. 8–11, brief.) So much for that question. I think that makes it clear as to our position, and it is elaborated on in the brief.

The CHAIRMAN. Yes.

Mr. MACCHESNEY. The next point to which I desire to call your attention is found on pages 4 and 18 to 22 of the brief and page 2 of the summary, with reference to commissions for obtaining long-term leases. There was a long series of decisions by the Treasury Department deciding that question both ways (see our prior brief to Finance Committee, dated February 7, 1927), in which it held that a commission paid for a long-term lease is a proper deduction from current income, and which it held in a final decision that it must be amortized over the period of the lease. It is an absurdity to say to a man who makes a lease that he must amortize the commission paid over the life of the lease, because he never has that opportunity.

Take two specific cases, for instance, in Chicago, about which I happen to know. One was a case in which the commission paid was $125,000. The annual rental was something like $40,000, so it would take more than three years to get back the commission. In the other case the commission has $16,000, and the annual rental was $4,500, a lease for 199 years. If it were spread over 199 years it would mean the party who paid that commission for the securing of the lease would have to pay a return upon an income which he did not in fact receive.

The chairman may remember that he did me the courtesy of permitting me to discuss this question with him, and there were two alternative suggestions made with reference to this matter. (See pp. 21–22, brief.) It seems very unfair that a man who pays a commission of that kind upon a piece of property should have an income tax collected in advance of his receipt of any return, which is what

it amounts to. We believe and ask here that it should be allowed as a deduction from current income on some basis. The chairman suggested that it was perhaps not wise to have the Government postpone it so long, and we discussed two suggestions. One was that there might be a division of that income so that one-half of the rent should be taxed as income immediately, and the other half should be allowed to be applied as against the commission paid until such time as it should be amortized. The other was that a shorter period should be fixed in which presumably the owner might get the advantage of the amortization; in other words, amortize it over a period of 5 or 10 years, so that he might during his lifetime get the advantage of the deduction. It is very evident that where it is amortized over a period of 99 or 199 years he is in actual effect wholly deprived of the deduction, and it fixes a tax burden upon him which it seems to us is wholly unjust and unfair.

It does not seem to us that it is fair, or that the Government really contemplated that a tax should be fixed in such a way as to be payable out of funds that were not or could not be received by the taxpayer. The Treasury Department has decided this both ways. They have wabbled back and forth so often that people did not know what the rule was, but they finally reached the conclusion that it must be amortized over the life of the lease. We ask that the old ruling should be incorporated in the law, to be deducted from current income, or that either the Government and taxpayer should divide the income for the purpose of taxation or that it may be amortized over a shorter period like 5 or 10 years fixing it so the taxpayer may get the advantage contemplated by the Government.

Now, the third point to which I desire to call your attention is with reference to subdivision property, and is found outlined on pages 4 and 22–52 of the brief and pages 2 and 3 of the summary. That covers three or four different points.

The first point is with reference to deferred payment sales, or sales on the installment plan (pp. 22–32, brief). That refers to those cases where property is not sold for cash, known technically as the installment sales basis; in other words, where the amount received is such or the character of the deferred payment is such that it can not be treated as an installment sale. We are asking that the Government take cognizance of the actual condition of the market, and that a man should not be taxed upon a sale of property where he takes down, say, 40 or 45 per cent or a smaller payment, and the entire amount in a mortgage back, where that mortgage is not of such a character that it can be discounted in ordinary commercial channels. We attempt to fix on page 22 of the brief a suggestion that evidences of indebtedness shall be deemed not to have a fair market value unless they ordinarily can be disposed of under normal commercial usage at a rate of discount not in excess of 10 per cent, or at a proportionately higher rate if the rate of taxation is less than 5 per cent per annum. That last clause, I may say, was put in at the time Mr. William G. McAdoo and myself argued some specific cases before Mr. Gregg, at the suggestion of Mr. Gregg, at the time he was general counsel of the bureau. He suggested that while there might be some rule arrived at when the paper was not commercially discountable, that in order to evade it the taxpayer might issue paper without any interest rate so the discount would become

very high. So we put in this additional clause: "Or at a proportionately higher rate if the rate of interest is less than 5 per cent per annum," to prevent that subterfuge being used against the Government. Perhaps 10 per cent under extraordinary market conditions is not sufficiently high. We would not quarrel with 15 per cent, but ertainly a man who has to discount his paper at 20 per cent is on the road to bankruptcy. Some of us know of these finance companies that discount paper at 20 per cent, but a man can not discount his paper with these finance companies if it has any length of time to run, because it costs him too much. He can only discount it when it will enable him to go into the market at an earlier date in such a way as to make more use of his capital.

We are asking, therefore, that in all these cases of deferred payment sales, where the payment is not made on the installment basis, where paper is taken back, that a man shall be allowed to return for income-tax purposes only the payments as received, unless the paper can be sold in commercial channels for a discount not exceeding 10 per cent. In other words, we do not believe that the Government should say, as they have in case after case, that paper is good, or that the proof has failed to show it was not good, notwithstanding, as we point out in the brief, that no bank will lend any money on it, when the paper is to all intents and purposes from a commercial standpoint worthless. We do not believe the Government should take the position, as the Treasury Department has in effect, that it must be a bankruptcy proposition before a man is entitled to the relief granted.

Senator HARRISON. Do they make it incumbent upon the holder of a note to sue and get a judgment before he can get a rebate?

Mr. MACCHESNEY. Of course, they give the right to rebate when the paper is actually bad.

Senator HARRISON. What do they call "bad"? Say the paper is not collectible, you know it is not collectible, but you do not sue on it. Have you actually got to sue on it before they hold it is not good?

Mr. MACCHESNEY. No: I do not think you have to go that far, but I think you have to set it up as an actual loss and ask for a rebate on it.

The CHAIRMAN. If there is any question about it you have to prove it.

Mr. MACCHESNEY. Yes. Let me state a specific case.

Senator HARRISON. I know of several specific cases of my own.

Mr. MACCHESNEY. Here is one of the most glaring cases. Here is a civic institution with no income against which to charge a loss, which conceived the brilliant idea that they could be business men and make a large sum of money for the institution by buying a piece of property and re-selling it. That happened in Florida. They resold it and got back a second mortgage. The tax was $52,000. The Government made a demand for that $52,000 tax, notwithstanding the fact that before the demand was made the property had been foreclosed by the first mortgage so as to wipe out all the interest of the owner and the interest of the second mortgagee as well. Here was a civic organization attempting to make some money for public purposes faced with a $52,000 tax which meant bankruptcy without any income against which to charge it. So the right to charge it

off as subsequent losses did not mean anything to them. We can name hundreds of cases of that kind.

So it works a great hardship for the Government to insist that paper which can not be discounted has a value for tax purposes, and we think the Government should fix a rule by which, if paper in ordinary commercial channels can not be discounted at a fair rate, taxpayers shall be allowed to return for taxation the money received.

The second point under this is installment sales, which will be found on pages 32 to 35 of the brief and pages 12–14 of the supplemental brief.

The CHAIRMAN. Your brief covers that pretty thoroughly.

Mr. MACCHESNEY. Yes, sir.

The CHAIRMAN. I do not think you need take any time on that.

Mr. MACCHESNEY. Then may I just call your attention to this point, without going into it in detail: On page 32 of the brief, and also on page 12 of the supplemental brief which I filed with the committee, I want to call attention to the fact that the House increased the percentage from 25 to 40.

Senator HARRISON. You do not want that disturbed?

Mr. MACCHESNEY. We want to be sure that we keep at least that much, but we want to call your attention to one point in that connection, which is argued in the supplemental brief: That as a result of the dimunition in the selling market and the great sales resistance it is no longer possible to sell real estate in this country on a 25 per cent selling contract, and the result is that it means that the owner does not have the margin under the 40 per cent which he should have; that in the West, with 25 per cent down and 1 per cent a month on the property, it still enables them to keep the sale within the installment rule, but on a 1½ or 2 per cent basis, which is the common rule in Chicago and in the East, and is generally common east of the Mississippi River, it would run from 43 to 49 per cent. We urged before the House committee that if they would not give us the rule applicable to personal property, which we felt might be applied to real estate, they should allow installment returns where the payment did not exceed 50 per cent. We think it should be a minimum of 43 per cent, and that 49 per cent would be fair. In view of the chairman's suggestion, I will pass on to the next point with the specific request that the figure "40 per cent" in the House bill be increased to "49 per cent."

The next is subdivisions—net lot basis in subdivisions—on pages 35 to 37 of the brief. It is our contention that the subdivider should not be compelled to allocate the cost of property to specific lots, but should be allowed to count the cost of the property against that part of the subdivision which is being improved in such a way as not to return for income-tax money received until the cost of improvement of that particular section has been returned, because it is really impossible to tell in advance what the cost may be or what the profit will be. For instance, it has been perfectly evident in this last year that you can not set a sales schedule in advance and be sure of carrying it through to completion at a given date, so as to realize the rate of profit necessary to fix the income tax in advance. We are asking that they should be allowed to return the particular part of the property being developed, rather than allocate it to particular lots, which is a very great hardship.

The last point in respect to subdivisions, and the only one which I desire to take any particular time on, is the question of syndicates and trusts, found at pages 38 to 52 of brief. There are two amendments before the committee on that point. There is one amendment which you will find on page 39 of our brief, in the right-hand column, applicable to H. R. 1. There is another one which I understand has been or will be submitted by Senator Shortridge to the committee, which is an amendment to section 701, which I am informed was prepared by Mr. Gregg and which is as follows:

AMENDMENT TO SECTION 701 (A) (2) OF THE REVENUE BILL

The term "corporation" includes associations, joint-stock companies, and insurance companies. For the purpose of this act, trusts or other unincorporated agencies created for the primary purpose of liquidating property as a single venture (with such powers of administration as are incidental thereto, including the acquisition, improvement, conservation, division, and sale of such property) and the distribution of the proceeds thereof in due course to or for the benefit of the persons beneficially interested shall not be deemed to be an association. The trustee, or any person beneficially interested in such a trust or unincorporated agency, shall have the right to apply the provisions of this paragraph in returning income for any year prior to the enactment of this act.

There was a slight conflict between these two amendments, which attempted to cover the same situation, but in a conference yesterday with the gentleman from California and ourselves we eliminated the conflict. So I desire in behalf of the interests I represent to say to the committee that we hope both amendments will be adopted. Both the amendment suggested by Senator Shortridge and the amendment on page 39 of our brief should be passed. The Shortridge amendment is necessary to protect the trustee and is the proper way to compute the income under trust but would constitute a great hardship on the beneficiaries unless amendment at page 39, brief, is also passed, as it is essential to protect situation as business is done generally in this country, as will be explained by Senator Deneen. We urge the passage of both.

The CHAIRMAN. Mr. Gregg is going to speak on these amendments.

Mr. MACCHESNEY. Yes; both amendments.

The CHAIRMAN. Both amendments?

Mr. MACCHESNEY. Yes, sir. The essential point is this, that a trust which is formed for the purpose of handling property, when it is contemplated that it be liquidated as a single venture, and is not a continuing trust, that such a trust should be taxable only in the hands of the beneficiaries when distributed, and that there should be allowed to the investor or landowner under those conditions a return of capital prior to liability for taxation. That is enormously important to many of these men, because under the rule of the Government which taxes trusts of that kind in advance of distribution an operator is oftentimes taxed heavily upon theoretical profits, whereas all the money is going to the investor. The amendment found on page 39, with the one which will be presented by Senator Shortridge, both of which we strongly urge, meet a situation we feel is vital to the real-estate interests of the country.

The next suggestion in our brief is found on pages 53 to 56, dividends out of surplus accumulated prior to March 1, 1913, is of great interest to us. Real estate and timberlands have not yet been liqui-

dated, and profits realized, and the old rule exempting such dividends should be retained.

The CHAIRMAN. We do not care to discuss that.

Mr. MACCHESNEY. The last is in respect to compulsory distribution by personal holding companies found at pages 57–59 of our brief. Our mortgage men all feel that to enforce this against real-estate holding companies would jeopardize the accumulation of surplus to amortize bonded indebtedness and result in lessening the safety of such investments.

The CHAIRMAN. The same is true of that.

Mr. MACCHESNEY. Now, just a word with reference to cooperative apartments. The matter of cooperative apartments is of very great interest to our big cities. I am advised that your committee the other day struck out the provision by which the individual apartment-home owner was allowed to deduct all interest and taxes paid as provided by the House bill. It has also been indicated to me that it was on the theory that there was some discrimination in favor of the apartment-home owner as cooperative apartment corporations, as against the ordinary building corporation. This question is covered quite thoroughly in the supplemental brief at pages 3 to 11, which I hope you will look at.

It is not a discrimination, for the reason that the ordinary building corporation has a right to deduct from its income the payments made for interest and taxes, whereas the cooperative apartment has no income from which it can deduct it. Therefore, to allow the deduction to the owner of the particular apartment does not deprive the cooperative apartment corporation of any rights and does not give the people who are in it any advantage over the ordinary building corporations, because the ordinary building corporation does deduct it from its net income. Neither is it any unfair advantage to the cooperative apartment-home owner, because you are only giving him the same right which yon now give to the single-home owner on the ground. We ask to be put on a parity, whether we live side by side or one above the other.

I beg to call your attention also to the important discussions on installment sales at page 12, supplemental brief, to taxation of real-estate boards and need for additional clarifying amendment at page 15 of supplemental brief and meritorious suggestions on exemption of residential property at page 18 of supplemental brief.

Mr. Chairman, I do hope the committee and the gentlemen who are going to work on these amendments will take the trouble to look through these briefs and illustrations which show the need to our business in this connection, and on behalf of myself and the real-estate interests of the United State, I thank you for your courtesy in this matter.

STATEMENT OF MORRIS L. ERNST, REPRESENTING THE REAL ESTATE BOARD OF NEW YORK CITY

The CHAIRMAN. Give your name and address.

Mr. ERNST. My name is Morris L. Ernst. I represent the Real Estate Board of New York City. I wish to take not over five minutes of your time.

We are in accord with Mr. MacChesney's position in regard to co-operative apartments.

In regard to the capital-gain section, we believe the sound position is that the capital gain should apply to real property, no matter if held to-day, 2 years, or 10 years. To come back to the intention of that provision it is this: That there be a tax rate on the sale of certain assets so as to prevent an abnormal or extraordinary profit being taken at the time of sale. In other words, the theory was that if a man held some stock as an investment he was not allowed to take the market fluctuations in his inventory, even if they showed no profit or losses, and if he held that stock for two years it would pile onto him heavy income-tax returns, and therefore Congress devised the plan of having a 12½ per cent rate. We say real estate is one commodity in the world that Congress has decided is not subject to inventory. In other words, in a declining market the owner of real estate, whether an operator, a home owner, or individual investor, may not take his losses. The owner of rare paintings or rare books may inventory and take his losses as the market declines. Not so with real estate.

Therefore, we submit that the profits and losses on real estate must be treated consistently, and therefore the profit from the sale of real estate, whether held for investment or otherwise, should receive the benefit of the capital-gain section, so as to prevent the piling on of undue or extraordinary profits in one year, which profits in fact occurred over a spread of years. The owner of real estate is now allowed to have credit for those losses, because he could not put real estate in his inventory.

Just one other word in regard to section 104. That section is the outgrowth of the old section 220, the attempt of Congress to tax the undue accumulation of wealth. We submit that in section 104 you have two inconsistent provisions.

The CHAIRMAN. I do not think you need take very much time on that.

Mr. ERNST. I will not take much time. Part of section 104 looks to the matter of the accumulation of wealth, and says, if it is unduly accumulated beyond the needs of the business, there is a penalty. The other part does not look to the purpose of it at all, but only looks to the source. When you come to look at the source, you look at the matter of unearned income, and in that is included rents, which by no means are unearned. A man who has managed a piece of property knows he does not get his income without some human labor and energy in connection with the upkeep and maintenance of the property, and to that extent we think rents should be excluded.

I would like to submit this brief, and I will furnish a copy to each member of the committee.

STATEMENT OF M. D. FERRIS, REPRESENTING CERTAIN OWNERS OF FOREIGN-BUILT YACHTS

The CHAIRMAN. You may give your name and whom you represent.

Mr. FERRIS. My name is M. D. Ferris. I represent eight owners of foreign-built yachts. These yachts are now built or building outside the United States, and were contracted for prior to December 1,

1927. The gentlemen who are building these yachts are not unpatriotic in building yachts abroad, any more than the man who buys a foreign-built motor car or foreign paintings or a suit of clothes.

Senator HARRISON. Are these Americans who are building these yachts abroad?

Mr. FERRIS. Yes, sir; these are American men who are building them for their own use, pleasure yachts.

Senator HARRISON. In foreign countries?

Mr. FERRIS. Yes, sir.

The CHAIRMAN. They are purchasing foreign boats. They are not building the boats.

Mr. FERRIS. They are citizens of the United States, and these yachts when built will come to the United States and be documented under the laws of the United States. The class of boats I am speaking of now are those over 100 feet in length. As it happens, all of my clients are building that size.

Last year there was less than $8,000 collected by the Treasury Department from their foreign-built yacht tax. I made an analysis of the foreign-built yachts which have been built outside the United States and are owned by Americans in the last 10 years. That analysis appears on page 6 of my brief. In that period there were 40 American yards that built 108 yachts, and only 14 yards built more than 1 yacht, and only 4 yards built 6 or more. In only two cases were there more than 10 yachts in 10 years built at any yard. Those two yards are the Newport News Shipping Co. and George Lawler & Son, of Boston. In only three years have there been more than three yachts built in foreign countries for Americans, which were over 100 feet in length. In other words, the ratio between American-built yachts and foreign-built yachts is 10.8 to 1.4, showing the relative unimportance of the foreign-built yacht as compared with the American-built yacht.

Senator SIMMONS. In that comparison did you take the length of the yachts built in the American yards, the same as those built in foreign yards?

Mr. FERRIS. Yes, sir; I have prepared and would like to submit to the committee the analysis I have made. Those are all 100 feet in length. It shows the name, length, builder, place where built, and owner.

The CHAIRMAN. That need not go in the record, but may be referred to.

(The document referred to was filed with the committee.)

Mr. FERRIS. If we would go into the smaller sized yachts, I believe there are many more built in the United States than are built abroad. I think the proportion is much smaller of the larger yachts. The value of these yachts is great to the United States in time of war or other national need. These yachts could be used by the Navy. They could be used for scouting purposes. Many of them would be usable for transportation of troops. A vessel 260 to 280 feet long is a vessel of considerable importance, and they are all built of steel and have Diesel engines, so they are about the last wrinkle in well-built vessels.

The CHAIRMAN. What is the greatest length of the yachts now in the United States?

Mr. FERRIS. There has been recently built a yacht called the *Savanora*, which I think is 260 feet long. One of these vessels I am representing, which is being built in Germany to-day, is 264 feet long. I have secured a catalogue view which the members of the committee might look over and look at the photographs, so they can see what these boats are.

The CHAIRMAN. You may file it.

Mr. FERRIS. I would rather not file it. I have not permission to do that.

Senator SIMMONS. I wish you would go a little further and put in the record the names of the persons who are having these yachts built abroad.

Mr. FERRIS. I filed a brief, Senator.

Senator SIMMONS. Do you give the name of each person having these yachts built abroad?

Mr. FERRIS. Those I represent. This other memorandum gives a list of all the present owners of yachts that have been built in foreign countries, so far as I know. That includes those owned and documented, and a small number that are not.

Senator HARRISON. How much is the tax increased on these yachts in this bill?

Mr. FERRIS. It is increased five times the existing rate. As you all know, if a yacht costs $300,000 there is a certain class of men who can afford that luxury. If a yacht costs $400,000, the differential being about 25 per cent cent, the number of men who can afford that luxury is greatly reduced. There would be fewer yachts built. There would be fewer yachts under the American flag, fewer yachts available for the United States in time of war.

Senator SHORTRIDGE. There would be fewer yachts built abroad?

Mr. FERRIS. There would be fewer yachts built anywhere, Senator, because if the cost to build them in the United States is $400,000, and the cost to build them abroad is $300,000, the difference may mean that the yachts would not be built at all.

Senator SHORTRIDGE. That would not perhaps deter the multimillionnaires from building them.

Senator MCLEAN. How much does it cost to maintain one of these yachts for a period of a year?

Mr. FERRIS. That is a very important question. I was just coming to that. The cost of maintaining one of these large yachts is probably at least 10 per cent of the original cost per year. That money all goes to citizens of the United States. It is spent here in the repair yards, in repairing, or painting, or whatever is done to the yacht.

Senator SIMMONS. Would you not be going a little far in saying it all goes to American shipbuilders? Probably a yacht might be in some other country when repairs are needed.

Mr. FERRIS. In cases of emergency, that is possible; but there is a duty on repairs made in foreign ports.

Senator MCLEAN. How much does it cost to man one of these yachts, to keep it afloat?

Mr. FERRIS. There is a gentleman here, Mr. Morgan, who is a naval architect, while I am a lawyer. He can answer that question better than I.

Senator SHORTRIDGE. It depends on the size of the yacht and the number of men.

Senator MCLEAN. My point is that it is a very expensive luxury.

Mr. FERRIS. There is no question about that.

Senator MCLEAN. The man who can maintain one and keep it afloat and manned and supplied will not think very much of the difference between $300,000 and $400,000.

Mr. FERRIS. My experience has been that there is no class of men who look on both sides of the dollar more than the men who own yachts.

Senator MCLEAN. That is very likely true, but it is not necessary.

Mr. FERRIS. Maybe that is the reason they have them.

Senator SHORTRIDGE. They are the men who give dimes away.

Mr. FERRIS. I do not know any of them who are reckless with their money.

Senator HARRISON. As I understand you, there are certain taxes now imposed, and these gentlemen in the United States have contracted abroad for the building of these yachts, and they are now being built.

Mr. FERRIS. Yes, sir.

Senator HARRISON. When they are finished, five times the present tax will be imposed?

Mr. FERRIS. That is what we want to avoid, so far as these gentlemen are concerned. These particular boats were all contracted for prior to this question coming up in Congress, and the House bill as it is made now recognizes the equity of exempting these yachts now building from the increase in rates. They are quite willing to pay the tax which is now in force, because they made their contracts when that law was in force. The tax for a 100-foot yacht is $8 a foot per year, which is a considerable sum per vessel.

As I say, the repair work on these yachts is all done in the United States. There is one yard in New York alone that admits that its work on foreign-built yachts amounts to a gross of $100,000, so that it is to the interest of the shipyards of this country that these yachts should exist and should be owned in America.

Senator SIMMONS. You mean it is to the interest of the people of this country that these yachts should be built abroad instead of here?

Mr. FERRIS. Rather than not built at all.

Senator SIMMONS. This is a very important question and has far-reaching aspects.

Mr. FERRIS. Yes, sir.

Senator SIMMONS. I would be very glad if you would give us the reason that leads you to that conclusion. It would apply to many things besides yachts, if you could establish that contention.

Mr. FERRIS. If the cost of building yachts is much less than in the United States——

Senator SIMMONS (interposing). That is an argument of your business.

The CHAIRMAN. That is the argument here, too.

Senator SIMMONS. He says it is to the interest of the United States that they should be built abroad. I want him to give me the reason for that proposition that he has just asserted.

Mr. FERRIS. In the case of yachts there is more work in the way of repairs and upkeep performed than is done on any other article of commerce, because every owner wants his yacht to be in as good shape as possible.

Senator SIMMONS. You can say that about the automobiles, can you not?

Mr. FERRIS. No: because a man buys an automobile only for a year or two. A man buys a yacht for a long period of years. Many are owned 15 or 20 years.

Senator SIMMONS. When a man buys an automobile he has to begin repairing it in about a year after he gets it.

Mr. FERRIS. That depends somewhat on the car.

Senator SHORTRIDGE. About a week.

Senator SIMMONS. Yes; sometimes that is true.

Mr. FERRIS. The cost of those repairs each year is so large that it may frequently run as high as 25 per cent of the original cost of the vessel, and if these yachts are not built in America it is much more important to this country to have them built abroad and owned here than not to have them at all.

Senator MCLEAN. If they are built abroad, why do they not have them repaired abroad? They stay abroad most of the time.

Mr. FERRIS. I think you are mistaken in regard to that, Senator. I think very few stay abroad. There may be a few, but it is negligible. They are mostly owned and home ported on the Atlantic and Pacific coasts.

Senator SIMMONS. They stay down in Florida most of the winter, and then go over to Europe in the summer, do they not?

Mr. FERRIS. You are correct. There are a lot of them in Florida in the winter, and they are in Long Island Sound and Chesapeake Bay and other places like that in the summer.

Senator HARRISON. Do they not ever get out to California?

Senator SHORTRIDGE. Indeed, they do. Have you the history of the *Venetia*? Pardon me for interrupting, Mr. Chairman. The statement was made that these yachts are very valuable in time of war. The *Venetia* was taken over by the Government, and sank the submarine that wrecked the *Lusitania*, and sank another submarine in the Mediterranean.

Senator SIMMONS. Would it not have been just as valuable if it had been built in this country?

Senator SHORTRIDGE. I think it would be much greater, because they would be better boats. I want them built in America.

Senator KING. May I inquire whether there have been any yachts built abroad and registered abroad, which were owned by Americans?

Mr. FERRIS. I do not know of any. Unless done as a subterfuge, that would be contrary to the law of that country. If a yacht is owned by an American citizen it could not be documented under the laws of France or Germany.

The CHAIRMAN. You are not talking for your present clients; you are talking for some anticipated future clients?

Mr. FERRIS. Not at all. I am satisfied with the wording of the bill.

The CHAIRMAN. The House bill says that it shall not apply where the contracts were entered into before December 1, 1927.

Mr. FERRIS. I am satified with that.

Senator HARRISON. You have no objection to this increase in that tax?

Mr. FERRIS. Not if it does not affect these contracts entered into before; no.

The CHAIRMAN. Then there is no need of taking any time on that question.

Mr. FERRIS. I just wanted the committee to understand the situation.

The CHAIRMAN. We understand the provisions of the bill.

Mr. FERRIS. If the committee desires, there is a gentleman present who knows the practical side of this and who would like to say something.

The CHAIRMAN. No. We have had enough.

Senator KING. If there is no change in the bill, you are satisfied with it?

Mr. FERRIS. My clients are satisfied with it.

STATEMENT OF CHARLES LEDERER, ESQ., CHICAGO, ILL., REPRESENTING THE NATIONAL RETAIL FURNITURE ASSOCIATION

The CHAIRMAN. You may give your name and address.

Mr. LEDERER. My name is Charles Lederer, Chicago, Ill.

The CHAIRMAN. You are here on installment sales?

Mr. LEDERER. Yes.

The CHAIRMAN. Is the present law satisfactory to you?

Mr. LEDERER. No. I want to submit an amendment.

The CHAIRMAN. Have you a brief suggesting that amendment?

Mr. LEDERER. We have suggested an amendment and filed a brief for the National Retail Furniture Association.

The CHAIRMAN. Does that cover the question?

Mr. LEDERER. Except that some matters have to be called to the attention of the committee to show the necessity for the amendment. I will make it very brief.

The CHAIRMAN. Make it as brief as possible. We have a long list of witnesses.

Mr. LEDERER. I appreciate I should take not in excess of 10 minutes, and I may not take that.

I appear in behalf of the National Retail Furniture Association, which has a membership of 3,500 dealers throughout the United States, and certain individual dealers who are not members of this association.

We are suggesting an amendment to section 44, as set out on the last page of our brief, to the effect that:

> In any case where the gross profit to be realized on a sale or contract for sale of personal property has under the provisions of the revenue acts of 1916, 1917, 1918, 1921, 1924, and 1926 or this act been reported as income for the year in which the transaction occurred, and a change is made to the installment plan of computing net income, no part of any installment payment received subsequently to the change, representing income previously reported in account of such transaction, should be reported as income for the year in which the installment payment is received.

The CHAIRMAN. That, of course, is a retroactive feature.

Mr. LEDERER. That is a retroactive feature. That is why I desire the opportunity to address the committee.

The CHAIRMAN. We will be glad to hear you on that.

Senator KING. Did you file a brief?

Mr. LEDERER. The National Retail Furniture Association has filed a brief. I will see that each member of the committee gets a copy.

I understand that an amendment was introduced in the Senate by Senator Metcalf, which has been referred to your committee. An amendment is necessary because an inequitable double tax is imposed upon installment dealers who in past years were permitted to change their method of reporting income and can not now escape the effect of that which they were permitted to do in prior years. In the case of one client I represent, who had been reporting upon the accrual basis, the Commissioner of Internal Revenue allowed a change to the installment basis in 1918. They changed from reporting on the straight accrual basis to the installment-received basis; that is, from reporting the entire profit on sales made on the installment plan before such entire profit was received, to reporting the profit on each installment as received.

We believed, at the time we made this change to the installment-received basis, that an installment of a sale, the entire profit of which had already been reported and the tax thereon paid, should not again be reported for taxation. We believed the law to mean that where the entire profit on a sale prior to 1918 had been reported on the straight accrual basis, the installment received in 1918 and in subsequent years on that same sale need not be included in the return for that year, nor any tax again paid thereon.

Senator KING. Your contention is double taxation?

Mr. LEDERER. Yes. That is our contention, Senator; double taxation.

The Commissioner of Internal Revenue issued the following regulations in 1919:

> Such income may be ascertained by taking that proportion of the total payments received in the taxable year from installment sales (always including payments received in the taxable year on account of sales effected in earlier years as well as those effected in the taxable year) which the gross profit to be realized on the total installment sales made during the taxable year bears to the gross contract price of all such sales made during the taxable year.

These regulations we believed applied only to include payments received in the taxable year on account of sales effected in earlier years subsequent to the adoption of installment method and to those effected in the taxable year. We believed, therefore, that because all of the profit on sales prior to 1918, the date of our change to the installment method, had been reported in full in prior years, no installment received in 1918 and 1919 on such prior sales need be again reported in our returns for these years. Our construction of these regulations was subsequently verified by the commissioner himself on October 20, 1920, about a year after the issuance of the above regulations. On that date the Commissioner of Internal Revenue interpreted these prior regulations and promulgated new regulations on the subject, specifically stating:

> Where the entire profit from installment sales has been included in the gross income for the year in which the sale was made, no part of the installment payments received subsequently on account of such previous sales, shall again be subject to tax for the year or years in which received. (Article 42, regulation 45.)

This regulation remained in full force and effect from October 20, 1920, until the effective date of the revenue act of 1926.

My clients had the right to close their returns during the entire period of six years from October 20, 1920, to the effective date of the revenue act of 1926, under the regulations then in force, without paying the double tax now claimed to have been required by the prior regulations of 1919, which were in effect for only about a year. As a matter of fact my clients, late in 1925, asked for permission to make payment of the tax found due under their returns in accordance with the regulations then in force, which explicitly excluded double taxation. The Income Tax Department informed us that the Commissioner of Internal Revenue had issued instructions to close no returns involving installment sales until a certain case known as the Todd case, then pending in the Board of Tax Appeals, was decided, as that case involved the question of whether a taxpayer could make a return on the installment basis at all.

We were unable, therefore, to pay the tax upon our returns computed in accordance with the regulations then in force, although we offered to do so, and now find ourselves in the situation where we are compelled to pay a double tax unless a change is made in the 1928 revenue bill as drafted.

Shortly before the enactment of the revenue act of 1926, the Todd case was decided by the Board of Tax Appeals in which case the board held that the Commissioner of Internal Revenue had no right to allow any returns on installment basis. This ruling caused the Senate to insert section 212(d) and section 1208 in the revenue act of 1926, which act affirmatively recognized the right of the taxpayer to make his return on the installment basis. Under the act of 1926, the Commissioner of Internal Revenue promulgated a regulation requiring a double tax for those making a change of accounting method under the new act.

Senator SHORTRIDGE. Was that in harmony with that decision?

Mr. LEDERER. The Todd case never touched that decision. It said no return should be made on the installment basis. I doubt whether this committee had in view any question of double taxation when the act of 1926 was discussed here, because it was then only concerned with remedying the situation created by the Todd case.

In July, 1927, the Board of Tax Appeals decided a case known as Blum's (Inc.), in which the board held that Congress intended by the revenue act of 1926, to require a double tax from all taxpayers who changed from the straight accrual basis to the installment-received basis in any of the years prior to the enactment of the revenue act of 1926. This decision was based upon excerpts from the conference report and the report of the debates in the Senate of the United States when the bill was pending, but a reading of these debates in their entirety, I think, shows that the board was mistaken in so interpreting that intention.

May I call attention to two excerpts from the debates in reference to this matter? The Blum case was decided upon the statement that the honorable chairman made in this committee, but in quoting that statement they did not quote your honorable chairman in full. In the Blum case they said that Senator Reed Smoot in that debate made this statement:

The committee intends that the installment provision of regulations 45, promulgated on December 29, 1919, will be substantially followed in settling all cases under prior acts of this provision.

That is to say, the regulations of 1919 required a double tax, which was not true in the first place, but they so construed that regulation, and they say that evidently this committee intended that the 1926 act should carry with it a double tax feature where a change had been made from the accrual basis to the installment-received basis. But they omitted this statement made by Senator Smoot, in the same debate:

It is carrying out the regulations of the department that have been in effect in past years.

Those regulations were the regulations that were in effect for six years, from 1920 to 1926, inclusive, decidedly and affirmatively presenting a double tax.

Senator David A. Reed, of your committee, answering the question of Senator McKellar, made this statement. Senator McKellar asked if this bill would open up all cases where payment has been made on the installment plan, and Senator Reed replied:

No, Mr. President; it would not open them up, because for all these years the Treasury regulations have provided what is now proposed in this bill. We are making it retroactive so as practically to validate the regulations that have been in effect for all these years. If we do not do this, then we will have to open up the returns and assess additional taxes against all these people.

In the face of those statements in this debate the Blum case was decided upon the ground that this Congress intended that there should be a double tax carried by that act of 1926.

No appeal was taken by the taxpayer from the decision of the Board of Tax Appeals in the Blum case, and I am informed that the Government settled the case with the taxpayer after the decision of the Board of Tax Appeals by making allowances on items other than the installment sales feature in that case. As a result the Blum decision has become final.

The Senate amendments in section 212 (d) and section 1208 were enacted to remedy the situation produced by the Todd decision, and there was no question of double taxation being considered at that time, as the regulations in effect up to the date of the enactment of that act did not require a double tax. It was only afterwards, when the Blum case was decided, that that question arose at all.

My clients' returns for the years 1918 and 1919 which excluded installment sales that had been previously reported on the accrual basis, and upon which the tax had been fully paid in prior years, were received by the Internal Revenue Commissioner without objection as to this exclusion of such installment sales. In fact, these returns had been from time to time recognized by the Commissioner of Internal Revenue as correct with reference to the installment-sales feature, both in conferences and communications to us. Our returns were never audited by the department during the life of the 1918 and 1919 regulations, and we doubt that any returns filed in 1918 and 1919 were in fact audited before the regulation of October 20, 1920, was put into effect. In fact, that regulation (of October 20, 1920) became the rule upon which all returns not already audited should be and were to be audited.

Nevertheless, on November 17, 1927, the Commissioner of Internal Revenue issued his 60-day letter to us, which is equivalent to a judgment in a suit at law, assessing against my clients the double tax upon installments of sales received in the years 1918 and 1919, although it is admitted without controversy that all of such installments were reported in prior years and fully taxed, which tax it is also admitte l has been paid.

We contend that all taxpayers who prior to the enactment of the 1926 revenue act had changed from the straight-accrual basis to the installment-received basis should obtain the benefit of the regulations which were in effect for six years from October 20, 1920, to the enactment of the revenue act of 1926, as these regulations were the final regulations promulgated by the Commissioner of Internal Revenue under the then existing revenue act.

This proposed amendment does not give the right to taxpayers who did not file returns on the installment-sales basis to now come in and file returns on the installment basis for years past.

Those cases differ from our case, where prior to the enactment of the 1920 act, we in good faith had filed returns on the installment-sales basis in conformity with the regulations subsequently held to be without warrant of law by the Board of Tax Appeals in the Todd case.

As the taxpayers who so filed their returns in good faith are not taking advantage in any way of the retroactive provision of section 1208 of the revenue act of 1926, it seems in all fairness that their tax liabilities should be governed by the final construction of the act under which they filed their returns, as evidenced by the regulation of October 20, 1920, in effect for six years, and until the enactment of the revenue act of 1926. The proposed amendment is to the same effect as the regulation of October 20, 1920, and will not require any substantial rechecking of the accounts, as a far greater part of these returns filed prior to the 1926 revenue act have been checked and audited under the regulations deemed binding prior to the decision in the Todd case.

Senator REED. What amendment do you suggest? Do you suggest cutting out the word "not" in 44 (c)?

Mr. LEDERER. We suggest the following amendment:

In any case where the gross profit to be realized on a sale or contract for sale of personal property has been reported as income for the year in which the transaction occurred, and a change is made to the installment payment received subsequently to the change, representing income previously reported on account of such transaction, should be reported as income for the year in which the installment payment is received; the intent and purpose of this provision is that where the entire profit from installment sales has been included in gross income for the year in which the sale was made, no part of the installment payments received subsequently on account of such previous sales shall again be subject to tax for the year or years in which received.

Senator REED. Could you not get the same result in fewer words?

Mr. LEDERER. We tried to do that, with the experts of this committee.

Senator REED. Have you the act before you?

Mr. LEDERER. Yes.

The CHAIRMAN. This is retroactive?

Mr. LEDERER. This is retroactive, and must go in two provisions. I think we could easily discuss that.

Senator REED. If you will look at the act, section 44 (c), as it comes from the House, if you were to strike out the word "not" in the last line, and add the words "if a tax has been paid thereon in the year in which such sale was made," would not that accomplish your purpose?

Mr. LEDERER. That would be all right for the prospective part, but it would not affect the retroactive part. It would not help us.

Senator REED. It would take care of all future cases.

Mr. LEDERER. Yes.

The CHAIRMAN. Is paragraph (c) of section 35 satisfactory to you, with the word "not" stricken out?

Mr. LEDERER. For the future; but it would not help our case, because we are caught in 1918 and 1919, when we thought that we were filing with the permission of the Government, and paying only one tax.

I will show you in a minute that if we did try to comply with the regulations of the Government now, we not only would not make any profit on our sales, but we would actually lose a large amount of money in doing business in those past years. We can not go back and change that. We were invited in, and they sprung the trap.

The CHAIRMAN. The House took the position that they were not going to provide for retroactive legislation, and this provision (c) has nothing whatever to do with the past at all.

Mr. LEDERER. No.

The CHAIRMAN. Is it satisfactory to you now for the future?

Mr. LEDERER. For the future, with the word "not" out; yes. But may I say that in the House Ways and Means Committee, the United States Daily reported that the Ways and Means Committee of the House endeavored to compromise with this proposition, and inserted in its original draft a provision to the effect that the net income upon installment sales returned for prior years should be held correctly returned if computed in accordance with the regulations applicable in respect of such taxable year and in force at the time prescribed for filing the return, which meant that if a man filed a minute after October 20, 1920, he paid only a single tax, but if he filed a minute before October 20, 1920, he paid a double tax, whereas all regulations were retroactive, and the amendments and the revised regulations were retroactive the very moment that law was in effect. At that time, there being a retroactive effect to all regulations from the very moment we filed our return in 1918, we should be put in the same position as anyone who filed prior to the 1926 revenue act.

The above provision was finally stricken from the bill, and properly so, for it would have validated only such returns as were filed after October 20, 1920, and would not have given relief from double taxation to taxpayers who filed during the years 1918 and 1919. Such a distinction would have been highly inequitable, because taxpayers who filed in the years 1918 and 1919 filed under the same revenue act as those taxpayers who filed after October 20, 1920. Moreover, the commissioner, by his regulation of October 20, 1920, amended his prior regulations of 1919, and admitted thereby that his regulations of 1919 should not have required a double tax, thus reversing himself upon that proposition.

The CHAIRMAN. I have a great many letters on this matter here, but this is the first statement that I have seen or the first word that

I have received indicating that they wanted this retroactive. They wanted it to apply to the future. For whom do you speak?

Mr. LEDERER. For the National Retail Furniture Association and for my individual clients who are interested in this thing intensely, because their cases are cases where they were invited into a change from the accrual basis to the installment-received basis on the representation that there would be a single tax. They read the regulation. Their counsel interpreted it to that effect, and after they were in the commissioner confirmed that in his rulings, which remained in effect for six years. After that the door was closed, so that they could no longer step out, and they were presented with a bill for a double tax, which is ruinous.

Senator REED. Why do you not take it to court?

Mr. LEDERER. That is where it is, but, Senator, the Board of Tax Appeals has held that this Congress intended that the act should be retroactively a double tax.

Senator REED. I think they are wrong, and so do you. The way to find out is to take it to court.

Mr. LEDERER. If we go to court, we can not raise the question of whether this Congress intended that it should be a double tax, except from the debates in Congress, and the Board of Tax Appeals has said that their construction is that you intended a double tax. We are, therefore, running the chance.

Senator HARRISON. They did not believe the argument of the Senator from Pennsylvania, Mr. Reed.

Mr. LEDERER. I do not know.

Senator HARRISON. He clearly stated the intention of Congress on the proposition.

Mr. LEDERER. Yes, Senator Reed, you clearly stated the intention of Congress to be that there should not be a double tax. If one court has already so misconstrued your language, and has quoted only a part of your honorable chairman's language, may not some other court say, "Well, that is the construction, in our opinion"? Should we not, therefore, be permitted, in this Congress, to ask this Congress to correct a mistake which is attributed to this Congress by the courts?

Senator MCLEAN. What is the amount involved?

Mr. LEDERER. I can not give you the exact amounts involved. One client has $230,000, and there are various amounts.

Senator REED. I do not see why you do not have one test case. Let them pay the tax and bring their suit in the district court, and get a prompt decision.

Mr. LEDERER. We can not do that very well.

Senator REED. Why not?

Mr. LEDERER. We have to go through the routine of appealing to the Board of Tax Appeals.

Senator REED. No, you do not. You have your option.

Mr. LEDERER. It was presented to the House committee, and in the debates before the House committe we were offered this compromise measure, and it provided in the draft, as I understand, to the effect that the man who filed one minute after October 20, 1920, was subject only to a single tax, and the fellow who filed one minute before was subject to a double tax. Of course, it was inequitable.

Senator REED. You have not answered my question. You have two remedies. One is not to pay the tax, and to appeal to the Board of Tax Appeals.

Mr. LEDERER. Yes.

Senator REED. The other is to pay the tax.

Mr. LEDERER. And appeal to the board.

Senator REED. No; not appeal to the board at all. Pay the tax and bring suit right away, and you will get a prompt decision.

Mr. LEDERER. We have that right. From the decision of the district court there is a review in the court of appeals, and then the Supreme Court of the United States. That is a long and tedious process.

Senator REED. Absolutely; but you will get your decision sooner than you will from the board. You can take a test case that does not involve very much money.

Mr. LEDERER. I know; but we can not find cases on all fours on all these questions. They differ. There are various phases. There are many small amounts, and some large amounts.

Senator REED. Out of 3,000 cases you can surely find a test case.

Mr. LEDERER. There are not 3,000 cases. There are not more than half a dozen cases, probably, involved in that period of 1918 and 1919. I doubt if there would be half a dozen. Those cases are cases that have already traveled up to the Board of Tax Appeals. In order to take the course you suggest, we would have to dismiss our appeal to the Board of Tax Appeals, pay our tax, and then sue for a refund, which is hardly practicable.

Senator REED. It seems to me I could find a test case.

Mr. LEDERER. I have been looking for one, but it does seem to me that where a court attributes to this Congress an intent which this Congress has a right to say, from its records, was not the intent of this Congress, that when the very bill in question comes before it again, it is the proper forum for us to come to and ask you to directly state your intent.

Senator REED. I do not see it. I do not see why Congress should be expected to chase around patching up every mistake every court makes, when you have a proper course of procedure.

Mr. LEDERER. I said, before the House committee, that that was not our purpose. I said I did not want any patchwork in any bill, to stop up any decision of a court, but I said this bill came from a Congress which tried to express itself clearly in its debates and in the act, and that there is a doubt to-day in the departments as to what the intent of this Congress was. Inasmuch as this new revenue bill is up, I think it would be eminently proper for Congress to say affirmatively, "Our intent is that there should be no double tax."

The CHAIRMAN. I think the committee understands thoroughly your position.

Senator SIMMONS. I think the committee thoroughly understands your position, but I do not agree with your proposition that the courts will decide a case based upon the debates and the expression of opinion of individual members of this committee or of the Senate. I think the court might consider those things, and does always consider them.

Mr. LEDERER. I agree with your statement.

Senator SIMMONS. But the court must, in the last analysis, decide the question upon the meaning of the language.

Mr. LEDERER. I did not mean to be understood in any different light, but I do say that in the Blum case the Board of Tax Appeals based its decision upon the apparent meaning of those debates in Congress.

Senator SIMMONS. I think we understand your viewpoint.

Mr. LEDERER. May I be given just one minute to say this, because I want to leave this brief with the committee, and they may not understand it unless I say this: I shall leave with this committee, with the permission of the chairman, some statements showing that by actual computation, if a double tax were paid, we would, in each of our sales, not only not make a nickel, but we would actually lose money, because our sales were not based upon any theory that we would ever have to pay twice upon the same sale. If I leave this with the committee, I hope the explanation will be sufficient.

Senator HARRISON. I think your argument is very appealing, myself.

Mr. LEDERER. There have been several questions asked which I would like to have had further time to answer. I realize how important this is to us.

Senator SIMMONS. It is very appealing to us, because I think, if it does, in effect, impose a double tax, it is an outrage. We will have to investigate that.

The CHAIRMAN. Mr. Harold R. Young.

STATEMENT OF HAROLD R. YOUNG, REPRESENTING NATIONAL RETAIL DRY GOODS ASSOCIATION

Mr. YOUNG. My name is Harold R. Young. I represent the National Retail Dry Goods Association, having a nation-wide membership of about 3,000 stores, in each State in the Union, doing an aggregate volume of business of $3,000,000,000, composed of a number of small corporations, with very widely spread stockholdings, but at the same time having in its membership the most progressive retail dry goods and department stores in the country.

I also represent the National Association of Retail Clothiers, having a membership of approximately 6,000 stores.

At the outset I should like to say that it is the view of the two associations which I represent that, rather than use as a basis for the 1928 law the present bill now before you, with its many litigation-provoking provisions, to which sufficient consideration has not already been given, it would be preferable to amend, as to rates, the 1926 law now in effect, deferring until sufficient time has been given for study by the taxpayers of the country, under the leadership of the Joint Committee of Internal Revenue Taxation, those administrative provisions which are now contained in 1928 bill.

The CHAIRMAN. You do not mean to just leave the administrative features as they are in cases where we know there ought to be an amendment?

Mr. YOUNG. No, Mr. Chairman. I should have made my statement a little clearer. I mean the noncontroversial administrative features.

I say that because the present bill, if the joint committee on internal revenue taxation had carried it out to its logical conclusion, would have been quite an improvement upon the 1926 law, but the bill in its present shape is neither self-contained nor all-comprehensive.

The CHAIRMAN. With respect to those things that the joint commission have decided upon, and in cases where there is no question that there should be amendments to the administrative features of the 1926 law, you would not object to those amendments, but leaving the sections as they are. Is that your idea?

Mr. YOUNG. You mean the sections of the 1926 law as they are?

The CHAIRMAN. Yes.

Mr. YOUNG. Yes, sir; because in the form in which it is now, it is very confusing to those of the practioners who understand the form in which the bills have been in the past. For instance, a section number does not indicate the title under which it falls, and I could go on and explain further objections which we have to it in that respect. They are contained in a brief which I want to file with the committee.

The CHAIRMAN. You can file it at this time, and it will be a part of the record. Is it very long?

Mr. YOUNG. No; it is not long.

The CHAIRMAN. Have you had it printed?

Mr. YOUNG. I have; and I am filing it with the committee.

(The brief referred to is as follows:)

WASHINGTON, D. C., *January 30, 1928.*

HON. REED SMOOT,
Chairman Committee on Finance,
United States Senate.

DEAR SIR: The taxation committee of the National Retail Dry Goods Association wishes to present to the Committee on Finance criticism of H. R. 1, the revenue act of 1928, which study of the act and of Report No. 2, which accompanied its submission to the House by the Committee on Ways and Means, has convinced it to be proper and necessary.

The National Retail Dry Goods Association is a nation-wide organization with a membership of about 3,000 stores, with members in every State in the Union, doing an aggregate annual business of more than $3,000,000,000. It is an organization for the most part of small corporations with widely spread stock holdings, although it includes in its membership the most progressive stores in the country. Its taxation committee for more than 10 years has existed without change in personnel, although within the last year the membership has been augmented by five new members. During these 10 years the committee members have studied each successive revenue act and have had the privilege of cooperating to a somewhat unusual degree with the Bureau of Internal Revenue, at the bureau's request, in matters pertaining to interpretations of the various acts and the administration of revenue laws.

Referring directly to H. R. 1 as read twice and referred to the Committee on Finance, it is our unanimous belief that one outstanding fault in this bill is that it is neither self-contained nor all-comprehensive.

If enacted, it will be necessary constantly to refer to previous acts, and the amendments to previous acts, to know what the taxation laws of the United States are to be from the date of the enactment of this bill. Further on in this letter we shall comment more specifically upon the form and structure of the act itself, which comments we trust will receive earnest consideration.

We desire now to refer directly to the following: Section 45, allocation of income and deductions; section 141, consolidated returns of corporations.

H. R. 1 as originally reported December 6, 1927, by the Ways and Means Committee, contained on page 90, section 118, affiliated corporations, which allowed any corporation which was a member of an affiliated group sustaining a net loss in 1929 or any succeeding year to transfer such loss to other corporate members of the same affiliated group, to be used by them as offsets or

credits against their net income. By amendment on the floor of the House this section 118 has been eliminated.

During the years in which excess and war profit taxes were imposed by revenue acts successively in force, certain percentages of invested capital of corporations were allowed as credits. In the case of affiliated corporations, consolidated returns were required in order that such credits should be based upon a percentage of the actual investment in all of the affiliated concerns taken as a whole. If the revenue act of 1928 is adopted in the form in which it has been read twice to the Senate and referred to the Committee on Finance, we believe a reasonable construction placed on such elimination, by business men, will be that the requirement during the excess and war profit years that consolidation must be made was illegal.

The final incident of tax imposition is never on the corporation. It goes down through the corporation to the stockholder. If by the laws of States and by the laws of the United States it is legal for one corporation in the furtherance of its interests to organize and control another corporation by direct ownership or by the control of its stockholders, all for the purpose of better handling and better operation of its business, then any attempt to depart from the custom long established by preceding revenue acts to treat such affiliated corporations as one, imposing taxes on the net income of all, is to place upon the stockholders of such corporations a tax on income which is not realized if any of the affiliated corporations have produced a net loss.

It may be said generally that the original corporation will be able in the year 1928 to readjust its relations with its subsidiaries and affiliated corporations so that the elimination of section 118, as provided in the original draft, will not be burdensome, but this can not be said of public-utility corporations, which are under control of either State or National Government, as to mergers or dissolution of mergers.

A great railroad line is not always one corporation, but ordinarily a parent corporation owning the main line with its numerous feeding lines owned by separate corporations but with ordinarily a common-stock ownership. Railroads have no control over their affiliations with such subsidiary lines. They can do only that which is approved by the Interstate Commerce Commission, and there is no element of fairness which says to the hundreds of thousands of small stockholders in such companies, "You shall pay an income tax on that part of your investment which is profitable, with no relief in the way of credit or off-set for that part of your investment in the same operating whole which produces a net loss."

As a specific illustration of the hardship which will result because of the elimination from the bill of the right of offsetting the taxable income of one affiliated corporation or a group of affiliated corporations by the net losses of other corporate members of the same affiliated group, which hardship will extend to those of the small stockholders of large corporations our committee wishes to cite the result in the case of the American Telephone & Telegraph Co., the stock of which is owned by more than 440,000 stockholders.

The American Telephone & Telegraph Co. controls a majority of the stock of all the State telephone companies. It will be very easy for your committee to establish the fact that not always are these separate State telephone companies profitable, that in the past many of them have been decidedly unprofitable. If the parent corporation, the American Telephone & Telegraph Co. can not pay an income tax based on the net taxable income of all of the companies taken as a whole, then the United States Government will take from the 440,000 small stockholders of the parent company money in the shape of taxes to which it is not entitled.

There must be no losing sight of the fact that the ownership of the State telephone companies rests in the 440,000 small stockholders of the American Telephone & Telegraph Co., and that these 440,000 small stockholders bear the burden of the tax.

There is no question in the minds of our committee that the section, affiliated corporations, which as reported to the House bore the section numbered 118 should be restored to the bill.

Section 104, accumulation of surplus to evade surtaxes, 1928, or subsequent taxable years.—We wish particularly to call attention to subdivision (c) in section 104, tax on corporations formed or availed of to evade surtax, and subdivision (d), information statements. The Committee on Finance must recognize that it is often necessary for many corporations, in order to success-

fully operate and to provide for necessary expansion of its business, to retain the greater part, perhaps the whole, of its earnings over a period of years until either, in the case of a continuing corporation, a depletion of surplus caused by losses in prior years has been corrected or, in the case of a new, struggling corporation, necessary surplus has been built up. It is difficult for any agency outside the directorate of the corporation itself to determine the "reasonable needs of the business." The necessities of no two corporations are alike.

No arbitrary mandate contained in the revenue act of 1928 can fix that percentage of net income which is reasonable to be retained in surplus. The need of a corporation in building up its surplus for proper operation of its business may require that 100 per cent of its net income be retained, while the retention of a very small percentage of the net income of another corporation would be unreasonable. After a continued period of operating at a loss a corporation often has needs which only by careful financial budgeting can again restore to an effective amount the capital investment which it requires.

It is admitted that in certain, and we believe, very few cases, the commissioner is entitled to information as to why under this section net income is not distributed, but that he should be given mandatory powers to require as part of the taxpayer's return a statement giving in detail the reasons for such accumulations if they are beyond 60 per cent, is dangerous in the extreme. To give him such powers would mean that into the collector's office in every internal revenue district in the country would go the most intimate secrets of those corporations finding it necessary to retain more than 60 per cent of their net income in addition to their surplus. Such information would become available to all of the thousands of employees of the Bureau of Internal Revenue attached to collectors' offices, as well as to the thousands of employees within the bureau at Washington.

The schedules which are filed as part of returns at the present time in most cases disclose the fundamental facts of corporation operation so clearly that from a study of them the commissioner can determine as to whether the building up of surplus is beyond reason. If from such schedules he can not so determine, or if for any other reason he is impressed with the necessity of further information, he should without doubt have the power to require it of the tax-paying corporation.

Our committee believes that subdivision (d), information statements, should be changed from its present form of requiring corporations to file information returns as to accumulations of more than 60 per cent of net income, to that form which will permit the commissioner to ask the tax-paying corporation for such information, if in the discretion of the commissioner the return itself and the schedules attached thereto do not give the commissioner sufficient information.

One of the most unfortunate conditions attached to the Bureau of Internal Revenue is the turnover of its employees, both in Washington and in the scattered collectors' districts. The information required by 104 (d) would quickly become familiar to all employees to whom employment in the Bureau of Internal Revenue is but a step in their business career. The information might disclose to irresponsible employees the secret plans, for years in advance, of growing corporations, which, if the bureau employees should leave the bureau, might easily be spread to the corporations' competitors. Under our suggestion dissemination among bureau employees of such vital information would be restricted to the corporation audit section at Washington, and the danger of disclosure reduced.

Section 115, distribution by corporations.—The Ways and Means Committee reporting the bill to the House commented on this section as follows:

"Under previous revenue acts corporate distributions from surplus accumulated prior to March 1, 1913, were exempt from tax. There appears to be no reason for continuing this exemption indefinitely. Over 14 years have elapsed since March 1, 1913, and most corporations have distributed the surplus accumulated by them prior to March 1, 1913. It seems an appropriate time (particularly in view of the resulting simplification) to eliminte this exemption."

Amendment 16 to the Constitution of the United States "the Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration" was submitted to the legislatures of the several States by a resolution of Congress passed on July 12, 1909, and by proclamation of the Secretary of State dated February 25, 1913, was duly ratified.

In the revenue act of 1913 there is the following provision:

"A. Subdivision 1. That there shall be levied, assessed, collected, and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum per annum upon such income, except as hereinafter provided; and a like tax shall be assessed, levied, collected, and paid annually upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere. * * *

"D. The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first: Provided, however, that for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive. * * *"

This provision, for simplicity, sets March 1, 1913, as the date on which taxes on income, without regard for the original provision in the Constitution, that "no capitation or other direct tax shall be laid unless in proportion to the census or enumeration hereinbefore directed to be taken," shall become constitutionally effective rather than the date of the Secretary's proclamation.

Such date, March 1, 1913, has been recognized by all succeeding revenue acts as the date of constitutional effectiveness. Court decisions and Treasury decisions have recognized that profits accumulated before March 1, 1913, are not profits which can be taxed, but that the distribution of such accumulation is, in fact, a distribution of principal, not of profits.

We are firmly of the opinion that no act of Congress can make constitutional the taxation of profits accumulated prior to the ratification of amendment 16, by which the imposition by the United States of taxes on a basis other than population, was made legally effective.

Section 606, closing agreements.—Unquestionably there is in this section a meeting of the requirement that there shall be absolute finality in agreements between the taxpayer and the commissioner.

Section 606 would bar to taxpayers rights which, at the time of execution of agreements, had never been determined by court decisions. It would bar to them rights resulting from a discovery that there had been at the time of the agreement, errors in governing regulations, later discovered and corrected. It would even bar them if subsequent revenue acts had changed the basic law.

Even though under such circumstances the Government might in certain cases retain tax moneys illegally collected, and in other cases be barred from collecting taxes legally due, we are firmly of the opinion that finality of settlement by agreement is an administrative provision, the sanctity of which should be as strictly safeguarded as that of a statute of limitations.

Section 611, collection stayed by claim in abatement.—Nothing has been more disturbing to business in recent years than uncertainty as to tax liability. Many corporations are still carrying large reserves against contingent liabilities for taxes accruing as long ago as 1918. Credit is impaired and plans for extension of business are seriously hampered by the inability of taxpayers to secure the closing of their tax cases. Under these conditions, the bar of the statute of limitations has come to be looked upon as the only guarantee of safety against further demands for taxes. Section 611 directly destroys this guarantee and violates flagrantly the principle of ending controversy by limitation. Without providing any equivalent relief for taxpayers whose just claims for refund are barred by limitation, it sets aside limitations which the Supreme Court of the United States has declared to be effective against the Government.

The principle involved in section 611 is more important than any amount of revenue that may be at stake. The income tax law can not long be retained as the bulwark of our revenue system if the confidence of taxpayers in its fair and honest administration is destroyed.

In section 1106 (a) of the revenue act of 1926, Congress placed its seal upon the principle that statutes of limitation are inviolate in these words: "The bar of the statute of limitations against the United States in respect of any internal revenue tax shall not only operate to bar the remedy, but shall extinguish the liability."

It is unthinkable that Congress in 1928 should repudiate this doctrine by a retroactive repeal of section 1106 (a) (see sec. 612, revenue act of 1928) and reopen cases barred by prior acts.

Section 611 raises but one question of moment—"Are statutes of limitations meaningless?" If sections 611 and 612 are enacted no taxpayer can ever know when his tax liability for any year is satisfied.

Section 13, tax on corporations.—As reported to the House by the Ways and Means Committee, H. R. 1 fixed the rate of tax on corporations at 11½ per cent. By amendment on the floor of the House, the section was changed to provide for a graduation of taxes when the net income of corporations, less the credit allowed in section 26, is not more than $15,000, 5 per cent being the rate on the amount not in excess of $7,000, 7 per cent on the amount in excess of $7,000, but not more than $12,000, and 9 per cent on the amount if $12,000, but not more than $15,000.

We believe this change is entirely illogical. For the first time it injects a system of double graduation of taxes into a revenue act of the United States, double because a corporation is not in itself an entity but a collection of individuals, and a graduated tax upon a corporation is therefore the first graduated tax upon the individuals holding the stock of that corporation. In the present system of surtax upon the income of individuals, there is the second graduated tax on that part of income which individuals receive as dividends from corporations.

It is illogical also because it arbitrarily defines a small corporation as one which has a net income of not more than $18,000. By setting up such a line of demarcation between small and large corporations, it implies that a corporation having an income of $18,100 is a large corporation and not entitled to any relief.

It is inequitable because if there is any merit in the principles underlying such double graduation of taxes, it should be applied to all corporations, just as the graduated tax on individuals is applied to all individuals. As an example of its inequity, a corporation having a net income of $18,000 deducting the credit of $3,000 allowed in section 26, will pay the following graduated tax.

First bracket, $7,000 at 5 per cent	$350
The second, $5,000 at 7 per cent	350
The third, $3,000 at 9 per cent	270
A total tax under the graduated plan of	970

Another corporation has a net income of only $100 more, a net income of $18,100. Under the credit allowed in section 26 to a domestic corporation earning more than $25,000, this corporation also can deduct $3,000, giving it a taxable income of $15,100, on which it must pay a tax of 11½ per cent, $1,736.50 or $766.50 in excess of the corporation which had an income of $18,000. It must therefore be admitted, if the computation of the tax in these two cases is correct, that the second corporation because it earned $100 more than the first corporation, has paid on that $100 additional earning, a tax of 766½ per cent. Of course the proposer of the amendment which so changed section 13, had no intent to impose a tax so high in rate on income in excess of that of the small corporation which he intended to favor, but notwithstanding that he did not so intend, the fact remains that the section as it now reads has that result.

There is no question in the minds of our committee that section 13 should be restored to the form which it was reported by the Ways and Means Committee to the House.

INSTALLMENT SALES

The Ways and Means Committee in report No. 2 on H. R. 1, stated as to installment sales, that it was leaving the matter to judicial determination. As a matter of fact, judicial determination already had been based on the law as it was written. According to the law, there was no chance for the Board of Tax Appeals, or the courts to set upon the law any interpretation other than that at which they arrived. Our committee believes no criticism of the action of he Ways and Means Committee for its action on this point can be too severe. There is no right and no power conferred upon Congress by constitutional amendment 16, to impose double taxation, and unless the revenue act of 1928 corrects the error made in the enactment of the 1926 law, the benefits of reporting income on the installment basis will be barred to those who have not before used such form of report. The income tax law is based upon the profit content in a consummated transaction. It was never intended to be computed upon an anticipated profit. Installment sales are not completed transactions,

and yet many firms and many individuals in business have in the past used a cash or accrual basis, and have reported all of the profit contained in an installment transaction, even though payments had not been completed. As the law is now written such person changing to the installment basis, made valid by the law itself, must necessarily pay a tax upon profits upon which it has already paid a tax, in fact has paid all of the tax for which the law calls. To say to such taxpayers wishing to avail themselves of the privilege of reporting on the installment basis that they must pay a tax on profits already reported is to say to them most emphatically, that the benefits of the installment basis are not for them, but for those who in previous years have gone to such a basis. This is so decidedly unfair that it would seem that comment on the subject beyond the point of calling it to the attention of your committee is unnecessary, but our committee feels it can not dismiss the subject without expression of our belief that both the 1926 act and the proposed 1928 act as they relate to installment sales, are violative of the due process provisions of constitutional amendment No. 5.

This committee's recommendation as to installment sales does not extend to the granting a firm doing an installment business, which heretofore has reported all its profits on such business as taxable income, the right to ask a redetermination of previous years' taxes, in the event it should elect to change to the installment basis which is provided by law. On the contrary, we believe that such firm has had all opportunity to avail itself of the advantages provided by the installment sections in previous revenue acts, and that if it did not care to report on the installment basis in previous years, it should not have the privilege of redetermination and to any consequent refund of taxes paid in those years, although as already set forth, it should have the privilege of making the change without incurring the penalty of double taxation on profits already reported.

STRUCTURE OF THE NEW BILL

Our reference throughout this letter has been to H. R. 1 as read twice and referred to the Committee on Finance in the Senate of the United States.

Our committee believes the form of the new act, if it were carried to a logical conclusion, would be a decided improvement over the form of previous revenue acts, but we would respectfully call attention to the fact that the purpose of the Ways and Means Committee in adopting the present form or structure of the act, has not been carried through, with the result that in its present form it has not been simplified, but is much more confusing than any previous act. It is neither a self-contained nor all-comprehensive taxation bill. It is necessary to refer to previous acts and the amendments to previous acts, to know what the taxation laws of the United States are to be from the date of the enactment of this act.

Title 1.—Title 1, income tax, seems to carry further than any of the other titles, the intent of the Ways and Means Committee to draft a self-contained bill, but even title 1 is incomplete, for title 3, "Amendments to 1926 income tax" must be read in conjunction with title 1 to arrive at an understanding of the tax on individuals and corporations, and even then complete understanding can not be had without further reference to previous acts and to amendments to previous acts. Our committee recommends that the contents of titles 1 and 3 shall be merged.

We have later suggestions to make as to the numbering of the titles in the act.

Title 2, miscellaneous taxes.—Title 2, miscellaneous taxes does not disclose what the estate tax is, without reference to the previous acts, for it consists largely in amendments to the previous acts, with no setting forth as to what the law is to be after enactment. Complete knowledge of the law can be had only by reference to this act and several preceding acts. We believe this is true of all the sections in title 2, and we again recommend that title 2 shall be so rewritten that it will be self-containing of the law prevailing after enactment, without necessity of referring to any other acts.

Title 3, amendments to 1926 income tax.—Our criticism of this title is incorporated in our criticism of title 1.

Title 4, administrative procedure.—The same criticism as to form which we have made of the preceding titles, applies to title 4. We recommend this title be so rewritten that it contains the law in entirety, as it will be after enactment.

Title 5, general provisions.—Title 5, general provisions, seems to more nearly approach the ideal aimed at by the Ways and Means Committee than any of

the preceding titles, but reference to section 702 will disclose the necessity of referring to previous acts, particularly the act of 1918, for complete knowledge as to the full coverage of the section. The same criticism, therefore, attaches to title 5 which we have made in regard to the other titles.

The foregoing is criticism confined entirely to the structure or arrangement of the new bill. We wish to extend our criticism, by pointing out the fact that there is no linking up of section numbers with title numbers. One of the outstanding excellencies of previous acts has been that a section number was always indicative of the title in which the section fell. There was no question with any one even slightly conversant with the tax law, that section 700, the capital stock tax in the revenue act of 1926, could be found in title 7, nor that section 800, stamp taxes, could be found in title 8.

We believe there would be a decided improvement if that part of the revenue act of 1928 which is really introductory to the act itself, should be given the title 1, "Introductory provisions." In its present form, title 1 is income tax, subtitle A is "Introductory provisions." Subtitle B is "General provisions," the matter of which proceeds directly to taxes on individuals. If title 1 could be used to cover only "Introductory provisions," then title 2 could become general provisions, if "general provisions" is the proper title, but it seems to our committee that the proper title to use is "income tax."

The other titles would then be advanced so that there would be six titles instead of five, and then there should be a renumbering of sections in conformity with former acts, and in agreement with titles, so that in each section number there would be a revelation of the title to which it belonged.

The criticism of form and numbering which we have respecfully raised in the foregoing, is not met nor overcome by the table of contents which is a part of the act.

In closing our criticism on the form or structure of the act, we wish to call attention to one case which we think shows most emphatically the need of rewriting of the 1928 act, so that it will be all inclusive. Section 600 (2), the revenue act of 1926, imposes a tax on pistols and revolvers. There is no mention at all in the present print of the revenue act of 1928 of this section as having been repealed or retained. Not having been repealed, it is still the governing tax, and it certainly should be incorporated into the revenue act of 1928. This specific case illustrates the necessity of the changes we have suggested.

It is not enough for the Ways and Means Committee to state they have reduced the pages of previous acts by fifty or more, if such reduction results in a sacrifice of accurate knowledge of the law by the taxpayer who must understand that law. The result of such sacrifice is not simplicity but complication and unnecessary confusion.

Comment in this letter has been confined to H. R. 1, as referred to the Committee on Finance. At the invitation of the Joint Committee on Internal Revenue Taxation, we submitted to that committee a brief, and also made presentation of the matter therein to the Ways and Means Committee. Believing the suggestions in the brief prepared for the Joint Committee on Internal Revenue Taxation to be pertinent and relevant to your consideration of H. R. 1, we are inclosing copy with this.

Yours respectfully,

COMMITTEE ON TAXATION,
NATIONAL RETAIL DRY GOODS ASSOCIATION,
CARLOS B. CLARK, *Chairman.*

Mr. YOUNG. I want to deal briefly with two or three points to which I should like to direct the particular attention of the committee.

Mr. Lederer has gone quite into detail as to the installment feature, in which we are very much interested. The income tax law is based upon the profit content of a consummated transaction. An installment sale is not a completed transaction, and it was never intended, we believe, that the tax should be computed upon an anticipated profit. There results in the present installment sales law a double taxation, which we think is unjust. Mr. Lederer has largely covered our views.

I think, also, that the discussion which occurred in the Senate on February 4, 1926, and the statement by Senator Reed on the floor

showed clearly that the intent of Congress was that we should not have double taxation, as provided under the December, 1919, regulations, but the regulations, revised 45, as promulgated January, 1920.

I should like to say in this connection that our committee does not want to be understood as recommending the granting to a firm doing an installment business, which has heretofore reported all its profits on such bases as taxable income, the right to ask a redetermination of previous years' taxes in the event it should elect to change to the installment basis as provided by law.

We think that section 1208 (d), the retroactive section, has caused all the trouble which you have experienced. On the contrary, we believe that a firm such as I have mentioned has had all the opportunity to avail itself of the advantages provided by the installment sections in previous revenue acts, and that if it did not care to report on the installment basis in previous years it should not have the privilege of redetermination and the right to any consequent refund of taxes paid in those years, although, as already set forth, it should have the privilege of making a change without incurring double taxation on profits already reported.

Senator SIMMONS. Let me understand you, please, with regard to this expression "double taxation" which you are using. I do not know whether you use it as meaning that you have to pay a specific tax twice or whether, under some different method of computation, you would have to pay an additional tax. Which do you mean? Do you mean that if, under one method of computation of your tax, you pay a certain amount, and then the department decides that that was the incorrect method and assesses you at a larger amount, that you would not get credit for the smaller amount?

Mr. YOUNG. Senator Simmons, I think I understand your question, and I think I can answer it. Section 212 (d) gave the taxpayer the right of reporting on the installment-tax basis. Those who, prior to that time, reported on the accrual basis had already paid the tax upon the entire profit realized. Then, when they go upon the installment-tax basis, under the privilege given under 212 (d), the commissioner is reopening cases and requiring the payment of a tax again, under the installment-tax basis, a pro rata, it already having been paid.

Senator SIMMONS. Are you not allowed any credit for what you have already paid?

Mr. YOUNG. There is a credit. I can not answer that question, because I am not an accountant. There is a credit, but it still results in the paying of a tax which you have already paid.

The CHAIRMAN. An increased tax?

Mr. YOUNG. An increased tax.

Senator SIMMONS. An increase, instead of a double tax?

Mr. YOUNG. Yes.

Senator SIMMONS. That is where you confused me. You say "double tax" where you mean an increased tax?

Mr. YOUNG. They have already paid the tax upon the profit. Our law, as I said at the outset, does not contemplate the payment of a tax upon an anticipated profit, but only a tax upon the completed transaction.

Senator REED. Let me see if I can not clear it up by an illustration. Suppose, in 1917, a furniture store had sold this table for

$200, payable in two years, $100 in 1917 and $100 in 1918. The table cost them $100 originally, so there is a profit of $100. These people reported that transaction as consummated in 1917 and they paid their tax on the $100 profit in 1917, although half of the purchase price had not been received and would not come in until the next year. The commissioner said "that is all right. You paid your whole tax on the whole transaction that year. Therefore, you do not pay any tax on this deferred installment of the purchase price, which comes in in 1918."

Now, then, retroactively they have construed the law to mean that although they paid the tax on the whole profit in the first year, the year in which the sale was made, nevertheless they must also pay a tax under the 1918 rates on that installment which was received in 1918, ignoring the fact the whole transaction had been taxed in the prior year.

The CHAIRMAN. Providing, however, that they elect to pay under the installment plan rather than the original plan?

Senator REED. Yes. At the time they were given that election in the regulations of the Treasury Department, this system of double taxation of the profits was not dreamed of.

Senator SIMMONS. The illustration you give would be a clear case of double taxation?

Senator REED. Yes.

Senator SIMMONS. And something that we never intended?

Senator REED. I am sure we never did, and that is why I said we never did, on the floor of the Senate.

Senator SIMMONS. It is amazing to me to hear that the department has made any regulation or ruling that requires them to do it.

Senator REED. For six years, Senator Simmons, from 1920 to 1926, their regulations were exactly in accordance with your understanding and mine, and then, all of a sudden, they turned around and put in new regulations and said "no matter if you did pay the tax on the whole transaction in the original year, nevertheless we have changed the rule now, and you have to pay a tax again on the installments from that transaction in the succeeding year.

Senator SIMMONS. That is the reason I asked the question.

Senator REED. How in the world the Board of Tax Appeals ever reached that conclusion I do not see.

Senator SIMMONS. I thought it was only increased taxation he was complaining of, but according to your explanation it is a double taxation.

Senator EDGE. There was not not any additional legislation?

The CHAIRMAN. Yes. The regulation was made after the passage of the 1926 act.

Senator EDGE. Based upon what is in the 1926 act?

The CHAIRMAN. Yes.

Senator REED. We provided in the 1926 act just what the regulations had theretofore provided, that the taxpayer might have his option, whether to pay on the transaction at the time it was consummated, or whether to pay on the proportion of each installment that constituted profit. The regulation had said that he might do that, so we put it in the 1926 act to make it permanent. Then, down at the end of the bill, in section 1208, we said that the provisions of subdivision (d) of section 212, where he was given the option, shall

be retroactively applied in computing income under these earlier acts, and on that, without any more from Congress, the Board of Tax Appeals has decided that we meant to tax the same transaction twice in the year in which it was made and the year in which it was paid.

Senator SIMMONS. Senator Reed, you make the point, which I think is well taken, that if that matter was presented to the court we would get a decision in conformity with the equities of the situation.

Senator REED. If it were my client, I should take it to court in the quickest possible way. Mr. Alvord, have I stated that incorrectly?

Mr. ALVORD. No.

Senator REED. If I have, I wish you would correct me now.

Senator SIMMONS. I think we ought to hear from the tax board upon that matter. I understand they made some recommendation about it.

The CHAIRMAN. The recommendations we made in this bill were made by the joint commission.

Senator REED. If I have misstated it, I wish you would correct me now, so that any misunderstanding will not become fixed.

Mr. ALVORD. The only additional point I might make, Senator, is that in the conference report, under section 212 (d), the conferees stated that they were intending to ratify the double-tax regulations, and not the single-tax regulations. Furthermore, I believe that was the general understanding at the time.

Senator REED. We never saw that. That may have been sent to the House, but there was no such statement in the report to the Senate.

Mr. ALVORD. That was in the statement to the managers of the House.

Senator REED. I never saw it.

Mr. ALVORD. It was the statement in the conference report upon which the department relied, and, to a large extent, I believe, upon which the Board of Tax Appeals relied.

Senator REED. I am sure no member of the Senate conferees would have agreed to that.

The CHAIRMAN. I think every member of the committee now understands that thoroughly.

Mr. YOUNG. May I point out one other thing?

The CHAIRMAN. We will take it up. Senator Reed has distinctly stated exactly what it was. We declared it in 1208, and then in 212 (d), just as the Senator says.

Senator SHORTRIDGE. We can straighten it out when we get into executive session.

Mr. YOUNG. May I make just one statement that I think will clear it up? The commissioner finds justification for his position, and I believe the Board of Tax Appeals does in its decision, in a very simple error which occurred in the discussion on the floor of the Senate between Senator Smoot, Senator Reed, and Senator Simmons, wherein Senator Smoot said, "The committee intends that the installment provisions of regulation 45, promulgated on December 29, 1919"—

Whereas I think you meant to state the regulations promulgated January 20, 1921, which statement is supported by the later statement by Senator Reed, when Mr. McKellar asked him what effect it would have, and whether it would result in opening up all these

cases. Senator Reed said "No, Mr. President, it would not open them up, because for all these years the Treasury Regulations have provided what is now proposed in the bill."

What was proposed in the bill, according to a reasonable interpretation, was revised regulation 45, as Senator Reed pointed out.

The CHAIRMAN. I think those are the 1919 regulations.

Mr. YOUNG. The revised regulations is 1920.

The CHAIRMAN. I know; but the regulations of 1919 to which I referred there, are the regulations upon which the change was made.

Mr. YOUNG. The regulations of 1919 were the regulations which provided for double taxation, and I think Mr. Alvord will bear me out, whereas it was the intent of Congress not to provide for double taxation, as the statement of Senator Reed has indicated.

Senator REED. Why can you not answer my question to the other gentleman? Why do you not take this to court? If you can get into court you will get to a forum where a tax law is construed, in case of ambiguity, favorably to the taxpayer. The very best you can say of this is that it is ambiguous?

Mr. YOUNG. Yes.

Senator REED. If given a construction favoring the taxpayer, surely double taxation will not be permitted.

Mr. YOUNG. True.

Senator REED. No American court will require the payment of a tax twice on the same income, unless the language of Congress drives it to it, and this language does not.

Mr. YOUNG. Yes, sir; but would we not be confronted with the apparent intent of Congress——

Senator SHORTRIDGE. Has there been an erroneous interpretation of the law?

Mr. YOUNG. That is our contention.

Senator SHORTRIDGE. Is it your contention that this committee, or the Congress, could grant relief?

Mr. YOUNG. Yes.

Senator SHORTRIDGE. You ask that relief be granted by a bill now under consideration?

Mr. YOUNG. Yes.

Senator SHORTRIDGE. Rather than to compel you to go to court with the consequent expense and delay?

Mr. YOUNG. Rather than to compel us to go to the expense of litigation; yes. That is our position.

Senator REED. I think we understand the issue. We can decide it in executive session.

Mr. YOUNG. The next sections with which I would like to deal are, jointly, sections 45, 141, and 118. Section 118 was originally in the bill as reported to the House, and was stricken out. That section and section 141 would deprive different units of a consolidated whole——

The CHAIRMAN. I was going to say that that deals entirely with consolidated returns.

Mr. YOUNG. That is true.

The CHAIRMAN. I hardly think it is worth while to take the time of the committee to discuss that.

Senator REED. The committee has its mind pretty well made up on that.

Mr. YOUNG. On section 104 there are two objections.

The CHAIRMAN. I think the same situation applies to that section.

Mr. YOUNG. The committee has its mind made up. We object particularly to the information reports, which would divulge secrets.

The next is section 115, on distributions prior to——

The CHAIRMAN. The same thing applies to that.

Mr. YOUNG. The next is one upon which I assume the same condition of mind exists on the part of the committee, with reference to 611, claims in abatement.

The CHAIRMAN. We have the record full of that.

Mr. YOUNG. And your mind is already made up on that?

The CHAIRMAN. Mine is. I do not know about the other members of the committee.

Senator SIMMONS. In other words, I think we do not want to sit here as a court to try to correct all the errors made by the department in its rulings. I think that when the department has made a clear error in its rulings the best course for you to pursue is to go into the courts. I do not think our committee is required to sit here and pass laws to correct errors in their rulings, unless the law needs amendment. If the law needs amendment, then we ought to amend it.

Mr. YOUNG. Under section 611, Senator——

Senator SIMMONS. But where the law is clearly, as I think it is in this case, in favor of the tapayer, but the taxpayer has not followed his remedy, I do not think he ought to come here and ask us to revise all the erroneous rulings of the Treasury Department.

Mr. YOUNG. Does that statement also apply to the attempt made in section 611 to overrule the decision in the New York & Albany Lighterage Co. case?

Senator SIMMONS. No. I think that is another thing altogether.

Senator HARRISON. That has been discussed very fully.

The CHAIRMAN. That has been discussed. I do not think there is any need of spending any time on it.

Mr. YOUNG. Are you interested in hearing a discussion on the graduated tax on small corporations? I should like to point out, for just a moment, the effect that is going to have.

The CHAIRMAN. We have not had anybody speak on that.

Mr. YOUNG. As reported in the bill at present before you, under section 13, there is a tax upon small corporations, less the credit provided in section 26, where the income is not more than $13,000, 5 per cent on the amount not in excess of $7,000; 7 per cent on the amount in excess of $7,000 and not more than $12,000; 9 per cent on the amount in excess of $12,000 and not more than $15,000. That has a peculiar effect. We think it is entirely illogical, first, because, for the first time, it injects a system of double graduation of taxes into the revenue act. It is double because the corporation is, in itself, not an entity, but a collection of individuals and a graduated tax upon a corporation is therefore the first graduated tax upon the individuals holding the stock of that corporation.

In the present system of surtax upon the incomes of individuals, there is the second graduated tax upon that part of the income which the individuals receive as dividends from corporations. It is illogical because it arbitrarily defines as a small corporation one having a net income of not more than $18,000; that is, with the $3,000 credit.

By setting up that line of demarcation between large and small corporations, it necessarily implies that a corporation having an income of $18,100 is a large corporation and not entitled to any relief, and I can show you in a moment just how that will work out.

Senator SIMMONS. Does not that same thing follow in our graduated income tax?

Mr. YOUNG. Not to the same extent, as I shall point out in just a moment.

It is inequitable, because if there is any merit in the principles underlying such double graduation of taxes, it should be applied to all corporations, just as the graduated tax on the income of individuals is applied to all individuals.

As an example of its inequity, a corporation having a net income of $18,000, deducting the credit of $3,000 allowed in section 26 of the act, will pay the following graduated tax:

In the first bracket, $7,000, at 5 per cent, it will pay $350; in the second bracket, $5,000 at 7 per cent, $350; in the third bracket, $3,000 at 9 per cent, $270, or a total tax of $970.

Then, another corporation, which has a net income of only $100 more, or $18,100, with the credit allowed by section 26 to a domestic corporation earning more than $25,000, can also deduct $3,000, giving it a taxable income of $15,100, on which it must pay a tax of 11½ per cent, or $1,736.50, or $766.50 in excess of the corporation which had the income of $18,000.

Senator REED. In other words, it gets $100 more income, and that requires it to pay $700 more taxes?

Mr. YOUNG. It pays $766.50 more tax than the corporation with an income of $100 less.

Senator EDGE. That is based upon the 11½ per cent provision contained in the present bill.

Mr. YOUNG. Yes. That will necessitate closer policing by the Bureau of Internal Revenue, because of the desire to shift income to come within the lower brackets, where the percentage of tax is that high.

Just one more thing and I will have concluded. I have dealt with the structure of the bill. I should like, as we outlined before the Ways and Means Committee——

Senator HARRISON. Is your organization satisfied with 11½ per cent as a corporation tax?

Mr. YOUNG. We are satisfied with the 11½ per cent, but the matter of rates is a matter in which we do not feel that we are as well qualified, lacking intimate information as to the fiscal requirements of the Treasury, as the Treasury Department is itself, to determine the amount of income.

Senator HARRISON. So you are not recommending any particular rate?

Mr. YOUNG. We think that is wholly within the discretion of the committee.

Senator SIMMONS. Do you think that 11½ per cent would be a reasonable tax?

Mr. YOUNG. I do not feel that I am prepared to answer that question, Senator. I think that is peculiarly within the province, not of an outside agency, but of those who know more intimately the details of the fiscal requirements of the Treasury.

The CHAIRMAN. You have no desire whatever to have rates lower than would bring sufficient money to maintain the Government?

Mr. YOUNG. That is it.

Senator SIMMONS. That is not what I said.

The CHAIRMAN. I did not say it was.

Senator SIMMONS. I am assuming that the finances of the Treasury Department will justify a reduction to 11½ per cent. I was asking you if you thought, if the financial situation of the Government would justify it, that that would be a reasonable amount of tax for you to pay? Do you think it ought to be lower than that?

Mr. YOUNG. Qualified as you have qualified it, Senator, I should say 11½ per cent, because we all desire to get as low a tax as the fiscal conditions of the Treasury will permit, but I do not think I am qualified to answer the question.

Senator SIMMONS. Then, you would like to have 11 per cent?

Mr. YOUNG. I would like to have it down to 5 if the fiscal requirements of the Treasury would permit it.

Senator EDGE. If we could repeal the income tax law we would not have to deal with the structure.

Mr. YOUNG. I do not think I am qualified to answer the question.

Senator SIMMONS. I do not think so.

Senator SHORTRIDGE. The witness has made a very frank statement.

Mr. YOUNG. One more statement, and that is with respect to an amendment to the law to allow corporations to deduct donations for charitable contributions. That is just as much a business expense for a corporation as it is for a partnership. If you have charitable organizations coming into your stores, it is absolutely necessary to give to them. It is not a deductible item. They do not take that into consideration when they make the demands upon you. They do not take into consideration the fact that it is not a deductible item when they make the demand, whereas your competitor, a partnership across the street, has it as a deductible item, which is unfair and unjust.

Senator REED. Do you not think it is ultra vires a corporation to make charitable contributions?

Mr. YOUNG. That is a question that might be debatable.

Senator SHORTRIDGE. It would depend upon the laws of the different States, and the charter.

Mr. YOUNG. It would depend upon the local jurisdiction. I think the corporations, if that privilege were given them, are sufficiently interested so that they would not make contributions that are out of line with their ability to make them.

Senator SHORTRIDGE. Do you think the corporations would be more charitable if they were granted the privilege?

Mr. YOUNG. I think that would be the tendency, but even now they are compelled to make donations, which is a business expense, and they are deprived of the benefit of deductions.

Senator SHORTRIDGE. They think they ought to have that privilege, the same as a partnership or an individual?

Mr. YOUNG. Yes.

Senator REED. I do not see why we should encourage officers of corporations to be charitable with other people's money. That is what it amounts to.

Mr. YOUNG. I think they are so controlled by the board of directors that they would not exceed, Senator Reed, the amounts that they knew would be approved by the board of directors.

The CHAIRMAN. The corporations of the country can not get along without it, for instance, at Christmas time.

Senator SIMMONS. I think a corporation, being a soulless concern, would not contribute to charity unless it was in its interest to do it.

Mr. YOUNG. They are compelled to do it.

The CHAIRMAN. They are compelled to do it.

Mr. YOUNG. It is in its interest, even from a competitive standpoint.

The CHAIRMAN. Mr. Hausserman.

STATEMENT OF JOHN W. HAUSSERMAN, REPRESENTING INTERESTS IN PHILIPPINE ISLANDS

Mr. HAUSSERMAN. Mr. Chairman, and gentlemen, I have in mind the section relating to income from sources within the possessions of the United States, the Philippines, and Porto Rico. You are probably sufficiently familiar with the tax situation in the Philippine Islands.

Prior to 1918, all income taxes were paid to the Philippine Government. Up to 1918, there was no attempt on the part of the Federal Government to collect any taxes on business conducted in the Philippine Islands. In 1918, during the war, the provisions of the 1918 act were sufficient to cover Americans doing business in the Philippines, although it did not cover Filippinos, or other nationals doing business in the Philippine Islands. It has always been a question whether Congress really intended to do it, and for a number of years——

The CHAIRMAN. There is no question with the Committee that Congress decided to do it.

Mr. HAUSSERMAN. The courts have so held.

After the year 1918, the whole machinery of the Philippine Government and the War Department became interested in trying to get Congress to put the Americans back where they were prior to 1918. The Philippine Legislature unanimously passed this resolution:

Be it resolved by the Senate and House of Representatives of the Philippines concurring, That the resident commissioners be, and they hereby are, instructed to ask Congress for the amendment of the United States internal revenue act of 1918, in the sense that American citizens who are bona fide residents of the Philippine Islands, shall not be subject to any income tax greater than that required of other residents of said islands.

That was followed by a cablegram from General Wood and Mr. Forbes. Subsequently General Wood became Governor General, and the fight was kept up.

In 1921 you attempted, I thought—and we all thought—to rectify that situation, and you passed a new amendment, 262.

SEC. 262. (a) In the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States:

(1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section), for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

(2) If, in the case of such corporation, 50 per centum or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

(3) If, in the case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

We all thought that solved the problem from 1921. We attempted to get the Congress to make it retroactive, so as to cover 1918, and all subsequent acts.

There are possibly 2,000 Americans over there that may be subject to that income tax. As a matter of fact, not over 15 reading that law considered that they were liable, and paid the tax. No machinery was put in force out there to collect the tax. No attempt was made to collect it, so the situation resolved itself down to about 14 or 15. I, being one of them, paid the tax under 1918.

In 1921 I made my return, complying with that, and under the rulings of the Collector of Customs I was exempt on my Philippine revenue, because 80 per cent of the whole came from the Philippine Islands, and, as we all thought, 50 per cent of my income came from the active conduct of the business.

I proceeded along for four or five years, feeling perfectly secure, but in 1926 I received a very polite note from the taxing unit here, which said that they had reaudited my account, and that I was not entitled to the benefit of section 262.

Why? Well, they admit that 80 per cent of my income was derived from the Philippine Islands. They admit that during all that time, and all the preceding years, I was in the active conduct of a trade or business, but they said, "The business that you are actively conducting and managing is a corporation, and to make up this income of 50 per cent you have to include your dividends, and the dividends that you receive from that business which you are managing and conducting come by virtue of your ownership of the stock, and not because of your active conduct of the business." Hence, I was eliminated.

Now, it so happens that this is the situation. Justice Fisher and myself were trying to think this morning of any American over there who does not do business, outside of the professional men, in the form of a corporation. We could not thing of a single one. Of course, the lawyers have partnerships, and there is no question that they are exempt. Doctors, as a rule do business as partnerships, and they are exempt. The same applies to dentists and professional men. But when you are in the active conduct of business, you usually incorporate.

That being the case, the department has construed it. It says there is no ambiguity in that language. They will concede that there is no doubt that if the attention of Congress had been called to it, and they really wanted to relieve all actual, bona fide busi-

ness men in the island from that tax, in order to assure that they were only exempting bona fide business men there, they would have described, or made a method of determining whether they are actually, bona fide business men, engaged in business.

First, you must show that 80 per cent of your income come from the Philippine Islands. That is pretty good evidence that the fellows in the Phillipines are actually interested there. But that is not sufficient. They do not want to make that a haven of safety, or a safety zone for tax dodgers, and let them take their money to the Philippine Islands and invest it, and thereby become exempt from taxation. You must be engaged in the active conduct of business. They could foresee that a person might open a little shoeshining parlor and consider himself actually engaged in business, so they said that his income that he seeks to exempt must, at least to the extent of 50 per cent, come from the active conduct of the business. the way it is worded, that will apply to a partnership, or to an individual who owns the whole of his business, but if he happens to incorporate his business, he is not exempt. So, the result is that under this construction the section, as written, has absolutely no practical value in the Philippines, except for lawyers, doctors, and dentists. So far as the real business men in the Philippines are concerned, Americans in the Philippine Islands, it has no practical application, because we all, as a matter of fact, do business in the form of a corporation. I am not the only one.

Senator REED. Is that carried into the subsequent revenue acts since 1921?

Mr. HAUSSERMAN. Yes, sir. We have it exactly in this one, without an amendment.

Senator REED. What section?

Mr. HAUSSERMAN. Section 251. Just to show you how unjust that is——

Senator SIMMONS. Do you mean that if your part of the dividends or receipts from the activities of the corporation should amount to 80 per cent, and that represented 50 per cent of your income, that because you receive that through a corporation you would not be entitled to the benefit of it?

Mr. HAUSSERMAN. Received as dividends. I am there actually managing that whole business and conducting it. All the dividends distributed to all the shareholders are the result of my active operation and conduct of the business, but because my share that I get is in the form of dividends I am not entitled to the benefit of section 262.

Senator SIMMONS. Would that be true if your share of the dividends amounted to 80 per cent of your income?

Mr. HAUSSERMAN. It does not say 80 per cent. It says 50 per cent. As a matter of fact, my dividends amount to about 80 per cent of my income. It is all I have. They are calling on me——

The CHAIRMAN. But your income is more than 50 per cent in the corporation?

Mr. HAUSSERMAN. Oh, yes; but I am a shareholder and consequently I am not entitled to that benefit. Now, if I were a corporation——

Senator SIMMONS. That is to say, you are not actively engaged because it is done by a corporation?

Mr. HAUSSERMAN. They will admit that I am physically actively engaged in the conduct of that business.

Senator SIMMONS. But you are doing it through a corporation.

Mr. HAUSSERMAN. Yes.

Senator REED. Did you ever corsider paying yourself a salary instead of dividends?

Mr. HAUSSERMAN. Yes; but I could not do that without committing a fraud upon other shareholders who are actual shareholders in that particular business.

The CHAIRMAN. You do draw a salary?

Mr. HAUSSERMAN. Certainly. They will concede that my salary, if it amounted to 50 per cent of my income, would be exempt, but my salary does not amount to 50 per cent.

Senator SIMMONS. What Senator Reed meant to imply was that you ought to get the benefit of a very shrewd corporation lawyer's advice.

Mr. HAUSSERMAN. We have had all that. We think you ought to leave that section just as it is, but with this proviso:

Provided, That for the purpose of this subsec ion dividends shall be deemed to be derived from the active conduct of a trade or business where the taxpayer is actively engaged in the conduct of such trade or business, either on his own account or as the employer or agent of another.

That shows that dividends ought to be included.

The CHAIRMAN. We will adjourn until 2 o'clock.

(Whereupon, at 12 o'clock noon an adjournment was taken until 2 o'clock p. m.)

AFTER RECESS

The committee resumed at 2 o'clock p. m., in its hearing room in the Capitol, Senator Reed Smoot presiding.

The CHAIRMAN. If the committee will come to order we will proceed. Mr. William S. Elliott, I believe, is the first witness.

STATEMENT OF WILLIAM S. ELLIOTT, ESQ., CHICAGO, ILL., GENERAL COUNSEL FOR THE INTERNATIONAL HARVESTER CO.

The CHAIRMAN. You may state your name and address.

Mr. ELLIOTT. My name is William S. Elliott, Chicago, Ill. I am general counsel for the International Harvester Co.

The CHAIRMAN. Proceed, Mr. Elliott.

Mr. ELLIOTT. The matter I wish to present is a proposed amendment to section 165, employees' trusts, which I think is within the spirit of the present section, which has been in the law since 1926, but which amendment I think carries out the intent more fully. This section is intended to encourage certain provisions by employers for the benefit of their employees. It does so by providing that a trust created by an employer for the exclusive benefit of the employees, in the way of stock-ownership, profit-sharing, or pension plan, that trust as such shall not be required to make an income-tax return, the tax being deferred on the interest on the trust funds until it is actually distributed to the employees.

The problem I wish to present relates exclusively to pension funds. I do not think it has any bearing on the other things mentioned,

stock ownership or profit sharing, because pension funds involve a special situation of building up a reserve out of which to pay pensions. The question of pension plans is a very live subject at the present time throughout the country with a good many other concerns besides the International Harvester Co. That company was one of the pioneers of the pension plan, starting it in 1908. During each year from 1908 to the present time it has set aside a pension reserve out of profits upon which it has paid tax; that is, this reserve has not been deducted for tax purposes. It has set aside in its pension reserve a certain amount to meet the future liabilities under the pension plan. This fund is not trusteed. It is part of the assets of the company. I have been told and shown figures—I do not know how accurate they are—that of some 600 pension plans now in force in the country, only about 20 per cent have had their funds trusteed to date.

I assume that it was considered that such a trust is desirable, because it protects the fund for the employees, and Congress has provided in this section that the interest also can be accumulated on that fund tax free for the protection of employees. The matter has become a large subject in the last two years, because of two or three instances where there was expectation of pensions on the faith of which employees had been working, which had been defeated, when the fund was not trusteed. There have been cases where the corporation became insolvent, and the pension reserve went into the assets and to the creditors. I have heard of one case where stock control of a corporation was bought up and the control taken out of the hands of the people who wanted to build up this fund for employees. In such a case there is nothing to prevent them from turning the pension reserve back into the surplus, or distributing it as dividends, or using it to increase the value of the stock.

There have been some instances in the Chicago district which have circulated through the employees of other companies, where one large company got into financial difficulties and their pension fund went to the creditors or the stockholders, I do not remember which, and it has affected the whole morale of employees in that district. There is always considerable effort by agitators to discount to employees anything a company does for them, and to say:

> You can't count on this. Let us get something for you. Look at this other company. These men worked on the faith of this pension plan, and it was taken away from them and went to the creditors.

We want to trustee our pension reserve, and there are a lot of other companies who want to do the same thing, not because of any tax benefit they will get by it, but to put the fund where it is absolutely beyond the control of the company and will be devoted in any event to the employees so the employees can work in the faith of that fund.

Now, under section 165, as it is drawn now, I might first state to you how it would work out in a new pension plan which is now starting, and the point I wish to make is that it does not quite meet the situation with the companies which have heretofore established a pension plan and want to change their existing plan from the nontrustee form to the trustee form. If a company starts a pension plan at the present time under which, we will say, they provide

that an employee can retire at 60 years of age and 30 years of service. The Treasury Department allows a deduction for the money applied to pensions, on the theory that it is in the nature of deferred compensation. We will say a man enters the employ of a company at 30 years of age and retires at 60. During each of those 30 years they are paying him in cash wages of so much, and they are putting into the pension fund each year a cash amount, say 2 per cent of his salary. When he gets to the age of 60 he retires. His expectancy of life is 12 years, and they must have on hand at that time a fund sufficient, with interest, to pay him out a pension during the next 12 years, exhausting both interest and principal.

The pension fund is on an actuarial basis, and is in the nature of an insurance annuity, where you pay in so much money for so many years, and they pay you out so much money for so many years. The present section 165 encourages such trusts by saying that if an employer establishes a trust fund and pays into that fund the amount necessary to build up the reserve and pay out the pensions, he may deduct that as an expense of the business. It further encourages it by saying that while that money is in the fund and the interest is accumulating on it, that interest shall not be taxable because it is a part of that reserve, and will be distributed at a later date.

Now, that is the way it applies on a new trust. Our problem is that we have had our pension fund for 19 years, and I think most of the established industries of the country have had pension funds for probably not that long, but we will say on an average of 10 years. During that period they have appropriated out of their income each year a certain amount and set it up on their books as a pension reserve, the money still remaining the property of the company. If they wish to shift from their present pension plan to a trustee plan, it involves transferring to the trustee not merely the additions to the fund in the future but the reserve already accumulated.

I have taken that up with the Treasury Department, and I know that attorneys for other companies have done the same thing. I think I am stating the fact when I say they are sympathetic with the situation, desire to help the trust to be formed, and recognize that a deduction should be allowed in some way. The only provision in the law permitting it, is that the employer may deduct the ordinary and necessary expenses of the business. The annual addition to the pension fund comes within that definition, but when you want to transfer a reserve accumulated during several past years, the point comes up that that is an abnormal amount which has no direct relation to the business of the year, and I think I am stating their position when I state that they feel it is a matter for legislative consideration and policy, and that if the Congress wishes to take a position on the matter it should be stated in the law.

Section 165 is where the matter should be dealt with, and I have suggested a wording here, simply to make a concrete suggestion, adding to this section which deals with the various features of employees trust, the following:

An employer establishing or maintaining a pension trust may deduct as an expense of business amounts transferred to such trust representing pension reserves accumulated under a pension plan previously in force and not theretofore claimed and allowed as a deduction, provided that the reasonable-

ness of all such deductions actuarially determined with respect to the pension obligation to be provided for shall be subject to the review and approval of the commissioner.

(Complete proposed amendment inserted at end of testimony.)

Senator REED of Pennsylvania. Has the trust reserve been deducted from the employer's income in past years?

Mr. ELLIOTT. It has not, Senator; no.

The CHAIRMAN. They have generally got it, whether they pay it into the company or the company pays it out. What he wants now is——

Senator REED (interposing). I know what he wants, but I thought that had been deducted heretofore.

The CHAIRMAN. No.

Senator REED. Under your pension plan an employee who reaches a given age after a given length of service is entitled to a certain specified amount?

Mr. ELLIOTT. Yes, sir.

Senator REED. Based on his rate of pay?

Mr. ELLIOTT. Yes, sir.

Senator REED of Pennsylvania. And that is considered to be deferred compensation to the employee?

Mr. ELLIOTT. That is the basis of the Treasury Department's rulings. It is in the nature of additional compensation.

Senator REED of Pennsylvania. If the earnings of this fund were taxed as the earnings of other trusts are taxed, the employer would be required to put in more money each year in order to build up the reserve fund.

Mr. ELLIOTT. Yes, sir.

Senator REED of Pennsylvania. His contribution would have to be increased by an amount equivalent to the tax which the Government would take from the trust?

Mr. ELLIOTT. Yes, sir.

Senator REED of Pennsylvania. So that the employer gets the benefit in his operating expense of the nontaxability of that fund?

Mr. ELLIOTT. Yes, sir.

Senator REED of Pennsylvania. The employer is the beneficiary of that tax exemption given by section 165 and not the employee. Is that not right?

Mr. ELLIOTT. That is correct to this extent: I would rather say they both get the benefit. The employee gets the benefit of working on the assurance that there is an irrevocable provision to provide for his pension, and to get away from these situations which are shaking the faith of the whole employee class.

Senator REED of Pennsylvania. You did not catch my question. Inasmuch as the employer would have to increase his annual payment into the trust by an amount that the trust was taxed, in order to have a sufficient fund, it necessarily follows that the employer, and not the employee, is the beneficiary of the tax exemption which is given by section 165.

Mr. ELLIOTT. He is the beneficiary of the tax exemption in a sense.

Senator REED of Pennsylvania. Yes. And the employee, when he finally receives his share of those accumulated earnings, pays a tax on them as a part of his income in the year in which he gets them.

Mr. ELLIOTT. That is correct.

Senator REED of Pennsylvania. I am wondering about the wisdom of section 165 in its entirety. Why should we make an exception in such cases? What useful purpose is served by exempting that variety of income?

Mr. ELLIOTT. I came here with the assumption that that had been in the original law, and had passed the House and that, so far as it stood, the policy of it had been approved. Even if you wipe out the present section and say that the fund in the employees' trust shall pay an income tax, that would be a collateral question to the one I am now presenting. The point I am now presenting is that if, as it does, the Treasury Department permits you to deduct as an expense of the business the money which you put into a trust to pay back to your employees, then that provision should be so worded as to enable companies with existing pension plans to come under it.

Senator REED of Pennsylvania. Yes; I caught your point. You want to increase your deduction by the aggregate amount of all the reserves you have set up in the past, which you are now going to turn over to the trust?

Mr. ELLIOTT. Yes.

Senator GERRY. Under the statutes, it would go into the trust?

Mr. ELLIOTT. Yes, sir.

Senator GERRY. And you want it so it will be set aside but not put into a trust?

Mr. ELLIOTT. No, sir.

Senator REED of Pennsylvania. They set up a reserve in the past, Senator, over a series of years. Now they are going to create a trust to make the fund more secure. They want to take credit as a business expense for this payment which they make in one year of all the accumulated reserve for past years.

Mr. ELLIOTT. Do not forget that during the past years we have paid an income tax on this money which has been appropriated out of our taxable income and put in the reserve. The average tax paid on the money now in the Harvester Co. reserve has been 11 per cent.

Senator REED of Pennsylvania. I am not quarreling with your suggestion, Mr. Elliott, because I see the comparative justice of it; but I got you off the thread, because I wondered what was the sense of the original section.

The CHAIRMAN. Let us take your own practice. In the past you have not put it into a trust, but put it into a reserve.

Mr. ELLIOTT. It stands as a reserve on the books.

The CHAIRMAN. The company paid a tax on that reserve?

Mr. ELLIOTT. Yes, sir.

The CHAIRMAN. Now, you want to change that policy and put it into a trust. Do you want to treat the amount you have already been taxed as a trust amount, or do you want that retroactive, so that no tax shall be paid on that portion on which you have already paid a tax?

Senator REED of Pennsylvania. He wants to get a retroactive exemption on it.

The CHAIRMAN. That is what I wanted to know. He wants a retroactive provision.

Mr. ELLIOTT. Whether it is retroactive or not, the Treasury Department's theory is that what was paid out in pensions is allowable

as a deduction, and it is also their theory that it is deferred compensation. If, during the last 19 years we had, in addition to the cash salaries, paid that other 2 per cent to the employees, it would already have been deducted and saved us the 11 per cent tax. Because we held it to pay pensions in the future, we paid 11 per cent to the Government on that additional amount. If we had kept it or paid it out directly to the employees, we could have deducted that and got the money back when we paid it. If we trustee it, then when the actual pension payments are made to the employees later we can not deduct them, because that would not be a transaction by the company.

The CHAIRMAN. If your suggestion is adopted, it would mean giving the Harvester Co. whatever tax they have heretofore paid on that fund?

Mr. ELLIOTT. It would save that fund.

The CHAIRMAN. That is the result of it?

Mr. ELLIOTT. Let me state it this way: I presume, as the Treasury Department says, it is in the nature of withheld compensation. There are three possible times to pay to take the deduction. You might pay these employees the additional 2 per cent in each year in which they earn their compensation and provide that they invest it with an insurance company and buy themselves annuities. That would be deducted at once. At the other extreme, you can keep it and pay it out to them as an annuity when they reach the required age. That would also be deducted. The third intermediate situation is that you can transfer it to a special trust which would be in the nature of an insurance company's actuarial fund, out of which to pay annuities. The law says that you can deduct that, so far as starting a new plan at this time is concerned. If our pension fund were now trusteed and the deduction allowed we would not be getting any deduction which we would not have had if the present law had always been in force.

As we view it we are not anticipating our rightful time of deduction. We view we have set aside for additional compensation this fund during the last 19 years, during which period we might have deducted the amount, and could have done so if we had trusteed our reserve at the start. We believe the companies which have been foresighted enough to start a plan for the benefit of their employees in advance of that provision of the law should not be penalized over those which start such a plan at the present time.

The CHAIRMAN. The objectionable part to me is that you are going to take exemption immediately for this period of years by transferring it to the trust fund. There would be some justification for splitting that up into the years that you have already paid and taking credit for those amounts, as you would have done in the first place, but you are asking to take the whole amount for nineteen years and have remitted upon that amount the taxes which were imposed, just what you could have done heretofore, but you did not do it.

Senator REED of Pennsylvania. How much do your accumulated reserves amount to?

Mr. ELLIOT. $13,000,000.

Senator REED of Pennsylvania. How much was the annual income of the Harvester Co. last year?

Mr. ELLIOTT. I can not tell you what it was for tax purposes. The published report was $23,000,000. There were reserves that were not permitted for tax purposes, fire-insurance reserves, and such as that.

Senator REED of Pennsylvania. That would give you pretty complete tax exemption for the next year?

Mr. ELLIOTT. It would if taken in one year, but I am not insistent on getting it all in one year. I want to present plainly the logic of the proposition. I do not think we are anticipating an admitted right of deduction in claiming it now. It is rather claiming now what might have been over 21 years.

The CHAIRMAN. It is not the fault of the law; it is your own fault.

Mr. ELLIOTT. I do not get that.

The CHAIRMAN. I thought you said it was 19 years.

Mr. ELLIOTT. Yes; it is 19 years, not 21.

The CHAIRMAN. You come in now and want that whole deduction made in one year which, of course, would mean the Harvester Co. would not pay any tax next year, and perhaps half the next year.

Mr. ELLIOTT. Even so, you are admitting we might have had it during the last 19 years.

The CHAIRMAN. Certainly, but you did not decide to do it that way.

Mr. ELLIOTT. If we could begin with some assumption, might I ask you to consider whether it is desirable to encourage the protection of pension funds for employees?

The CHAIRMAN. Yes; I believe in that.

Mr. ELLIOTT. By far the larger number of people employed are with the established concerns of this country which already have pension plans, over 600 of them, and none of those companies can ever go under a trustee form to protect their employees in a plan which is conceded to be beneficial. Can you not devise some equitable method for doing it? You are recognizing that the item is of a legitimate nature for deduction, but the objection is that the deduction is in year of a fund accumulated over a period of years. Could you not provide that where the reserve is trusteed, the deduction should be taken over a period of three or four years?

The CHAIRMAN. I think I understand what you want.

Mr. ELLIOTT. We have 40,000 employees, so that $13,000,000 reserve would be only $333 per employee put into that reserve for future payment. I do not think the problem is essentially different from that of a company having 400 employees and $130,000 of reserve. It is only larger because of our large number of employees and because we have had it in existence for a long time. I will leave that question with you.

There is one other thing, and that is the last sentence of this proposed amendment, which says:

> This section shall apply to similar trusts created and maintained jointly by a group of employers for the benefit of their employees.

I ask to have that put in to clarify a point which I think the Treasury Department would be glad to have clarified. The first sentence says: "A trust created by an employer * * * for the exclusive benefit of his employees." It is singular. This amendment

makes it clear that the section covers a pension plan for an affiliated group, which is quite essential for two reasons. One is that an employee may be shifted from one company to another, and if it is not a joint plan that would break his service record and he would have to start to build up his 30 years of service again. The other is that it enables the companies to pool their reserves and work out better actuarial results. I think such joint pension plans have been recognized by the Treasury Department as coming within section 165, but they feel the section needs clarification.

I might say that I addressed to Mr. Alvord, your legislative advisor, some time ago a letter on this subject, and if agreeable to him I would like to have it go in the record.

The CHAIRMAN. It may be inserted in the record at this point.

(The document referred to is here made a part of the record, as follows:)

RIGHT OF EMPLOYERS TO DEDUCT TRANSFERS TO PENSION TRUSTS CREATED FOR BENEFIT OF THEIR EMPLOYEES

February 4, 1928.

MR. E. C. ALVORD,
Treasury Department,
Washington, D. C.

DEAR SIR: Referring to our conversation last week, I understood you to say that if I would submit a written statement of the pension problem on which I was seeking light, you would give further study to the question of whether it could be adequately handled by regulations or was a matter for legislative consideration. Herewith is a statement of the problem which I hope will be sufficient for the purpose.

1. In the administration of the income tax law, pension payments have long been recognized as proper business expenses and allowed as deductions on the theory that the payments formed a part of the compensation scheme and were in the nature of deferred compensation.

2. Where pension plans have taken the form of building up a trust fund by annual transfers of cash or securities to a trustee who thereafter makes the pension payments, the Treasury Department, I understand, has permitted the deduction of such annual transfers in lieu of the direct payments to employees.

3. A pension plan in the form of a trust gives greater assurance to employees that the future pensions, in reliance on which they may have worked for many years, will be paid irrespective of the solvency of the employer or any action of the creditors or stockholders. Presumably in recognition of this fact the 1926 revenue law has expressly encouraged the trustee form of pension plan by a special deferment of taxation. Section 219 (f) defers taxation of the earnings of such trust funds until actually distributed to employees.

4. There has recently been an actual case of a large company whose employees lost all pension rights and expectations due to the fact that the pension fund was not adequately secured to them against the rights of stockholders and creditors; that is, no assets were trusteed, but the pension liabilities were reflected in the balance sheet by a reserve. This case has had much publicity and has naturally caused comment among employees of many other companies with nontrustee pension plans, and raised doubts in their minds. Obviously full faith and reliance by employees on a pension plan is essential to its success. Without this the morale of the organization is not built up, continuous employment and reduction of turnover of labor are not obtained and the value of the pension plan to the business which justifies the deduction of the pension payments as a business expense is greatly decreased. For these reasons there has been a distinct movement in recent years toward the trusteeing of pension funds. This movement I assume both Congress and the Treasury Department regard as desirable.

I am reciting the above facts, with most of which you are doubtless familiar, simply as the foundation of the problem presented, which is this:

The problem.—Does the income tax law as it now stands and as interpreted and administered by the Treasury Department, adequately provide for the special transaction involved in changing an existing pension plan in nontrustee

form to the trustee form, or are these transactions so penalized by way of taxation that the cost of the change is made prohibitive?

The special transaction involved in such a change of pension plan is the transfer to a trustee of cash or securities to the amount of the company's pension reserve built up by annual appropriation over a period of years against the accrued and growing liabilities as more of the employees approach the pension age. If the amount so transferred is deducted in computing the taxable income of the employer in the year of transfer, the question arises whether the Treasury Department (while recognizing the right to deduct the usual annual transfers to a pension trust) may not deny the deduction of the initial large transfer because of its size and lack of relation to the business of the particular year. It is believed the deduction should be allowed for sound accounting and business reasons, aside from any public policy to encourage the protection of employees by trusts, for the following reasons:

(*a*) The law does not require or state that the test of an ordinary expense be the relation to a particular year's income. A pension payment, being in the nature of additional compensation, is essentially an ordinary business expense and deferred compensation actually earned in prior years should be permitted to be deducted in any year in which paid. In other words, the employer has in theory withheld a certain amount of compensation over the period, say 20 years, during which the employee has been working, for the purpose of paying a pension over a subsequent period, and this amount in its entirety is paid over to a trustee for the benefit of the employee.

(*b*) The employer has had no previous right of deduction as the law and regulations do not permit the deduction of pension reserves set up on the employer's own books. Such reserves, therefore, represent profits upon which the income tax has already been paid and which, if the trustee plan were not adopted, would be recovered back in future years as pension payments are made from time to time direct to employees. With the trusteeing of the pension fund, however, this right of the employer to deduct the individual pension payments is lost as these payments are thereafter made by the trustee. In other words, if the employer is not allowed to deduct the initial transfer to the trustee of the pension fund therefore built up, he would lose forever the right to deduct this amount from taxable income, which right he should have as a matter of law and public policy, and can retain by maintaining his pension fund in nontrustee form.

(*c*) There is no difference in principle between deduction of the initial transfer to a pension trust and annual additional transfers. So long as the pension plan itself is reasonable and the total amounts trusteed do not exceed a reasonable reserve against the expected liabilities, no distinction should be made. All such payments are proper business expenses.

Simply as an illustration I will refer to the pension plan of the International Harvester Co. which has been in force since 1908, the company being one of the pioneers in establishing such a plan. During this period annual appropriations out of profits have been transferred to a pension reserve, against which the individual pension payments to date have been charged. The balance of the fund now in reserve is more than five times the amount of the ordinary annual appropriations. Actuarial computations show this reserve to be essential to meet the accrued and growing liabilities which must be paid in the future, and in fact no sufficient alone for this purpose as it must be built up in future years, as in the past, by further appropriations. The unexpended balance now in this pension reserve has been returned in prior years for taxation and taxes paid thereon at an average rate of between 11 and 12 per cent.

In the earlier years it would have been difficult to establish a pension trust as the capital needs of the company required the use of all reserves in the business. In more recent years, however, it has been possible to invest the greater part of the pension reserve in securities and, if practicable, the company would now like to consider trusteeing the funds in order to give its employees a guaranteed protection. But if this involves loss of the right of deduction for tax purposes, the penalty is, of course, too great and the company must continue its pension fund in its present form.

We believe this is a matter of great and general importance. The great majority of established industries, railroads, utility companies, etc., have existing pension plans, many of them of long years' standing, and under most of these the pension funds are not trusteed. I have seen an estimate made with some care, that less than 20 per cent of existing pension plans provide for trusteeing

of the funds. If it is the legislative purpose to encourage pension trusts—and this is certainly in line with the best-considered and broad-minded humanitarian and business policies—it seems clear that such legislative purpose will be largely defeated unless adequate provision is made for the change of existing pension plans to the trustee form.

If your considration of this matter should lead to the conclusion that there is any uncertainty whatever under the existing law, may I suggest the desirability of clarification in the new revenue act rather than by department regulation? The trusteeing of a pension fund is a definite irrevocable action which obviously employers will be loath to take without the most definite, irrevocable assurance that they are not thereby incurring heavy and unnecessary tax burdens.

Very truly yours,

WILLIAM S. ELLIOTT.

PROPOSED AMENDMENT TO SECTION 165 REVENUE ACT OF 1928

It is suggested that section 165 of the revenue act of 1928 as passed by the House be amended to read as follows, the italic words being new:

SEC. 165. EMPLOYEES' TRUSTS.—A trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordnace with such plan, shall not be taxable under section 161, but the amount contributed to such fund by the employer and all earnings of such fund shall be taxed to the distributee in the year in which distributed or made available to him. Such distributees shall for the purpose of the normal tax be allowed as credits against net income such part of the amount so distributed or made available as represents the items of dividends and interest specified in section 25(a) and (b). *An employer establishing or maintaining a pension trust may deduct as an expense of business amounts transferred to such trust representing pension reserves accumulated under a pension plan previously in force and not theretofore claimed and allowed as a deduction, provided that the reasonableness of all such deductions actually determined with respect to the pension obligations to be provided for, shall be subject to the review and approval of the commissioner. This section shall apply to similar trusts created and maintained jointly by a group of employers for the benefit of their employees.*

PURPOSE OF AMENDMENT

Section 165 of the House bill, which is substantially the same as 165(f) of the 1926 law, indicates an intention to encourage trusts for the benefit of employees by dealing with the questions arising in this connection and disposing of them in a fair manner. One important question has not been dealt with and up to date the Treasury Department has not seen fit or been able to clarify it in the regulations, although it is a question actually confronting many employers who desire to create pension trusts for the benefit of their employees. This question is whether the pension reserve accumulated under a prior pension plan in nontrustee form can be deducted as an expense if transferred to a trust. If the deduction can not be made at that time, it is lost forever and the cost of converting the pension plan to a trust form bcomes prohibitive.

The last sentence of the proposed amendment relating to joint trusts may not be necessary as it is believed the Treasury Department considers such trusts as coming within the section. However, it is an important matter which it would be well to clarify. It is believed that the great majority of the pension plans maintained by large industries with affiliated and subsidiary corporations, are joint plans for the benefit of the employees of the whole related group. Such joint plans are desirable and should be encouraged for two reasons: (a) Only in this way can the continuous service records of employees transferred from one affiliated company to another be recognized as a basis for pension; (b) by pooling the reserves and dealing with a larger group of employees, better actuarial calculations can be made and the security of employees is increased.

EMPLOYEES' PENSION TRUSTS, SECTION 165. ADDENDA TO ORAL STATEMENT OF WILLIAM S. ELLIOTT

I desire to add a few words to my oral statement of yesterday, in answer to two questions from members of the committee, which at the moment I was not prepared to answer adequately.

TAXATION OF INTEREST ON PENSION TRUST FUNDS

One member of your committee questioned the policy of section 165 as it now stands in deferring taxation on the income of pension trusts until distributed. The thought seemed to be that this benefited the employer rather than the employees, through increasing the accumulation on the pension fund and thereby reducing the payments into the fund which the employer would be obliged to make. This would be true only if we assume a fixed and identical scale of pensions, which assumption is not justified.

As a matter of fact, pension rates vary and have frequently been changed, and the determining factor has ordinarily been what the business will stand; that is, ability to pay. Pensions are paid out of the principal of the reserve plus the accumulations of interest thereon, and where the amount of the principal is fixed by what the employer can afford to set aside for this purpose the scale of pensions to be paid is directly affected by the rate at which the interest accumulates. The policy with reference to taxing such interest therefore directly affects the scale of pension payments.

In this connection, an analogy should be noted with section 203, which exempts from taxation the interest on the reserves of life insurance companies up to the amount of 4 per cent per annum, thereby enabling such companies to build up their reserves more rapidly and pay out larger amounts in proportion to the principal paid in. A pension trust is a reserve of precisely the same character and deserves equal and perhaps more favorable treatment.

Doubtless there will be no difference of opinion as to the desirability of having industry take care of its own superannuated employees; but the committee may not know how serious the problem is which now confronts the industry of the country as a whole and to what extent encouragement is needed. Only recently have actuarial data and calculations become available to show the unexpectedly heavy burdens ahead, which will tax the ability of most, if not all, concerns to maintain their present pension rates.

In this connection I refer to a careful study of the problem in three articles in the Annalist of November 20, November 27, and December 4, 1925, and quote the opening paragraph of the first article, entitled "Industrial pension plans collapsing," by Gurden Edwards:

"Unforseen and unprovided for contingencies coming to light in many industrial pension plans in the United States threaten a general breakdown of these well-intentioned schemes upon which hundreds of thousands of corporation employees are trustfully depending for support in their old age. Some disquieting failures and unavoidable abandonments of apparently practical plans have already occurred, and scientific analyses recently made by competent experts of one after another of those still in operation show many more of them to be inevitably bound toward a similar fate unless radical measures of relief are promptly found."

TRUSTEEING OF PENSION RESERVES ACCUMULATED UNDER A NONTRUSTEE PENSION PLAN PREVIOUSLY IN FORCE

The chairman of your committee suggested (if I understood his thought correctly) that a company which had established a pension reserve in nontrustee form had by its own election failed to take advantage of the right to deduct its annual add tions to such reserve as an expense of business, which deductions it admittedly could have taken if the funds had been transferred to a trustee at the time; and hence it might be argued that the company should not now be permitted to claim the deduction on transferring the accumulated reserves to a trust, which, in effect, would give it a refund of taxes voluntarily paid.

This argument (which I do not understand the chairman intended to be taken as his own) will not bear analysis. There can be no waiver of a right which does not exist; and the company in question never had a right to claim the deduction in prior years as the pension reserve had not been definitely

parted with by conveyance to a trustee. The fact that it might have been trusteed seems immaterial, as there was no requirement that companies elect once for all to trustee their pension reserves; and only in recent years has it become clear that this is necessary and advisable to retain the confidence of employees and make pension plans a success.

Nor is there any basis for arguing that a company should be estopped to claim an otherwise proper deduction on the ground that its former conduct has misled the Government to its injury. On the contrary, the deferring of the deduction (resulting from the deferring of the trusteeing of the pension reserve) has benefited the Government, not injured it, that is, the Government has received a given amount of taxes at an earlier date. The amount of the tax over a period of years is the same whether the pension fund is trusteed at the start or later.

Nothing in the situation justifies the analogy of an undeserved or improper refund. It is conceded that the Treasury practice regards a pension plan as a proper and laudable feature of a compensation scheme and the general principle applied has been to permit the deduction of pension expense whenever the employer has definitely parted with the money for the benefit of his employees, either by transfer to a trustee or by direct payment to employees. Furthermore almost all pension plans when initiated have been, and have to be, retroactive, that is, giving credit for prior years of service, which necessitates building up a reserve against accrued liabilities similar in all respects to the reserve which would have been built up in prior years against the same liabilities if the pension plan had been initiated at an earlier date. Such reserves required to meet the increased liabilities resulting from the retroactive features of a pension plan, I understand, have been permitted to be deducted in the year in which set up and trusteed. I submit that the situation involved in converting a pension plan from nontrustee to trustee form is precisely the same.

If, then, pension expense (which the Treasury Department considers in the nature of deferred compensation) is a proper deduction in computing net income, which optionally could have been taken in the past, if the pension reserve had been trusteed from the start, and also optionally can be taken in the future, if the employer refuses to trustee such reserve and retains it until finally paid out to employees—is it logical or fair to say that this right of deduction is lost entirely if a pension plan is changed from a nontrustee to a trustee form, that is, by the trusteeing of the accumulated reserve? Further, would it be wise tax policy to so penalize the conversion of existing pension plans into a form which gives better protection to employees?

As I see it, the new problem presented by conversion of a pension plan from nontrustee to trustee form is not the propriety of deducting the trusteed funds (which deduction is recognized as a legitimate expense and would have been taken at an earlier date under the most approved and best form, that is, the trust form). Nor is it because it deprives the Government of any tax it should have. On the contrary, the Government has received all the tax it should have at an earlier date. The only new problem presented is the possible disarrangement of the Government's estimates of revenue between years, which might result from the allowance of unusually large deductions in one year, that is, the year in which the pension reserves accumulated during a number of years are conveyed to a trustee. This, I agree, is a practical difficulty, which may require a solution. I submit, however, that the answer should not be to deny to the taxpayer the right of deduction altogether, but rather to provide for spreading the deduction over a period of, say, three to five years, beginning with the year in which the pension reserves are trusteed. In this way the effect on annual revenue would be slight.

In conclusion, may I repeat that the problem of converting existing pension plans from a nontrustee to a trustee form is a serious problem now confronting many industries. Employees' confidence in pension plans not secured by a trusteeing of the funds has been badly shattered. The protection of employees, the indirect benefit to employers of bettering labor conditions, and the indirect benefit to the Government through keeping industrial relations in a sound condition, all suggest that an important question of public policy is involved, toward the solution of which Congress may well give some assistance. It should be possible to find some practical solution equitable to all parties concerned, employees, employers, and Government.

Respectfully submitted.

WILLIAM S. ELLIOTT.

STATEMENT OF BENJAMIN C. MARSH, ESQ., WASHINGTON, D. C., REPRESENTING THE PEOPLE'S RECONSTRUCTION LEAGUE

The CHAIRMAN. You may state your name and residence.

Mr. MARSH. Benjamin C. Marsh, Bliss Building, Washington, D. C., representing the People's Reconstruction League, sometimes known as the People's Lobby.

Mr. Chairman, I regret that there are only one or two members of the committee here. The rest are busy trying to vote a gold brick relief for the farmer, to be vetoed by the President. Perhaps you will pardon me for directly addressing myself to the question of some relief for the unemployed workers of this country.

We want to oppose vigorously the Mellon plan to reduce taxes on those best able to pay, the wealthy of this country, and point out the absolute injustice of the present revenue bill, which makes about a million and a half bankrupt farmers and about 4,000,000 unemployed pay more taxes in proportion to their ability than the wealthy people of the United States.

The CHAIRMAN. How can the farmer pay any tax?

Mr. MARSH. Through consumption taxes, and you ought to vote to repeal the Fordney-McCumber Tariff Act, because that makes the farmer pay an exorbitant tax on many things. I am answering your question.

The CHAIRMAN. This is a revenue bill?

Mr. MARSH. Yes.

Senator SHORTRIDGE. You do not believe in the protective tariff theory?

Mr. MARSH. Our observation is that the protective tariff operates to make millionaires and millions of unemployed and pauper farmers. The benefit of it should be made to apply if it were a protective tariff, but it never will be, because it protects the few against the many.

Senator SHORTRIDGE. That is your theory?

Mr. MARSH. It seems to me the facts which I will cite you, from your own Commissioner of Internal Revenue, answers that question. It is not my theory. I will give you facts which I have secured from official Government documents.

The Saturday issue of the New York Times, April 7, states that there was an increase of $2,083,590,851 in price of 216 stocks in March. That was just March, 1928. An analysis of these stocks on the New York Stock Exchange since May 1, 1927, shows these issues have increased in value by $5,575,945,228.

The CHAIRMAN. That has not increased in value at all, but the public is crazy in buying the stocks. That is all there is to it.

Mr. MARSH. Let me read this to you.

The CHAIRMAN. You can not take care of a man who wants to gamble.

Mr. MARSH. Apparently you do. That is what your legislation does. He has to be a rich man if he wants to gamble.

The CHAIRMAN. Oh, no. Lots of them borrow money for that purpose.

Mr. MARSH. Let me give you some figures from your own report.

The CHAIRMAN. I will not interrupt you. I know the purpose of this.

Mr. MARSH. The purpose of this, Mr. Chairman, is to get into the record the position of the large number of farm and labor organizations and the general public.

The CHAIRMAN. The purpose is to get these things in the record before this committee and send them out broadcast.

Mr. MARSH. I do not know whether this committee desires only to hear the wealthy. If it does, I wish you would say so.

The CHAIRMAN. I did not say that. That is the interpretation you seem to want to make. All who have asked to appear before this committee have been given an opportunity to appear, whether they were poor or wealthy.

Mr. MARSH. You have tried to prevent my putting in this record the position of the people I represent.

The CHAIRMAN. I did not try to prevent it at all.

Senator SHORTRIDGE. What section do you want to address yourself to?

Mr. MARSH. I want to discuss the organic principle, not the administrative principle of this act. I do not know the section numbers. You may renumber the sections. The first is that the surtax should be retained as at present or increased, certainly above $75,000; that the Federal estate tax should be restored to at least 40 per cent and retained for the Federal Government.

Senator SHORTRIDGE. Have you considered the question of whether the State should impose an estate tax?

Mr. MARSH. I have.

Senator SHORTRIDGE. Or the Federal Government?

Mr. MARSH. Certainly. The States do not need any estate tax. The States can not collect an estate tax now, or a progressive income tax, because people can evade State jurisdiction.

The CHAIRMAN. They are doing it now.

Mr. MARSH. Pardon me. They are not. They are not collecting it.

Senator SHORTRIDGE. They collcet some of it.

Mr. MARSH. They raise a little of it.

Senator SHORTRIDGE. Some people claim that each individual State should have the right to impose an estate tax.

The CHAIRMAN. Most of them are doing it.

Senator SHORTRIDGE. And most of them are doing it.

Mr. MARSH. And getting very little out of it.

Senator SHORTRIDGE. They get as much or more than the Federal Government could, operating at a distance.

Mr. MARSH. Of course, the distance has nothing to do with it, because you understand the Federal Government is the only Government that has jurisdiction throughout the United States, the only Government which can see that no wealthy man can evade his tax by evading jurisdiction or changing his residence. The various States can raise all the revenue they need, with the exception of three or four agricultural States where the Federal and State Government own up to 70 per cent of the land, by taxing land values. The Federal Government needs the revenue. It is evident that the European Governments are not going to repay our Government, certainly not for a long time to come.

Senator SHORTRIDGE. They are all paying except France, and I think she ought to be made to pay.

Senator REED of Pennsylvania. She is paying $30,000,000 a year.

Senator SHORTRIDGE. Not on the main debt.

Senator REED of Pennsylvania. Oh, yes.

Senator SHORTRIDGE. Twenty cents on the dollar.

Senator REED of Pennsylvania. No. After the settlement was signed she began to pay according to its provisions, $30,000,000 a year.

The CHAIRMAN. She has been paying $20,000,000 right along.

Mr. MARSH. Let me give you a few figures which I obtained from the report of the Commissioner of Internal Revenue. In 1926 there were 9,546 persons each with an income of over $100,000, with an aggregate net income of $2,372,000,000. Income and surtaxes on that were only $371,000,000, leaving them on an average $205,000 each. The 693 individuals who had an annual net income of over half a million dollars in 1926 had left on an average nearly $1,000,000 after paying such tax, $672,000,000 in round figures. Secretary Mellon has suggested that you should reduce the surtax on those receiving between $14,000 and $75,000. I could not get the exact number, but the nearest I could get was those having an income of from $10,000 to $100,000. There were in 1926 320,369 persons with an annual net income of from $10,000 to $100,000, but they paid in income and surtax only $328,686,876, and had left an average of $26,163 after paying the taxes.

Now, as to the Federal estate tax, it is obvious from the campaign made here last year for the repeal of that tax, delegations coming from Florida and other States, that it is the intention of most of the States to attract capital by not taxing inheritances or estates.

I might say, lest you think I have gone to some radical labor college to get my education, that I did not. I took four years graduate work in the extremely conservative schools at Chicago University and the University of Pennsylvania. Senator Reed will bear me out that there is no more conservative institution than the University of Pennsylvania.

Senator REED of Pennsylvania. You could not be as radical as the House of Representatives that wrote the 1918 act.

Mr. MARSH. I think it is time for Congress to be as radical as that Congress. I agree with you there.

The net taxable income subject to the estate tax of those who died in 1926 was $1,961,000,000, upon which the tax was only $138,000,000, and the Federal Government's share was only $101,000,000.

Mr. Chairman, we have heard an awful lot about the surplus in this country. I am sorry that none of the Democratic members of the committee are here.

The CHAIRMAN. You can tell it to Senator Simmons. He wants the tax repealed.

Mr. MARSH. I think they are absolutely in error in their program of trying to reduce taxes. We ought to be honest, it seems to me, and candid. Professor Tugwell, of Columbia University, makes the statement that 70 per cent of the American people are not getting enough to maintain a reasonable standard of living. That is quite correct. That means that only 30 per cent can be normal Americans.

There was introduced in the Senate a bill by Senator Wheeler, and in the House by Mr. LaGuardia, to provide, one bill $25,000,000,

and the other $75,000,000 to look after the children of the strikers, the unemployed, such as the textile workers and bankrupt farmers. Mr. Lewis, president of the United Mine Workers of America, wants to appear in favor of it, as well as Mr. McMahon, of the textile workers, representatives of the machinists, and I think of the American Federation of Labor. There are a million and a half children in the United States who are not getting a decent amount of food. You are going to have to appropriate a great many millions of dollars to take care of that kind of a situation, and for unemployment insurance, because anybody who is frank will tell you that no matter whether you nationalize the bituminous coal mines, no matter what you do, our unemployment, as pointed out in an article in the current Colliers, is going to keep on increasing, because we are the most efficient nation in the world, so efficient that we are going to increase our unemployment materially, and you will have to look after the children of those people, as well as appropriate for flood control and farmers' relief in election years. The Federal Government has got to face that proposition.

Now, I said you are going to cancel the debts. I think that is true. I talked some time ago with a gentleman who had been in conference with Mr. Morgan and representatives of bankers in Europe, and he told me they would do it just as soon as they could get the American people to stand for it. I am not sure it is not a good thing.

Senator REED of Pennsylvania. They are making a very poor start. They have had 10 years, and have only a handful of votes in either house.

Mr. MARSH. I question very much the advisability of compelling them to pay, for one reason that if they do pay it will be paid in farm products, which will bust the American farmer worse than ever.

Senator REED of Pennsylvania. Let us think about that for a minute.

Mr. MARSH. Yes, sir.

Senator REED of Pennsylvania. Foreign governments are paying us about $240,000,000 a year, as I understand it.

Mr. MARSH. What is the net debt?

Senator REED of Pennsylvania. That is more than is paid into the Treasury annually by about 95 per cent of the individuals paying income tax in the United States.

Mr. MARSH. That may be, as to their payment, but may I refer you to the current bulletin of the National City Bank, in which the statement is made that Great Britain's investments abroad are now about equal to those of the United States, in spite of her plea of poverty?

Senator REED of Pennsylvania. The point I make is that the foreign governments are now paying more in the United States Treasury than about 99⅔ per cent of the total population of the United States.

Mr. MARSH. If you figure only the direct tax, but when you come to figure all, the indirect taxes the people of the United States, who are good to vote and work, are paying, consumption taxes, tariff, internal revenue, consumption taxes of every sort, I think you will correct your statement. They are paying much over a billion

instead of $240,000,000. The tariff is supposed to fall equally on the rich and poor. I do not know who has a better right to buy delightful and pleasant things than the people who produce a large share of the wealth. That may be a wrong theory, but I still believe——

The CHAIRMAN. Mr. Marsh, will you tell us about the revenue bill?

Mr. MARSH. I am only answering questions.

Senator REED of Pennsylvania. I am to blame. I digressed.

Mr. MARSH. If you do not want me to answer questions, I will not do it.

The CHAIRMAN. That is all right.

Mr. MARSH. There is no excuse of any sort for a reduction in the surtax. It should be increased at least to the point where we could begin bringing down the national debt largely within a short time and still meet domestic needs. The Federal estate tax is essentially a national tax, which has got to be collected by the only agency which can exercise control throughout the United States. Every State in the Union, with the possible exception of Arizona and a few other Western States where the Federal and State Governments own two-thirds or three-fourths of the land, can raise taxes by taxing land values, and other State taxes, but the Federal Government is the only one that can levy and collect these national taxes, if the Secretary of the Treasury wants to do it. I make that point. I mean progressive income taxes and progressive inheritance and estate taxes. The Federal Government needs those taxes. The Navy Department has recently issued a book entitled "The Navy as an Industrial Asset," and has in it a list of our ships of the Navy located all over the world to get trade for the United States. That is a dangerous policy.

You have heard members of the chamber of commerce and representatives of the business interests ask you to take off various taxes. You have had pleas to repeal much of the taxes on the wealthy, and the Secretary of the Treasury says you ought to reduce taxes. I think I pay too little income tax. I went before the Ways and Means Committee during the war and asked them to double the tax on myself, as well as on Messrs. Morgan and Rockefeller, but for some reason they declined to do it. With an income of from $4,500 to $5,000 a year, I can perfectly well afford to pay $50 or $100 more income tax, rather than the 10,000,000 farmers of the United States with an income of a few hundred can afford to pay $5, instead of the $50 or $75 they pay in indirect taxes. We ask you to repeal all these indirect taxes. We appeal for some consideration by this Congress for the million and a half or two million indigent farmers, and four million unemployed.

What America needs to-day is not an increased production. God knows we are the most marvelously efficient country in the way of production in the world. If we paid decent wages to the working men and the farmers got decent prices, we could consume practically everything we raise, except wheat and cotton, instead of exporting a large percentage of our products. I think this revenue bill should be directed toward meeting the immediate situation, and help to increase domestic consumption.

If there are any questions, I will be glad to answer them, and I appreciate your courtesy, Mr. Chairman.

STATEMENT OF ALFRED L. SMITH, SECRETARY AND GENERAL MANAGER OF THE MUSIC INDUSTRY CHAMBER OF COMMERCE, NEW YORK

The CHAIRMAN. Give your name and address to the reporter.

Mr. SMITH. Alfred L. Smith, 45 West Forty-fifth Street, New York City; secretary and general manager of the Music Industry Chamber of Commerce.

The Music Industry Chamber of Commerce is a federation of various associations of various branches in the music trade. I speak more particularly in behalf of one of them, the National Association of Music Merchants, practically all of whose members sell on the installment plan, and a great many of whom have been reporting their income on the installment basis in accordance with the regulation of the Treasury Department for the last eight years.

I listened with a great deal of interest this morning to various other speakers on this topic and realize that the subject has been very well covered and that your time is limited, so I will take only a moment or two to address myself to two points only.

I speak now in behalf of any of our people, if there are any, who wish to change from now on to the installment basis and do it without this double taxation. We are perfectly willing that the Treasury Department regulation shall include this double-taxation feature, as far as the feature is concerned; but we do not think that our people who during the past years have relied on the department regulations and changed from the accrual to the installment basis should now be compelled to pay additional taxes that they never dreamed they would have to pay when they made the change. There is an element of unfairness in that which has not been brought out to the committee, as far as I know.

This does not apply merely to those few cases which have not been settled, which is still in dispute between the taxpayer and the Treasury Department. It applies to all of the cases settled, such as those in which the statute of limitations has operated, and our people who have been on the installment basis and individual taxpayers have not the slightest idea whether the Treasury Department is ever going to come to them and demand an additional payment. They have no way of foretelling that. Some of our people have received demands from the Treasury Department for additional payments on this account of double taxation, and have had to pay it.

I understand that it is going to be almost impossible, or at least that it is not feasible for the Treasury Department to go back and reaudit all the returns made on the installment basis, which means that those taxpayers who, for one reason or another, have their past returns brought up in connection with some controversy with the Treasury Department—possibly some controversy over a future act—and in that way have called to the attention of the department the fact that they changed to the installment basis, presumably are going to receive these demands and have to pay this double taxation, whereas many other taxpayers will not have their returns called to the attention of the Treasury Department and they will not have to pay it. Some of their competitors will have to pay the double taxation, in our opinion, and others will not.

We submit that it is not fair, and we think that in justice to all concerned, when taxpayers, in good faith, in accordance with the only regulations which could govern them in making their returns, make those returns, the administrative department of the Government should not change those returns later.

Just one other point. We think, from studying what has gone on before, and what has resulted in the present situation, that the situation came about through a mistake. It seems to us that it is clear from the debates in Congress, and from personal talks we have had with Members of Congress who are interested in this matter, that Congress did intend, at the time of the passage of the 1926 act, to offset the Todd decision of the Board of Tax Appeals, and, to use a layman's term, legalize the Treasury Department regulations. As has been brought out before this committee, the only statements made to Congress on the floor of the Senate covering that point were definitely that it was the intention of this provision to legalize those regulations as they then existed, and no one made any statement to the contrary.

It has been suggested that we should go to the courts.

The CHAIRMAN. Do you agree with the statement that has been made here by two other speakers with relation to that?

Mr. SMITH. Yes.

The CHAIRMAN. Then I do not think it is necessary to take further time on that.

Mr. SMITH. With respect to the suggestion that we should go to the courts, our people do not like litigation any more than anyone else does. It seems to us unnecessary if, as we understand it, there was only a mistake, and the people who passed this law, namely, Congress, in 1926, now working on an amendment of the very same act, could very easily put language into the act to show that that was their intention, and provide that returns on the installment basis filed prior to 1926 should be considered correctly filed if filed in accordance with the regulations in effect at that time.

The CHAIRMAN. We have had amendment after amendment suggested here. If we begin to put one amendment in, where are we going to stop?

Mr. SMITH. I think the amendment I desire would be the same amendment that all taxpayers in this situation desire.

The CHAIRMAN. The contention has been that a double tax has been paid.

Senator REED. This would, however, apply to a good many thousand persons.

Mr. SMITH. Yes. I know in our industry it would probably apply to a great many small dealers.

Senator REED. Right at this point can we not hear from Mr. Walker who had something to do with the installation of those regulations?

The CHAIRMAN. I am going to call Mr. Walker. Mr. Walker, we will hear from you.

STATEMENT OF JOHN E. WALKER, WASHINGTON, D. C., IN BEHALF OF UNITED STATES GRAPHITE CO., SAGINAW, MICH., AND GREEN-CANANEA COPPER CO., NEW YORK, N. Y.

Senator REED. Will you not address yourself, Mr. Walker, first to this installment sale business?

Mr. WALKER. Mr. Chairman and gentlemen of the committee, as you probably remember, in 1926 I assisted the Treasury Department in working upon the revenue bill. Some time prior to the consideration of the revenue act of 1926, the tax board had handed down the Todd decision, holding, in substance, that the Treasury installment regulations were invalid. All the installment taxpayers were then in a terrible situation.

The original 1919 regulations, when the installment dealers requested that they be permitted to change their business accounting from the accrual to the installment basis, were faced with a situation that the correct way to go ot the installment basis was to go back and restate the books back through 1913.

Of course, that would be a very cumbersome method of reaching a basis to go to the installment plan. The 1919 regulations were somewhat of a compromise, to permit the installment dealers to go to the installment basis, and at the same time not put them in a position where they would largely avoid payment of war taxes during the high tax year.

As I understand it, it was the opinion of those who prepared the 1919 regulations, that if they allowed installment taxpayers to go to the installment basis and to deduct, in the subsequent years, all income on which a tax had been paid on the accrual basis in the earlier year they would have to pay very little taxes, if any, in the war-tax years, so that a compromise, which appeared satisfactory to the persons in authority at that time, was effected, which stated, in the 1919 regulations, that if a taxpayer went to the installment basis, to the extent that taxable income was received during the subsequent years, although it had paid its proportionate tax at the lower rates in the earlier years, it would have to bear whatever tax applied in the later year.

Later the installment taxpayers convinced the Treasury Department that it was double taxation, and they agreed to amend that regulation, which they did.

Things went along all right until the tax board faced the situation, and I understand that the thing that largely influenced the tax board in holding that that regulation was invalid was the fact that they realized that the installment taxpayers, under that regulation, did not get a true reflection of the income, and were in an advantageous position as compared with other classes of taxpayers.

Senator REED. In other words, neither the Treasury Department nor the board seems to have been trying to find the intent of Congress, but trying to find some regulation that would yield a good income. Is not that about it?

Mr. WALKER. No; that is not it, Senator.

The Treasury, in good faith, under the 1918 act, tried to work out a basis where the installment taxpayers could go to the installment basis from the accrual basis, and at the same time would pay a fair

proportion of the taxes that Congress contemplated they would pay; and in order to get a short cut they wrote into the regulations a businesslike regulation, which is arbitrary, but which they considered was fair; and to that extent, anyone who went over to the installment basis under that 1919 regulation went over with his eyes open, and knew that to the extent that there was any income on which there was a tax paid in prior years, it would also go into the income picture in the later years.

Later a new group of people in the Treasury were in authority, and they were convinced by the installment taxpayers that that was inequitable, and they went the whole distance with them.

When it got to the tax board, the tax board took the position that it did not reflect the true income, and the regulations were invalid.

Senator McLEAN. Just why did it not reflect the true income?

Mr. WALKER. Because, Senator, when you transfer over to the installment basis and only pay taxes on the proportion of the payment in that year that is a profit, and you take off that, the proportion of income which has paid a tax in the earlier years, it leaves comparatively little income in that year to be taxed, and many persons shifting over, for the taxable year 1918, for example, were in many instances practically taken out of the tax picture, with your very extreme rates. The Treasury felt that at the time they wrote the 1919 regulation it was not fair to other taxpayers on the accrual basis to exclude the income which had paid tax in earlier years.

The CHAIRMAN. In other words, if they had made the full profit in one year, in the case of an individual, he would have had to pay the tax at a higher rate. If it had been divided into 20 parts, on some of it, perhaps, he would not pay any tax at all.

Mr. WALKER. In preparing to write the 1926 act, the installment taxpayers desired to validate the old regulations. The Treasury was just as anxious to do the same thing as was the taxpayer. At the same time, the Treasury took the position that in doing that, the old 1919 regulation should be validated rather than the subsequent ones. It was a sort of compromise. The installment taxpayers were in a terrible situation if they could not go through on the installment basis.

The Treasury Department were aware of the fact that under the other basis the regulation put the installment taxpayers in an extremely favorable position as compared with other taxpayers, and I was authorized, in behalf of the Treasury, to state to your committee that the Treasury would be pleased to have the regulations validated, provided that the 1919 regulations were validated, as Senator Smoot said, and it was my understanding that that was the action of the committee.

Senator REED. It seems to me that if the Treasury Department is going to establish its regulations not so much to comply with the intent of Congress as to secure a certain tax yield, and then when they find it does not secure a tax yield, the Board of Tax Appeals is going to change them or knock them out so as to secure another tax yield——

Mr. WALKER. I do not think I have made myself plain.

Senator REED. That is certainly what it sounded like, Mr. Walker.

Mr. WALKER. Not at all.

Your first regulation in 1919 was more or less a compromise. Rather than to go back and readjust amounts properly over all the other earlier years, the persons in charge of promulgating the regulation provided that in going over to the other basis you had to have some arbitrary basis on which to go, and that if you elected to change, in that case whatever pro-rata share of the income fell into the year in which the change was made would have to be subject to tax. Later, the persons in authority felt the subsequent amendment to the regulations, holding that any income that had been taxed should go out of the picture, was a mistake. If it had not been for the tax board's decision holding that regulation invalid, they would have gone ahead with it, no doubt, but when it came to validating the provision, the Treasury Department felt that if they were going to validate the regulations, the 1919 regulations should be validated rather than the later ones.

Senator SHORTRIDGE. Let me ask you this question. In making regulations, I suppose the Treasury Department, or the officer who has the matter in hand, undertakes properly to interpret the law.

Mr. WALKER. Absolutely; yes, sir.

Senator SHORTRIDGE. Rather than to legislate?

Mr. WALKER. Yes, sir.

Senator SHORTRIDGE. You were striving, I take it, properly to interpret or construe the law?

Mr. WALKER. Absolutely; yes, sir.

Senator KING. What I would like to ask is this. It will be stating a conclusion, too, on your part. If the requests made by the gentlemen who have spoken upon this subject should be acceded to and legislation accordingly made, in your opinion would there be any injustice done, or would it be in the interest of justice? Would it lead to further complications and other injustices, and compel additional legislation?

Mr. WALKER. This is just my opinion.

Senator KING. Your opinion, if you care to express it.

Mr. WALKER. I agree with everyone else that the changing of regulations is very unfortunate, and I am one of the school that thinks that things that are closed ought to be close for all time.

The CHAIRMAN. As I remember it, there was no law in effect upon the subject until 1926.

Mr. WALKER. The 1926 law validated what had been done, and it was the understanding of the committee, as you stated on the floor, that it was intended to validate the 1919 regulation.

The CHAIRMAN. Between 1919 and 1926 there was no law, as I remember, covering this subject.

Senator REED. Except as these regulations constituted a law.

The CHAIRMAN. That is all there could have been. There was no action on the part of Congress.

Senator REED. Whatever we do now, we will be called upon in 1930 to change it. If the result of our action now is to lower the revenue, the Treasury will be in here asking us to change it; and if the result of our action at the present time is to raise the revenue, the installment interests will be back here complaining against it.

Senator KING. That is the reason I asked if it would call for additional legislation, or would work in the interest of the Government and the mass of the people.

Mr. WALKER. Of course, you can always validate any return that is made in accordance with the regulation in effect at the time the return was made, and it would appear that that ought not to upset very many returns. On the other hand, you have the picture as the Treasury saw it in 1926, as I have just related.

Senator REED. Suppose we were to validate the regulations of 1920, which remained in effect through those six years until that decision came down. What would be the net effect?

Mr. WALKER. At the present time the statutes of limitation have run in the case of all the years to and including 1922. It would only mean that the Treasury would not make any additional assessments in the case of returns made under the subsequent regulations That would leave things in statu quo.

Senator REED. Would that not be the best solution? Suppose we should strike out all this elaborate section here and simply provide that the regulations of the Treasury promulgated in 1920 be hereby validated and declared to be the law.

Mr. WALKER. That would certainly give them essentially what they are asking for.

Senator REED. Would it cost us anything in revenue?

Mr. WALKER. Only in additional taxes. You would not be upsetting anything, because all the returns were made subject to the latter regulations at that time. It would leave things in statu quo.

Senator REED. It would leave things in statu quo, and prevent the Treasury Department from going back on its own regulations, which were in effect for these six years.

Mr. WALKER. That is true.

Senator REED. To get perfect justice in this case there is only one way to do it, and that is to open the whole works up back to 1913 and reaudit every year from that time down, on a uniform basis.

Mr. WALKER. To get exact justice; yes.

Senator REED. On the accrual or installment basis. It does not matter which?

Mr. WALKER. Yes.

Senator REED. That would give you perfect justice, but we all know that is impracticable.

The CHAIRMAN. There was no law at that time.

Senator REED. Installment sales were being made during all that time, and they were subject to an income tax, in one way or another.

The CHAIRMAN. But, up until 1919——

Senator REED. It would not matter which basis you took. If that were practical, that would be the only way to obtain exact justice, but it is not practical to do that.

The CHAIRMAN. It is not practical at all.

Mr. WALKER. That is true. Of course, the net result is——

Senator REED. Is not this true, Mr. Walker, that the fault of the whole thing was with the Treasury Department? The Treasury Department rather weakly, at the time of high taxes, allowed these people to shift their basis so as to escape the big taxes of the war years.

Mr. WALKER. Clearly, the installment concerns were trying to get a basis where they did not get a tax on their profits until they were actually realized.

Senator REED. Precisely. Having made that concession to them, and having wabbled a couple of times, the Treasury finally came down to the regulations of 1920 and let them stick for six years.

Mr. WALKER. That is right.

Senator REED. Then they were knocked out by the Board of Tax Appeals.

Mr. WALKER. As I understand it, the thing that was the basis of their decision was the shock that they got because of the low taxes in those high years, due to the shifting basis, which indicated that the subsequent regulation did not properly reflect the net income.

Senator REED. I think the Board of Tax Appeals ought to be blindfolded so that it could not consider what the money effect of its decisions is.

Mr. WALKER. I have just stated my opinion.

Senator REED. Then Congress, in a more or less muddy way, undertook to put into the law what it thought had been a consistent practice of the department, and it did not know, or did not remember, that the department had changed in 1919 and 1920.

Mr. WALKER. I am sorry if I left that impression, because I always try to state all the facts.

Senator REED. That is no reflection on you, in any sense.

Senator KING. In their attempt to shift in those years when the taxes were high, along in 1919, that resulted, did it not, in their evading—and I do not use the word in any offensive sense—a considerable amount of taxes?

Mr. WALKER. They paid less taxes than they would on the accrual basis.

Senator KING. They evaded a considerable tax which they would otherwise have had to pay.

Mr. WALKER. It resulted in less taxes than they would have paid on the accrual basis.

Senator REED. I think it was an act of weakness on the part of the Treasury Department, but we can not correct it now.

Senator SHORTRIDGE. They had a right to do it. It was not any evasion of the law.

Mr. WALKER. Of course, the commissioner has authority to permit tax returns upon any proper basis which, in his opinion, will truly reflect the income, and the persons in charge felt that this rather arbitrary way of shifting was a proper basis, and did give a true reflection of the income.

Mr. ALVORD. Mr. Chairman, at the morning session I did not discuss the other side of the double-taxation rule. The situation, however, has another side. The entire matter was discussed at length and in detail by the joint committee on internal revenue taxation and by the advisory committee of that committee. Considerable time was devoted to it by the Committee on Ways and Means. I expect, of course, to discuss the situation in the executive sessions of the committee.

Mr. WALKER. I appear to-day in behalf of the United States Graphite Co., of Saginaw, Mich., and the Green-Cananea Copper Co., of New York City.

The CHAIRMAN. Is this on section 113?

Mr. WALKER. It is section 45.

Senator KING. For whom do you speak?

Mr. WALKER. The United States Graphite Co., of Saginaw, Mich., and the Green-Cananea Copper Co., of New York City.

We are requesting an amendment to section 45 of the pending bill (H. R. 1). What remains of section 45 is a part of the consolidated return section, 240–F, of the revenue act of 1926.

Section 240–F, of the revenue act of 1926 is much broader than the provision in section 45. Section 240–F of the present act allows a domestic corporation which has to operate a foreign subsidiary company in order to do business in a foreign country, to file consolidated accounts upon the request of the taxpayer in order to get a true reflection of the net income.

I will speak first of the United States Grpahite Co.' The United States Graphite Co. has been operating in Mexico for over 30 years. It had originally acquired a title to its mine by purchasing a ranch. That is all it had to do at that time.

The Mexican constitution in 1917 gave authority to any Mexican corporation or Mexican individual to file claims on this property, in view of the fact that it was owned by a domestic company.

The United States Graphite Co. therefore, in order to continue to operate its mine in Mexico, had to organize a foreign subsidiary and to file a claim on its own property in order to prevent its property being taken without compensation.

Senator KING. That was under article 27 of the Mexican constitution of 1917.

Mr. WALKER. That is right. The United States Graphite Co. keeps its books to-day in the United States, the same as it did before, and is desirous of paying its tax to the United States upon its entire net income from both its foreign operation and from its operation at Saginaw, Mich.

The Green-Cananea Co. has to operate a foreign subsidiary in Mexico because it is in the restricted zone, just outside the 60-mile limit from the border. The Green-Cananea Co. also desires to return all its income in the United States, and to pay taxes the same as if it were operating a domestic company.

Senator KING. Where are they incorporated?

The CHAIRMAN. What taxes do they pay in Mexico?

Senator KING. Where are they incorporated?

Mr. WALKER. The Green-Cananea Co.?

Senator KING. Yes.

Mr. WALKER. The Green-Cananea parent company is incorporated in Minnesota. It has to have a foreign subsidiary because it is operating in the restricted zone. One of its chief competitors, the Phelps-Dodge Co., for example, just outside the restricted zone, is operating, because it acquired its properties prior to the passage of the Mexican constitution, with a domestic subsidiary. In view of that fact the Phelps-Dodge, for example, is able to file consolidated returns and get the benefit of depletion.

Under section 240–D of the revenue act of 1924 and under 240–F of the revenue act of 1926 the United States Graphite Co. and the Green-Cananea Co. have been able to secure the same result as the domestic corporation by filing consolidated accounts. This provision as now drafted takes away that privilege. It has never, as you know, been thought advisable to put in a blanket provision

allowing domestic and foreign corporations to file consolidated returns, but in order to do equity, whenever a parent company is willing to report all of its income in the United States and be treated exactly as a domestic corporation, from the revenue act of 1921 to date, they have been able to accomplish the same results through the consolidated account provision.

Senator REED. Then why are they not allowed to do so in this case?

Mr. WALKER. Because, in this provision, if you will look at section 240–F, the provision provides that in the case of domestic corporations owning or controlling substantially all the stock of another corporation, upon the request of the taxpayer, it may file consolidated accounts in order to get a true reflection of the income. The amended provision leaves it so that only the commissioner can require it whenever he deems it necessary to get a true reflection of the income.

In order to make this matter clear, and in order that there may be no confusion in the matter——

Senator REED. You are afraid that in your case the commissioner would not order that to be done?

Mr. WALKER. We do not think it is fair to the numbers of taxpayers that desire to return all of their income in this country and to be treated exactly as domestic companies, to leave the matter up in the air, where they may not be able to continue the past policy.

The CHAIRMAN. What tax do they pay in Mexico?

Mr. WALKER. The question, Senator, is this: A stockholder of a corporataion is not entitled to take depletion. In the case of the United States Graphite Co., it is a stockholder of its foreign subsidiary. In the case of the Green-Cananea Co., it is a stockholder of its foreign subsidiary. If they were domestic corporations they could file consolidated returns and get the advantage of depletion. All that these people ask is that they be treated the same as domestic corporations. As a proposed amendment we suggest a new subdivision.

The CHAIRMAN. The reason they do not do it is because they are within a restricted zone?

Mr. WALKER. Or else, under the Mexican constitution, they have had to organize a Mexican corporation to remain in control of their property.

Senator REED. And they do not dare to arrange their intercompany transactions so as to show a profit in Mexico?

Mr. WALKER. The United States Graphite Co. does not care to do that.

Senator REED. That would absorb the depletion all right, but it would get it into other troubles.

Mr. WALKER. That is true.

The CHAIRMAN. Does not Mexico impose a tax of any kind?

Mr. WALKER. Oh, yes. Mexico has an income tax also.

Senator REED. So, they take care that that company has no income. The result is that the depletion in that mine can not be charged off the American end of it?

Mr. WALKER. That is true. So far as the United States Graphite Co. and the Green-Cananea Co. are concerned, all they want to do

is to be put on an exact basis with other American companies, their competitors. They are perfectly willing to return every cent of income to this country, to which the United States ought not to object, and all they are asking for is to be put on the same basis as other domestic companies, that are not operating with foreign subsidiaries.

Senator REED. What is your suggestion?

Mr. WALKER. Our suggestion is to add a new subdivision at the end of section 45, as follows:

In case of a domestic corporation owning or controlling directly or indirectly 100 per centum of the capital stock of a foreign corporation (exclusive of directors' qualifying shares) maintained solely for the purpose of complying with the laws of such foreign country as to title and operation of property, such domestic corporation may make return of income with the same credits, deductions, and allowances as if the properties of such foreign corporation were owned and operated directly by such domestic corporation.

Senator REED. That would put the Treasury Department into a study of the foreign laws to see whether it was necessary to maintain that subsidiary.

Mr. WALKER. So far as Mexico is concerned.

Senator REED. I know; but this would apply to companies all over the world.

Mr. WALKER. I do not see any objection to that. The United States Government certainly does not lose anything, so long as they are willing to return all the income in this country.

Senator REED. But the section as you have drawn it there would require it to be established as a preliminary that the laws of that foreign country required the organization of the subsidiary in order to operate or to hold title there.

Mr. WALKER. I do not know of any country other than Mexico that imposes these restrictions; and, in the case of any company that found it to its advantage to follow this policy, there would be certainly little trouble on the part of such company in furnishing the Treasury with the necessary information to reach that determination.

Senator KING. Let me ask this question. I do not know that I quite follow all the implications of that proposed amendment. More and more American capitalists—and I am not complaining of that—are forming corporations to do business in foreign countries—in China, for instance, and some in South Africa and Mexico.

The CHAIRMAN. All over the world?

Senator KING. Yes; all over the world. Do you propose that if these same companies have business activities in the United States with a parent company, or a subsidiary corporation, they may mass or compound their foreign corporations and their domestic corporations with those formed in the United States for the purpose of getting all the benefits of depletion, etc., for the mines in Mexico, or their mines in South Africa, or their mines in Australia, and all the benefits of our act?

Mr. WALKER. As this is drawn, Senator, we have drawn it in the most limited manner we know how. We have limited it only to companies which, in order to operate in a foreign country, have to organize a foreign corporation to so operate. So far as I know Mexico is the only country that has such a requirement.

Senator REED. Would you be satisfied with the retention of the old section 240–F?

Mr. WALKER. I would prefer not to continue that provision. I would prefer to have this broader provision which, in effect, allows a domestic corporation to file a consolidated return with its subsidiary. As I see it, the old section 240–F accomplishes substantially the same result, but in order to settle this thing for all time I would prefer to see this other amendment adopted.

The CHAIRMAN. We can take that into consideration.

Mr. WALKER. At the conclusion of my statement I would like to have added the letter of the United States Graphite Co. and the Green-Cananea Co. addressed to Senator Smoot under a previous date.

The CHAIRMAN. You may put those in the record at this point.

(The communications referred to are as follows:)

UNITED STATES GRAPHITE CO.,
Saginaw, Mich., February 6, 1928.

Hon. REED SMOOT,
Chairman Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR: Some 30 years ago the United States Graphite Co. (a Michigan corporation) acquired under the Mexican laws then existing, a graphite mine in the State of Sonora, Mexico. At the time of acquisition the Mexican law provided that all "combustibles" (and graphite was officially classified as a combustible) belonged to the owner of the soil. Therefore, in order to obtain title to the mine the United States Graphite Co. had only to purchase the ranch on which the mine was located. The United States Graphite Co. still holds title to the ranch in question.

Article 27 of the Mexican constitution, effective May 1, 1917, provides in part as follows:

"Legal capacity to acquire ownership of lands and waters of the nation shall be governed by the following provisions:

"1. Only Mexicans by birth or naturalization and Mexican associations have the right to acquire ownership in lands, water, and their appurtenances, or to obtain concessions to develop mines, waters, or mineral fuels in the Republic of Mexico."

On March 20, 1918, the Mexican Government issued Circular No. 8, authorizing mining agents to include graphite among the denounceable products.

The effect of this circular was to make it possible for others to file a claim on the property of the United States Graphite Co., thereby destroying without any compensation this company's vested rights in a property owned by it in fee simple for a great many years.

Under these circumstances, the United States Graphite Co., in order to protect itself, complied with the law by causing the Cia Minera de San Jose, S. A. (a Mexican corporation of which all but three out of 5,000 shares of stock are held by Mr. Woodruff, president of the United States Graphite Co., in trust for the aforesaid company), to denounce (or file claim) on the property of the aforesaid company, and title was subsequently and in due form issued to the aforesaid Mexican company. Although Mr. Woodruff, who is president of the United States Graphite Co., holds the shares in the Mexican corporation in trust for the United States Graphite Co., the United States Graphite Co. has absolute control over the same under the trust agreement.

During the entire period of ownership the property in question has been operated as a graphite mine and not used as a ranch.

Under section 240, subdivision (d) of the revenue acts of 1921 and 1924, and under section 240, subdivision (f) of the revenue act of 1926, this company has been allowed to file a consolidated account with its foreign subsidiary in order that it may be entitled to take its deduction for depletion. The company returns all of its income from the operation of its Mexican subsidiary in the United States and it seems only fair that it should be allowed treatment equal to that afforded domestic concerns who are not compelled to organize subsidiary companies in order to operate foreign properties.

The pending revenue bill eliminates the provision of prior revenue laws permitting the filing of consolidated accounts in the case of domestic corporations operating foreign subsidiaries.

In order that this injustice may be corrected, please permit me to suggest for your committee's consideration the following amendment to be incorporated in the pending revenue bill:

"In case of a domestic corporation owning or controlling directly or indirectly 100 per cent of the capital stock of a foreign corporation (exclusive of directors' qualifying shares) maintained solely for the purpose of complying with the laws of such foreign country as to title and operation of property, such domestic corporation may make return of income with the same credits, deductions, and allowances as if the properties of such foreign corporation were owned and operated directly by such domestic corporation."

Please permit me to call your attention to the fact that even if the consolidated return provision of existing law is restored in the pending bill that this provision will also be necessary because under existing law domestic companies are not allowed to include foreign companies in a consolidated return. We hope that the consolidated account provision may be stated as above indicated in order that there may be no doubt with respect to the scope of the provision.

In the case of companies that are entirely willing to return all their income from their foreign companies in this country, if they can be treated on the same basis as domestic companies, it seems unfortunate, if they can not be granted such permission, as the tendency will be to cause them to leave their income outside of the tax jurisdiction of the United States.

Mr. John E. Walker, 1001 Fifteenth Street, Washington, D. C., our Washington counsel, is familiar with our tax problems and will be pleased to appear before your committee or furnish you with any additional information you may desire.

I sincerely hope that your committee may be able to incorporate the proposed amendment in the pending revenue bill before it is reported to the Senate.

Respectfully,

THE UNITED STATES GRAPHITE CO.,
By ALBERT S. HARVEY,
Vice President and General Manager.

JANUARY 31, 1928.

HON. REED SMOOT,
Chairman Finance Committee,
United States Senate, Washington, D. C.

DEAR SIR: We respectfully call to your attention, and that of your committee, the following situation relative to certain corporations that are organized under the laws of the United States of America for the purpose of mining, milling, and smelting, etc., and who are compelled to operate through foreign subsidiary companies.

Prior to the income tax act of 1924 mining companies whose properties were located within the so-called prohibited zone in Mexico (100 kilometers from the international border) were denied the right of depletion deduction in computing the United States income tax, despite the fact that similar properties situate right outside of the prohibited zone were valued as of March 1, 1913, by the United States Treasury Department and obtained depletion allowance in computing their United States income tax, with the provision that an apportionment of capital could be made which would provide for return of dividends out of a depletion reserve tax free, and the apportionment of such dividends would follow through to the ultimate stockholders.

This inequality was caused by the necessity of incorporating under the Mexican law (which prohibits ownership or operation except by Mexican corporations or citizens) those companies within that prohibited zone, while those without the zone could and did operate under a charter granted in the United States of America.

The acts of 1924 and 1926 recognized this inequality and through section 240 (d) and 240 (f), respectively, granted the equality that was due those properties within the prohibited zone.

The elimination of the consolidated returns section in the pending revenue bill will put the companies within the prohibited zone in the unequal position in which they were prior to the 1924 act. It will deny them the right to deduct depletion, notwithstanding the fact that the properties were valued by the

United States income tax bureau subsequent to the 1924 act and the units of depletion fixed, and will also compel the payment of the gross tax on all dividends received by the domestic corporations from the Mexican operating companies and all dividends paid by the domestic corporations to their stockholders, who are taxpayers in the United States of America, and will thus be a discrimination against American capital invested in foreign countries, which tends to the prosperity of the United States of America.

In order to continue the rights to these companies in the prohibited zone that were justly accorded them under the 1924 and 1926 acts, may we not respectfully suggest, first, that the consolidated returns section be reinstated in the pending revenue bill, and, second, whether or not the consolidated returns section is reinstated, that the following amendment be added (possibly under section 45) in order that the position of these companies be clearly defined under the law:

"In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per centum of the capital stock of a foreign corporation (exclusive of directors' qualifying shares) maintained solely for the purpose of complying with the laws of such foreign country as to title and operation of property, such domestic corporation may make return of income with the same credits, deductions, allowances as if the properties of such foreign corporations were owned and operated directly by such domestic corporation."

We sincerely hope that your committee may be able to have reinstated the consolidated returns section and to incorporate the proposed amendment in the pending revenue bill before it is reported to the Senate.

Should you desire a personal appearance before your committee or that you be furnished with any additional information, we stand ready and anxious to concede to whatever may be your wishes therein.

Respectfully,

GREENE CANANEA COPPER CO.,
By J. W. ALLEN, *Treasurer.*

STATEMENT OF JOHN E. WALKER, WASHINGTON, D. C., IN BEHALF OF THE NASH MOTORS CO., KENOSHA, WIS.—Resumed

Mr. WALKER. I am authorized to state that the American Smelting & Refining Co. of New York City also favors the proposed amendment.

Just one further matter. I would also like to put in the record a letter from Mr. C. W. Nash, president of the Nash Motors Co., to Senator Smoot, under date of January 18, 1928.

(The letter referred to is as follows:)

JANUARY 18, 1928.

Hon. REED SMOOT,
Chairman Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR: I desire to call the attention of the Finance Committee to a situation which the Nash Motors Co. and the Seaman Body Corporation find themselves in as a result of a very technical ruling of the Treasury Department with respect to the export body sales of the Seaman Body Corporation.

The Nash Motors Co. has owned 50 per cent of the stock of the Seaman Body Corporation since September, 1919.

The Seaman Body Corporation is located at Milwaukee, Wis., and makes practically all the closed bodies used by the Nash Motors Co. at its three plants at Kenosha, Racine, and Milwaukee.

The Nash Motors Co. at all times in its dealings with the Seaman Body Corporation has considered it the same as a division of its business. During the entire period of its dealings with the Seaman Body Corporation, the Nash Motors Co. has never had a written contract with the Seaman Body Corporation covering the purchase of bodies. Since the Nash Motors Co. acquired 50 per cent of the stock of the Seaman Body Corporation, it has dictated the policies of the Seaman Body Corporation. During this entire period the Nash Motors Co. has been the sole purchaser of the bodies manufactured by the Seaman Body Corporation.

Since the Nash Motors Co. began purchasing its closed bodies from the Seaman Body Corporation it has been its policy to estimate its body requirements three months in advance. These estimates include its estimated domestic and foreign requirements, and are based upon existing advance orders, prior years' experience and other anticipated commercial requirements. These estimates are corrected from time to time as the subsequent orders may require and are covered by purchase orders.

At frequent intervals conferences are held between the officials of the aforesaid companies with regard to the aforesaid estimated requirements.

It was the understanding at all times of the officials of both companies that the bodies ordered included the Nash Motors Co. export requirements, and the Seaman Body Corporation was notified by telephone from time to time with respect to the bodies required for export.

At the aforesaid conferences the officials of the Seaman Body Corporation were aware of the fact that some of the bodies included in the estimates were for export purposes and were ordered by the Nash Motors Co. to meet its export requirements.

The Seaman Body Corporation did not pay any tax upon the bodies that were actually exported.

The Treasury Department Revenue agents did not complete their investigation of the Seaman Body Corporation and the Nash Motors Co. excise tax returns for the period from June, 1924, to September 30, 1927, until November 30, 1927. Because the Nash Motors Co. did not place with the Seaman Body Corporation during this period a specific order for bodies for export, the Treasury Department has required the Seaman Body Corporation to pay $113,394.71 with respect to excise tax upon sales of bodies which were exported, which sum has been reimbursed to the Seaman Body Corporation by the Nash Motors Co.

It is submitted that the imposition of this tax is clearly not within the spirit of the provisions of the constitution with respect to export sales.

It is my understanding that practically all of the automobile body manufacturers and the automobile manufacturers find themselves in a similar situation.

In order to correct this injustice please permit me to suggest for the consideration of the Finance Committee the incorporation in the pending revenue bill of the following additional section:

"SEC. —. Refund shall be made of all taxes paid under the provisions of section 600 of the revenue acts of 1924 and 1926 with respect to sales of automobile bodies which were exported in due course prior to use, resale or further manufacture within the United States by automobile manufacturers or automobile body manufacturers whether or not such bodies were originally sold for export. In order to be entitled to such a refund the automobile manufacturer or the automobile body manufacturer who paid such tax shall furnish (a) proof of the selling price of the bodies so exported and (b) proof of the exportation in due course of such bodies, either as such or as part of an automobile sold for export and in due course so exported."

Mr. John E. Walker, 1001 Fifteenth Street, northwest, Washington, D. C., is the Washington representative of the Nash Motors Co. and the Seaman Body Corporation and is entirely familiar with the facts involved in the aforesaid case. He will be pleased to appear before the Finance Committee if you desire, or to furnish you any additional information that you may desire regarding this matter.

Trusting that the Finance Committee may deem it proper to correct this injustice, I am,

Respectfully,

C. W. NASH,
President Nash Motors Co.

Senator KING. What does this deal with?

Mr. WALKER. It deals with the situation in which the automobile companies find themselves with respect to export sales of bodies. Speaking for the Nash Motors Co., the audit under the 1924 and 1926 acts in their case was not completed until last November. The Nash Motors Co. buys its bodies from a subsidiary corporation, the Seaman Body Corporation, in which it owns 50 per cent of the

stock, the other 50 per cent being in the hands of the two Seaman brothers.

The Seaman Body Corporation is regarded by the Nash Motors Co. as merely a division of its business. It is so much of a family affair that there is not any written contract between the two companies for the purchase of bodies.

The officials of both companies knew at all times that the bodies were being purchased to meet their export and their domestic requirements. They thought that in view of the fact that they had no written orders and no written contract with respect to it, and in view of the fact that they knew that the sole consumer of the bodies manufactured by the Seaman Body Corporation was the Nash Motors Co., they had fully met the regulations with respect to the bodies that were purchased for export. When the audit was completed the Treasury Department held that because there were no specific bodies ordered for export, the tax being, as you will remember, on the bodies and not on the chassis, they were not, technically, sales for export, and they have held the Seaman Body Co. liable for the tax upon all bodies that went into the export trade.

All that is necessary to comply with the regulations with reference to sales for export—under a ruling which, so far as I know, has never been published—is for a manufacturer of automobiles to state in his order to the manufacturer of bodies that, of a thousand bodies—or any other number ordered—100, for example, or any specific number, are to be used for export, and then submit the export invoices. As I understand it, practically all the automobile manufacturers to a certain degree are in the same situation in which the Nash Motors Co. is. Many of the automobile manufacturers have one further complication.

In other companies, such as General Motors, they have an export corporation, and you have the additional transaction of a sale to the export corporation; and they say in the Treasury rulings that where the orders were not supplied before the manufacturer became familiar with the necessary procedure to meet the requirements, all such transactions are taxable.

I doubt very much if it was the thought of anyone, at the time the 1924 and 1926 acts were enacted, that such transactions would be held other than export transactions. I am advised that it is the opinion of the Treasury Department that taxes that have been collected on such transactions in the aggregate may run to $4,000,000. We are calling this situation to your attention, and we are very hopeful that you will deem it proper to authorize a refund of the taxes so collected and thereby correct this injustice.

Senator KING. You want a refund by law rather than by court decision?

Mr. WALKER. We would prefer it.

The CHAIRMAN AND MEMBERS OF THE SENATE FINANCE COMMITTEE,
United States Senate, Washington, D. C.:

This memorial of the Philadelphia Board of Trade respectfully represents:

That examination has been made of the draft of the proposed revenue act for 1928 now under consideration and, without reiterating the views heretofore expressed in respect to various matters connected with this proposed legislation, the board desires to direct your especial attention to the following:

That under section 115 of the new act, earnings or increases in value of property or corporations, made or accrued prior to March 1, 1913, will, when distributed, be subject to tax as income received by the stockholders of such corporations.

That in the various revenue acts passed since the income tax was first inaugurated the rule has been consistently observed making it unfair and wrong in principle to give to the income tax a retroactive effect by applying it to earnings or increases in value, made or accrued, prior to March 1, 1913.

That in the opinion of this board there is no sufficient reason for changing this long-settled policy, and the proposed change would, it is submitted, be most unfair and inexpedient.

That with reference to the argument advanced in support of the proposed change, which is that a large number of corporations have by now distributed earnings or profits made or accrued prior to the date mentioned, we would respectfully submit that if the principle originally adopted in connection with this matter was sound and right, it should not be abandoned because the change will work hardship in fewer instances now, perhaps, than would formerly have been the case.

That those who are subjected to this tax may rightly complain, despite the avowed object to reduce taxation, that there is thus imposed upon them an added burden which those who have received similar distributions, since the income tax was first levied, have not been called upon to bear.

That if the committee is right in its statement that most of such earnings or profits have by now been distributed, the proposed change would produce very little additional revenue to the Government.

That whatever the fact may be, any change at this late date in the rule which limited the effect of the income-tax act to earnings or profits accrued since March 1, 1913, is for many reasons undesirable: Therefore

Your memorialist, the Philadelphia Board of Trade, urges that the provisions of section 201 of the revenue act of 1928 and which comprise the existing rules as to corporate disbursements subject to tax, shall be substituted in place of the provisions of sction 115 of the proposed measure.

And your memorialist will ever pray.

[SEAL.] THE PHILADELPHIA BOARD OF TRADE.
WILLIAM M. COATES, *President.*

Attest:

W. R. TUCKER, *Secretary.*

The CHAIRMAN. We will adjourn until 10 o'clock to-morrow.

(Whereupon at 3.45 o'clock p. m., the committee adjourned to meet to-morrow, Friday, April 13, 1928, at 10 o'clock a. m.)

REVENUE ACT OF 1928

FRIDAY, APRIL 13, 1928

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

The committee met, pursuant to adjournment, at 10 o'clock a. m., in the committee room, Senate Office Building, Senator Reed Smoot presiding.

Present: Senators Smoot (chairman), McLean, Curtis, Reed of Pennsylvania, Shortridge, Couzens, Fess, Greene, Deneen, Simmons, Harrison, King, Bayard, Barkley, and Thomas.

The CHAIRMAN. If the committee will come to order, we will proceed with the hearing. Mr. Charles Henry Butler desires to put into the record at this point a memorandum in relation to section 702, with comments.

(The statement referred to is as follows:)

(Mr. Charles Henry Butler, on behalf of Messrs. Stewart & Shearer, New York City, attorneys for the owners of fourteen 10-meter boats, submitted the following brief relating to the tax on foreign-built yachts in section 431 amending section 702 of the revenue act of 1926, and stated that the provision in the House bill was satisfactory.)

Before the Ways and Means Committee of the House of Representatives. In the matter of the proposed increase of the tax on foreign-built yachts. Section 702 of the revenue act of 1926

MEMORANDUM IN OPPOSITION TO PROPOSED AMENDMENT OF SECTION 702 OF THE REVENUE ACT OF 1926

This committee has been asked to increase the rates of the special tax imposed by section 702 of the revenue act of 1926 on foreign-built yachts. This memorandum will deal only with the proposed amendment in so far as it would affect the owners of small foreign-built sailing yachts. We understand that a memorandum in opposition is also being submitted on behalf of the owners of the larger foreign-built power yachts.

THE PRESENT ACT

Under the present act, a special tax is imposed annually on the owners of all foreign-built yachts not owned by a citizen of the United States on January 1, 1926, which are over 5 tons displacement and over 32 feet in length. The rates of this tax are $2 per foot of over all length from 32 to 50 feet, $4 per foot of over all length from 50 feet to 100 feet, and $8 per foot of over all length over 100 feet.

THE PROPOSED AMENDMENT

It is now proposed to increase each one of these rates 10 times and to apply these increased rates to all foreign-built yachts of over 5 tons and over 32 feet in length which were not owned by a citizen of the United States on January 1, 1926.

POINT I. THE INCREASED TAX IN SO FAR AS IT WILL AFFECT SMALL SAILING YACHTS WILL NOT INCREASE THE REVENUES OF THE UNITED STATES

It is obvious that the desirability of the proposed increase in these tax rates may be considered from either the point of view of increasing Government revenues or from the point of view adopted by the proponents of the amendment who very frankly state that they wish the increased tax as a protection for American shipyards. We will consider the matter first from the point of view of Government revenue.

It is somewhat of an anomaly that at the very time when the Congress is considering a reduction of taxes that this proposed increase should be brought before this committee, and it is obvious from the testimony given at the hearing before the committee that its proponents have not urged its enactment as a means of increasing revenue. It appears from the statements made to this committee on behalf of the proposed amendment that in so far as sailing yachts are concerned it is particularly aimed at the owners of 14 so-called "10-meter" yachts which were built last year in Germany. These yachts are approximately 36 feet on the water line and 60 feet over all. They carry a crew of two men. Under the present rates they each pay an annual tax of $240. This is twice the rate paid under the revenue act of 1924. The testimony before this committee is that they cost about $13,000 built in Germany and delivered here and that it would have cost about $22,000 to build them here. These 14 boats now pay collectively an annual tax of $3,340 to the Government. Under the proposed increase of 1,000 per cent in rates they would pay, if they remained in this country, a collective annual tax of $33,400. For the purpose of determining the effect upon the Government revenues of so greatly increased a tax, it is necessary, however, to consider not merely the number of boats now subject to the tax but what effect such an increased tax would have on the ownership and taxability of these boats. As a matter of fact, the owner of a small sail boat of this character if required to pay an annual tax of $2,400 for her use, would not continue to use or own her. Such an annual tax is entirely out of proportion to the value, size, and use of the boat itself and would inevitably result in the sale of these boats out of the country at a very substantial loss to their owners. Not only would the Government not increase its revenue through such an increased tax but the small amount of tax now received from these yachts would, we believe, entirely disappear and most certainly no more sailing yachts of this character would be built abroad for American owners.

POINT II. THE PROPOSED INCREASED TAX ON SMALL SAILING YACHTS WILL NOT HELP THE AMERICAN MERCHANT MARINE

The proponents of the increased tax have urged in its favor that its imposition would help the American merchant marine through helping American shipyards. It is perhaps unnecessary to point out that small yachts of the character here under consideration are not as a rule built at yards which now construct or are able to construct merchant vessels. Yachts of this character if built here are built usually at small yacht yards, principally on the Atlantic coast. The most prominent of these yacht yards in the construction of racing sailing boats are Lawleys at Boston, Herreshoff's at Bristol, and Nevins at New York City. No one of these yards, except possibly Lawleys, has been used for the construction of merchant vessels and apart from Lawleys, they are not suited to that purpose. Nor would it follow for one moment that if these tax rates are raised, yachts of this character will hereafter be built in any quantity in American yacht yards. The history of yachting in this country shows that since the great increase in the costs of yacht construction that began with the war period, only two racing yachts of any size, *Katoura* and *Prestige*, have been built in this country. Not only is there no reason to believe that the fourteen 10-meter yachts which were built abroad last year and delivered here at a cost of about $13,000 each would have been built here if the proposed tax rates had then been in effect, but we assert confidently that none of these boats would have been built at all. The testimony shows that these boats would have cost about $22,000 if built here and that cost, as the yacht building experience of the past 10 years shows, is too high a price to pay for so small a boat. In so far even as the real interests of these few yacht yards are concerned, we believe that they are far better off under the present rates than

they would be under the proposed rates. All the repair work on these 14 boats has been done by American yards, they are all hauled out at American yards and they will be put in commission each spring in American yards and those yards are making a very considerable amount from work on these boats that they would have never made if they had not been built. Granting, as we must in view of the history of the building of racing yachts in this country in recent years, that the cost of construction in this country is so great that practically no racing yachts of any size will be built here, our yards are far better off under a law that permits these small yachts to be built abroad for use here with the attendant work which they bring to our yards during the many years of the life of these boats. The essential problem in building up our merchant marine is based on fundamental difficulties that are well known and have no connection whatever with the building of small sailing yachts abroad.

POINT III. THE PROPOSED TAX WOULD BE CONFISCATORY IF MADE APPLICABLE TO PRESENT OWNERS

That an annual tax of $2,400 (representing the interest at 6 per cent on $40,000) for the use of a small yacht costing $13,000 would be in its effect confiscatory, requires no argument further than the statement of the amount of the annual tax as compared to the cost of these boats. Certainly no such increase in the tax rate should fairly be made to apply to existing boats brought into this country in May and June, 1927, in good faith and under a law enacted as recently as 1926.

POINT IV. IT WOULD BE UNJUST TO APPLY THE PROPOSED RATES TO PRESENT OWNERS OF FOREIGN-BUILT YACHTS AND TO THOSE WHO HAVE ALREADY CONTRACTED ABROAD FOR THE CONSTRUCTION OF SMALL SAILING YACHTS

At the time the revenue act of 1926 was passed incorporating the present tax on foreign-built yachts, the fact was recognized by Congress that it should not in fairness apply to yachts then owned by American citizens. We submit that it would now be most unfair to the 14 American citizens who last year built these 14 small sailing yachts abroad, and to some 16 more who have already ordered small sailing yachts for racing purposes from foreign yards, but from American designs, to be suddenly faced with a change in tax rate which would increase their annual tax ten times and would in effect be confiscatory. Such a change in rate would not be "protection" but "prohibition," and that is doubtless the intention of its proponents. Certainly it would be most unjust to present owners and to those who have already contracted for and made payments on foreign-built boats, to apply such new rates to them. We believe that if the proposed rates are inserted in the law, these fourteen "10-meter" yachts will all have to be sold abroad at great loss to their owners and all of the orders for these new boats will be canceled, with serious loss to those who have ordered them and also with serious loss to the American yacht yards who would, for many years to come, have had the work of repairing, overhauling, laying up, and conditioning these boats at substantial profit to themselves. We assert confidently also that as a result of such cancellation the American shipyards will not receive orders for any of these boats and that none of them will be built. Such legislation would single out this small group of citizens and subject them, after the entirely legitimate and proper purchase of their yachts, to an increased tax which would in effect and for the supposed advantage of a few yacht yards, deprive them of their property. If there is to be so drastic a change in the law it should not in all fairness apply to those who already own or have already contracted for these boats.

POINT V. IF A TAX ON FOREIGN-BUILT YACHTS IS DESIRABLE FOR PROTECTIVE PURPOSES IT SHOULD BE INCLUDED IN THE TARIFF ACT AS AN IMPORT DUTY

We respectfully suggest that in dealing with this subject the proper place and the proper manner to consider it is in the tariff act and not in the revenue act. If after due inquiry it should be deemed proper to extend protection to American yacht yards in this matter, we believe that it can be best and most scientifically done, for the best interests of all concerned, by levying an import tax. We can see no reason for differentiating between small sailing yachts built adroad, if it is first determined that they should be taxed, and other products of foreign manufacture. We believe the special tax on the use

of such yachts is now an anomaly and is not the most appropriate method of legislation on the subject.

We submit that the proposed increase in the special tax on the use of foreign-built yachts, if applied to small sailing yachts, will not effect an increase in Government revenue or be of advantage to American shipyards. That it would be most unfair to make such increased rates apply to present owners, including those who have already contracted abroad for such yachts; and that if Congress on due investigation believes that American shipyards should be given protection in this matter it should be considered in connection with the tariff act and a proper import duty laid upon such yachts hereafter ordered and brought into the United States.

Dated November 25, 1927.

Respectfully submitted.

STEWART & SHEARER,
Attorneys for the owners of fourteen 10-meter boats.

(Charles Henry Butler, attorney, Washington, D. C., submitted on behalf of clients making installment sales the following brief:)

Installment sale tax law under its present construction admittedly involves double taxation.

Admittedly an income tax can not again be charged on an amount earned in a previous year and on which the full income tax for the year in which it was earned has been reported and paid.

The department took this position in the original regulations and all prior accrued payments on installment sales were excluded after changing from accrual to installment plan. Subsequently, the regulation has been changed and accrued items are required to be reported and this admittedly double taxation is justified as being the price paid by the taxpayer for the benefits received by reporting on the installment basis.

The taxpayers contend that this not only is exactly opposite to the intent of Congress as expressed in the act of 1926, but also makes the law unconstitutional as taxing for income purposes that which is actually principal.

The department contends that even if this double taxation standing alone would be unconstitutional, it is justifiable because by changing from an accrual to an installment basis the taxpayer accepts the provisions of the act as construed by the department and thereby makes legal and enforceable an otherwise illegal and unenforceable tax.

As this attitude of the department is based on its alleged understanding of an act of Congress it is only fair and proper that Congress should clarify the situation.

The CHAIRMAN. Is Mr. McWhirter in the room?

STATEMENT OF FELIX M. McWHIRTER, PRESIDENT PEOPLES STATE BANK, INDIANAPOLIS, IND., IN BEHALF OF CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. McWHIRTER. My name is Felix M. McWhirter. I am president of the Peoples State Bank of Indianapolis, Ind., and a director in the National Chamber of Commerce; also a member of the committee on Federal taxation.

I have here, Mr. Chairman, and members of the committee, a letter from Mr. Pierson, the president of the chamber, to the committee. [Reading:]

APRIL 12, 1928.

Hon. REED SMOOT,
Chairman Committee on Finance, United States Senate.

DEAR SENATOR SMOOT: Responding to your invitation I have the honor to present the position of the Chamber of Commerce of the United States on Federal tax reduction.

Since its organization in 1912, the chamber with committees composed of outstanding business executives and economists has continuously studied and from time to time submitted to its membership for referendum vote, ques-

tions on the fiscal policies of the Government, without regard to changing governmental administrations.

The essential function of the chamber is to develop and present nonpartisan principles which are in the public interest. Facts are ascertained through careful investigation by representative committees and after full consideration and deliberate vote of our member chambers of commerce and trade associations throughout the country the position of the national chamber is determined.

The chamber's war record of taxation policies has a direct relation to the policies the chamber now urges for the reason that by an overwhelming vote of its membership, effective soon after the declaration of war, the chamber immediately urged a large increase in income taxes, the imposition of excess-profit taxes and new and heavy excise taxes.

This position was in support of the principle that the largest possible part of war cost should be met through current taxation in order that during the inevitable readjustment of pos.-war years the tax burden might be more quickly lightened.

This policy was adopted by the Government and the war thus was financed, but since the war full application of the principle has not been made and taxes have continued out of proportion to the needs of the Government for current expenses and for amounts specified by Congress to be used in debt retirement.

Our latest taxation referendum 50 (October last) was carried by the largest vote in the history of the chamber. I am attaching this referendum showing the personnel of the chamber's committee, together with their report, and a tabulation of the names of the organizations which voted upon it and how they voted.

The officers of the national chamber are therefore charged with advocating:

1. Reduction of the corporation income tax to not more than 10 per cent.
2. Repeal of the remaining war excise taxes on particular businesses.
3. Repeal of the Federal inheritance tax.

These proposals were presented by the chamber's tax committee to the Committee on Ways and Means November 1, 1927.

The revenue bill which passed the House of Representatives on December 15 has been held in the Senate committee now four months. In this period our committee has had no reason to change its views in regard to the revenues of the Government for the fiscal year 1929 on any facts or developments which have arisen in the interval.

The national chamber has steadily advocated return to a peace-time taxation basis. Its recommendations have included for two years the repeal of the Federal inheritance tax, for four years the reduction of the corporation income tax, and for seven years the repeal of the war excise taxes. Two years ago it opposed the increase of the corporation income tax from 12½ per cent to 13½ per cent, now demonstrated to have been unnecessary.

The taxation recommendations of the chamber at previous sessions of Congress are demonstrated to have been entirely feasible and possible as shown by the following table indicating the total amounts of actual debt retirement in recent years, and the sources from which these amounts of retirement were made possible.

Funds used for debt retirement

	Compulsory (required by law gradually increasing each year)	Permissive		
		Interest from foreign governments	Year-end Treasury surpluses	Actual retirement
1924	$289,000,000	$159,000,000	$505,000,000	[1] $1,098,000,000
1925	306,000,000	160,000,000	250,000,000	[1] 754,000,000
1926	322,000,000	160,000,000	377,000,000	[1] 872,000,000
1927	359,000,000	160,000,000	635,000,000	1,133,000,000

[1] Includes an amount obtained through reduction in the balance in the general fund

Over one-fourth of the income of the National Government; that is, $1,133,000,000, during the fiscal year ending June 30, 1927, was applied to debt retirement. This is more than three times the statutory requirements for debt reduction. Nearly as much will be used to reduce the national debt this year should no tax bill be passed.

After careful consideration Congress passed legislation providing for the retirement of the national debt in an orderly manner. If it is the judgment of the American people that the debt should be retired more rapidly Congress would undoubtedly pass legislation increasing the statutory rate of debt reduction.

ESTIMATES FOR 1929

The national chamber believes that the official estimates of receipts for the year ending June 30, 1929, are low by a considerable figure.

CORPORATION INCOME TAX

We find that corporations showing any net income for 1925 had an aggregate of $9,340,000,000 in taxable income and showed on their returns a tax liability of $1,170,000,000, at a rate of 13 per cent. Through data published by the Treasury in December, 1927, it is demonstrated that the total taxable income shown by corporations for 1926 taxable year was increased over 1925 by at least $200,000,000, or to $9,540,000,000. On this figure therefore, at the rate of 13½ per cent, the total corporate tax due, according to the 1926 returns, would seem to be at least $1,242,000,000. It has now become evident that the tax liability shown by corporations upon their returns for 1927 will not vary substantially from the tax liability for 1926.

From these amounts due, however, the official estimates are that only $1,120,000,000 was collected in 1927 fiscal year, that $1,120,000,000 will be collected in the 1928 fiscal year, and that $1,120,000,000 will be collected in 1929 fiscal year. In other words, regardless of the nature of the income tax, and the undoubted growth in the volume of business, a "fixed" estimate is used for the receipts from a source yielding a good third of the total revenue receipts of the Government. It would seem reasonable to assume that—granted that business conditions in 1928 calendar year remain in general at a parity with the business conditions of 1927—receipts in 1929 fiscal year from current corporation tax at a rate of 13½ per cent would exceed the official estimate of $1,120,000,000 by at least $100,000,000.

It has been pointed out that these figures do not show actual collections made but only taxes due. If the criticism is accepted the Treasury estimate basis of the loss of $90,000,000 figured upon the same data for the reduction of the rate of corporate income tax by one point—i. e., from, say, 13½ per cent to 12½ per cent—is too high.

BACK TAXES

There is no public record over a period of years of the actual collections made from corporations within each fiscal year, of the taxes shown upon the returns as filed, or any public record of the part of the tax shown upon the returns on which there was delinquency with payment in subsequent years, or any public record of the amounts collected from corporations through assessment of taxes additional to those shown upon the returns.

A very large total is involved in so-called back taxes which fall into the following categories:

First. Uncontested claims which are merely delinquent in payment.

Second. Claims for additional taxes pending in the Internal Revenue Bureau which may be settled there.

Third. Claims for additional taxes which have been sent from the Internal Revenue Bureau to the Board of Tax Appeals on the appeal of the taxpayer.

Fourth. Unpaid claims for additional taxes involved in cases before the courts.

The first must naturally be the amount between the total tax liability admitted on income returns filed by taxpayers and the receipts from taxpayers at the close of the fiscal year.

Upon the second there is no public record of the total amount. One large accounting firm advises that Government claims of this character against their clients now pending in the Internal Revenue Bureau, total $100,000,000, and it is, therefore, apparent that the aggregate of all such claims in that bureau must amount to a very large sum, at least several hundred million dollars.

Senator SIMMONS. You are referring now to claims that have not reached the Board of Tax Appeals?

Mr. McWHIRTER. Yes, sir.

Upon the third the claims before the Board of Tax Appeals now amount to $685,000,000—the greatest total in the history of the board—an increase of $80,000,000 since October, 1927.

The cases under the fourth category while involving considerable amounts in additional taxes are particularly important in that the decisions of the courts will be precedents which may determine the outcome of the Government's claims under the second and the third.

Senator SHORTRIDGE. Is there any way to determine when that money will reach the Treasury?

Mr. McWHIRTER. Not precisely.

Senator SHORTRIDGE. Under those four classes or categories?

Mr. McWHIRTER. The committee feels that there can be some speeding up of collections.

The records show that collections from "back taxes" were: In 1926, 285,000,000; in 1927, $331,000,000.

The official estimate of last November of revenue from this source, of $180,000,000 which has recently been increased by $40,000,000 to $220,000,000 for the fiscal year 1929, is lower by $111,000,000 than the $331,000,000 of 1927 above, which to the chamber does not seem reasonable.

The official statements would seem to mean that in the $220,00,000 now estimated as receipts from "back" taxes in 1929 fiscal year there are $100,000,000 of these delinquent "current" taxes.

In other words, it would seem that in the official estimate there are only $120,000,000 of receipts from claims for additional taxes, for all preceding years. Without stopping to cite official testimony as to the amounts of additional taxes assessed and collected for a period within the last 12 months, it seems sufficient to point out that if only $120,000,000 in additional taxes are collected in the fiscal year of 1929 these recollections will not be sufficient to offset tax refunds, which are officially estimated to amount to $138,000,000. It is only reasonable to assume that the Government is receiving from its additional tax claims an amount in excess of the refunds made.

OFFICIAL ESTIMATES

In December, 1927, the official estimate of the surplus for 1929 fiscal year was $252,000,000. On April 3, 1928, this estimate was so changed as, upon a comparable basis, to be $297,000,000.

This revision has taken place three months in advance of the opening of the fiscal year of 1929. At the time of the opening of the fiscal year of 1928, now current, the official estimate was that the surplus at the end would be approximately $200,000,000. In December, 1927, when the year was almost half run, the estimate was increased to $454,000,000.

Table A (appended) shows that without exception for each of the past five years, the official estimates of receipts have been underestimates by wide margins, and that the estimates of expenditures have been overestimates.

Senator HARRISON. I did not catch that last.

Mr. McWHIRTER. For each of the five years, according to the table (appended), the official estimates have been underestimated from the one side, and overestimated from the other, the widest margin being in the first instance.

Senator BAYARD. Do you give your detailed estimates of those figures?

Mr. MCWHIRTER. Yes.

Senator HARRISON. So, the Treasury missed it both way; it underestimated it in one instance and overestimated it in another?

Senator SHORTRIDGE. A very safe thing for the Government to do.

Senator HARRISON. But a very hard thing on the taxpayer.

Senator SHORTRIDGE. That may be so, Senator.

Mr. MCWHIRTER (reading):

It shows, too, that the actual surpluses have exceeded estimates made only six months before the close of each fiscal year in amounts ranging from $100,000,000 to nearly $600,000,000, in the last year, $252,000,000.

RECENT OFFICIAL RECOMMENDATIONS AS TO TOTAL TAX CUTS

In connection with each of the past three revisions of the revenue act there have been official recommendations as to the total amount of tax cut that could not be exceeded.

The following shows that each of these recommendations was greatly under the actual tax cuts made by Congress and, still, large surpluses resulted.

	Cut recommended by the Treasury	Cut passed by Congress [1]	Surplus current year	Surplus year following
Revenue act, 1926	$[illegible]0,000,000	$422,000,000	$307,000,000	$635,000,000
Revenue act, 1924	323,000,000	519,000,000	505,000,000	250,000,000
Revenue act, 1921	[2] 372,000,000	663,000,000	[3] 313,000,000	[4] 309,000,000

[1] The amounts of these reductions are variously computed. The figures in this column are estimates appearing in the Budget message of December, 1927.
[2] The first recommendation of the Treasury was that taxes should be increased, and not decreased.
[3] 1922.
[4] 1923.

EFFECT OF CHAMBER'S PROGRAM ON 1928 (FISCAL YEAR)

The following table shows the effect of the national chamber's program for tax reduction in the fiscal year 1928.

Official estimate, surplus as of June 30, 1928, $401,000,000.

Senator CURTIS. You take that from the Treasury Department, do you not?

Mr. MCWHIRTER. Yes.

War excise and estate tax repeal as of July 1, 1928. (No effect.)

Corporation tax rate reduced to 10 per cent on 1927 incomes would cut receipts of present fiscal year by not more than $150,000,000.

Treasury surplus June 30, 1928, after cut to 10 per cent, $251,000,000.

NOTE.—It is discretionary with the Secretary of the Treasury by law to carry such surplus to general fund for ordinary expenditures in next fiscal year or for debt retirement.

EFFECT OF CHAMBER'S PROGRAM ON 1929 (FISCAL YEAR)

As has been shown, the national chamber's committee believes that the official estimates of receipts for the fiscal year 1929 are still too low by more than $100,000,000. Moreover, the chamber's committee has pointed out that there will be available approximately $400,000,000 for current expenses should an actual need arise. Approximately $160,000,000 of this is in interest received from foreign governments which can be used for current expenses of the government instead of being used as heretofore for debt retirement. Added to this would be a sum up to $250,000,000 from the surplus of June 30, 1928, carried into the new year.

Even though the official estimates are taken to be correct the national chamber's program is well within the principles of sound finance, as shown below:

Amount which can be carried forward from surplus of 1928	$251,000,000
Official estimate of 1929 surplus (with present tax rates) $279,000,000 less provision for new and unbudgeted expenditures of $85,000,000	212,000,000
Receipts from foreign loan service interest	160,000,000
	623,000,000
Less chamber's program of elimination and cut	394,000,000
Surplus year end	229,000,000

From the above it is apparent that it would be unnecessary to devote the $160,000,000 of interest payments from foreign governments to current expenditures, but the amount would be available for debt retirement and still leave a surplus of $69,000,000.

In those figures the committee has taken the highest estimate of cost on the one side and the lowest estimate of expenditure on the other. That is conservative from both sides.

Senator BARKLEY. May I ask you a question there? I do not know whether you can answer it or not. I should have asked somebody in the Treasury. I am informed that this debt retirement out of the surplus is brought about by the purchase of outstanding Liberty bonds, which are not retired but which are held by the Government, and interest is paid on them by the Government, and that interest is figured in the current expenses which go to make up the recommendations of the budget for the requirement of the current year. Is that correct?

Undersecretary MILLS. If you would be willing to defer that, I want to deal with that whole debt retirement proposition very full in answering the suggestion of the chamber that we change our practice with reference to it.

Senator BARKLEY. Very well. I shall not insist on it. I did not know you were here at the time I started to ask the question.

BUDGETARY PROCEDURE

Mr. MCWHIRTER (reading):

Since its first referendum in 1912, and without abatement after the congressional legislation of 1921 establishing the Bureau of the Budget, the chamber has been an outstanding advocate of proper budgetary procedure in the fiscal operations of the Government.

The chamber has always contended that the revenue side of the Budget of the National Government should each year properly provide for the expenditure side.

In support of budgetary procedure, the chamber has always contemplated the desirability of one centralized control over estimates both of receipts and expenditures in order adequately to present to the Congress and the country a properly balanced budget of income and expenditures, instead of, as at present, having the expenditure estimates presented by one agency of the Government and the income estimates by another.

The chamber has been a consistent advocate of economy in government and gives due recognition to the record of Congress during the last six years in keeping appropriations within the figures recommended by the President in his Budget messages.

The chamber has never hesitated to advocate and wholeheartedly support reasonable measures of taxation which will produce revenue sufficient to discharge all of the proper obligations of the Government arising out of legitimate governmental activities—whether special or recurring.

The national chamber recognizes that it is the province of Congress to fix the rates of taxes, and to set the amount to be raised by taxation, as well as to fix the amount of debt reduction.

We place before you the facts as we find and see them, the well-considered opinion of our members, representing every section of the country and every type of business and industry, in a sincere desire to help you in the consideration of an intricate question which affects the economic welfare of the Nation.

Respectfully yours,

LEWIS E. PIERSON, *President.*

TABLE A.—*Government revenues, showing variations between actual revenues and expenditures and official estimates*

[In thousands of dollars]

TOTAL ORDINARY RECEIPTS

Fiscal year ending June 30—	Actual	Estimates	Dates of estimates	Increase or decrease of actual over estimates
1923	$3,841,926	$3,338,182	December, 1921	+$503,744
Do		3,073,825	June, 1922	+768,101
Do		3,429,862	December, 1922	+412,064
1924	4,012,044	3,361,812	do	+650,232
Do		3,638,489	June, 1923	+373,555
Do		3,894,677	December, 1923	+117,367
1925	3,780,148	[1] 3,693,762	do	+86,386
Do		3,579,831	June, 1924	+200,317
Do		3,601,968	December, 1924	+178,180
1926	3,962,755	3,641,295	do	+321,460
Do		3,666,642	June, 1925	+296,113
Do		3,880,716	December, 1925	+82,039
1927	4,129,394	3,824,530	do	+304,864
Do		3,779,769	June, 1926	+349,625
Do		4,026,780	December, 1926	+102,614

EXPENDITURES PAYABLE FROM ORDINARY RECEIPTS

1923	$3,532,269	[2] 3,505,754	December, 1921	+26,515
Do		3,896,258	June, 1922	−363,989
Do		3,703,801	December, 1922	−171,532
1924	3,506,677	[2] 3,180,843	do	+325,834
Do		3,668,534	June, 1923	−161,857
Do		3,565,038	December, 1923	−58,361
1925	3,529,643	[2] 3,298,080	do	+231,563
Do		3,554,891	June, 1924	−25,248
Do		3,534,083	December, 1924	−4,440
1926	3,584,987	[2] 3,267,551	do	+317,436
Do		3,375,671	June, 1925	+209,316
Do		3,618,675	December, 1925	−33,688
1927	3,493,584	[2] 3,494,222	December, 1926	−638
Do		3,593,472	June, 1926	−99,888
Do		3,643,701	December, 1926	−150,117

SURPLUS OR DEFICIT

1923	+$309,657	−$167,571	December, 1921	+$477,228
Do		−882,433	June, 1922	+1,192,090
Do		−273,938	December, 1922	+583,595
1924	+505,366	+180,969	do	+324,397
Do		−30,044	June, 1923	+535,410
Do		+329,639	December, 1923	+175,727
1925	+250,505	[1] +395,681	do	−145,176
Do		+24,939	June, 1924	+225,566
Do		+67,884	December, 1924	+182,621
1926	+377,767	+573,743	do	+195,976
Do		+290,970	June, 1925	+86,797
Do		+262,041	December, 1925	+115,726
1927	+635,809	+330,307	do	+305,502
Do		+186,297	June, 1926	+449,512
Do		+383,079	December, 1926	+252,730

[1] Estimates made before passage of 1924 revenue law.

[2] These are not actual estimates, but are the amounts requested in the regular annual Budget, to which should be added supplemental requests for appropriation subsequently submitted to Congress.

The CHAIRMAN. As I understand, if any member of the committee desires to ask any question, it will be answered by Mr. John M. Redpath, of the chamber.

Senator SIMMONS. I want to ask the gentleman who was just read- a question. He represents the chamber, does he not?

The CHAIRMAN. Mr. Redpath will answer any questions.

STATEMENT OF JOHN M. REDPATH, MANAGER RESEARCH DEPARTMENT, CHAMBER OF COMMERCE OF THE UNITED STATES

The CHAIRMAN. Give your name to the committee.

Mr. REDPATH. John M. Redpath.

The CHAIRMAN. What position do you hold

Mr. REDPATH. I am manager of the research department of the Chamber of Commerce of the United States.

The CHAIRMAN. If there are any questions that any members of the committee desire to ask in relation to the report just read on behalf of the United States Chamber of Commerce, Mr. Redpath will be glad to answer.

Senator SIMMONS. Mr. Redpath, I want to ask you, please, to give the committee a brief statement of the personnel and activities of this research department that you say you represent.

Mr. REDPATH. The research department, of course, is a staff department. Its only functions is to bring material together in a wholly impartial way and place it before committees and officers of the chamber. It is because I have had that function that I assume I have been asked to endeavor to place before you the facts which our committee had before it. The other members of my staff are my assistants.

Senator SIMMONS. How many do you have assisting you in making these researches?

Mr. REDPATH. Of course, I have to divide my work in various ways. I have about seven men.

Senator SIMMONS. The whole time of this bureau is devoted to this research work?

Mr. REDPATH. Yes; I should say this, that the research work done in the research department is not by any manner of means all the research work done in the chamber, because a number of years ago, so far as the staff is concerned, we departmentalized, and we have a special department, for example which is given the title, for convenience, of "finance department," and that department is specializing all the while on questions of finance, including public finance and Federal taxation. Mr. O'Conner, the manager of that department, is here. That is only one of nine specialized departments which are engaged in specialized research in different directions.

Senator SIMMONS. But this is the department which is engaged in research work with reference to financial questions?

Mr. REDPATH. Both the finance department and the research department work upon these questions.

Senator SIMMONS. Do you regard their work as pretty thorough?

Mr. REDPATH. Yes, sir; we endeavor to be very sincere, and we have no purpose except to endeavor to get at the facts.

Senator SIMMONS. It is absolutely nonpartisan?

Mr. REDPATH. Wholly nonpartisan. We have no interest in proving a priori theory of any kind.

The CHAIRMAN. I take it for granted that you approve of all the estimates submitted to the committee this morning?

Mr. REDPATH. Those have been accepted by the committee and the officers of the chamber, and I have myself no reason to question them.

Senator HARRISON. Mr. Chairman, I would suggest, because of the importance of this proposition and the different views entertained by the Treasury Department and the United States Chamber of Commerce, that Mr. Mills, representing the Treasury Department, should be permitted, if he wants to, to ask any questions of Mr. Redpath touching the statement.

Senator SHORTRIDGE. At some time I wish to put a few questions to this gentleman or other gentlemen touching their forecast.

Undersecretary MILLS. I should prefer to make a statement, Senator. The whole basis of the chamber's estimate is so obvious that it does not require any questions.

Senator HARRISON. I think the opportunity should be extended to you.

Undersecretary MILLS. If you will give me the opportunity to answer this, that is all I want.

Senator SHORTRIDGE. That is what you mean, I take it. I think it should be answered if it is susceptible of successful answer.

Undersecretary MILLS. It is, Senator—a complete answer.

Senator SIMMONS. That will be a question, I take it, as to the completeness of it and the fullness of it, for the committee to pass upon, so far as it applies to this question before us.

The CHAIRMAN. Mr. Mills was speaking in behalf of the Treasury Department, and he is going to state the facts as he has found them in the Treasury.

Mr. REDPATH. Certainly.

Senator SIMMONS. I want to hear Mr. Mills, and I want to hear the chamber of commerce, too.

The CHAIRMAN. Yes. If you have any further statements to make, Mr. Redpath, you need not wait for a question.

Mr. REDPATH. I have no further statement of my own.

Senator SIMMONS. I just asked him that question to see how thorough this investigation of the financial question involved before this committee had been.

Senator SHORTRIDGE. Just one question, please, Mr. Chairman. I understood that the position of the chamber in respect to this matter was as of November last; and, second, that nothing had occurred since then to cause the chamber to change its position or its advice.

Mr. REDPATH. That is correct. You will understand, I am sure, the procedure of the chamber. It has to have a representative committee. The personnel of the committee is always placed in the phamphlets used in connection with the referendum and the results. I speak of the referendum. I shall describe that in a moment. In this instance the committee was composed of James R. MacColl, chairman, manufacturer, of Pawtucket, R. I.; president of Lorraine Manufacturing Co.; formerly president of the National Association of

Cotton Manufacturers; formerly a director of the Chamber of Commerce of the United States. Thomas S. Adams, economist, of New Haven, Conn.; professor of political economy, Yale University; formerly chairman of advisory tax board, Bureau of Internal Revenue; formerly president National Tax Association. Arthur A. Ballantine, lawyer, of New York City; member of firm of Root, Clark, Howland & Ballantine; formerly advisory counsel on taxation, Treasury Department, and solicitor Bureau of Internal Revenue. John W. Blodgett, lumberman, of Grand Rapids, Mich.; formerly president National Lumber Manufacturers' Association; formerly a director Federal Reserve Bank of Chicago; member Grand Rapids Association of Commerce. Stuart W. Cramer, manufacturer, of Cramerton, N. C.; president and treasurer Cramerton Mills and other cotton mills; formerly member advisory tax board Treasury Department; formerly president National Cotton Manufacturers' Association; vice president, Cotton-Textile Institute.

I wish to say that Mr. Cramer was unable to be active in the work of the committee.

William S. Elliott, lawyer, of Chicago; general counsel International Harvester Co. William F. Gephart, banker, of St. Louis, Mo.; vice president First National Bank of St. Louis; formerly dean of the school of commerce and finance, Washington University. Edward E. Gore, accountant, of Chicago, Ill.; member of Smart, Gore & Co.; chairman of taxation committee of the American Institute of Accountants; formerly president Chicago Association of Commerce. Robert P. Lamont, manufacturer, of Chicago; president American Steel Foundries; director, First National Bank of Chicago, Armour & Co., etc.; during war chief, procurement division, Ordnance Department; member Chicago Association of Commerce, and formerly vice president Illinois Manufacturers' Association; director Chamber of Commerce of the United States. Felix M. McWhirter, banker, of Indianapolis; president Peoples State Bank; president Peoples Building Co.; director, representing finance department, Chamber of Commerce of the United States; formerly president Indianapolis Chamber of Commerce. George O. May, accountant, of New York City; senior partner Price, Waterhouse & Co.; formerly member board of examiners, American Institute of Accountants; formerly special adviser on taxation, Treasury Department; member New York State Chamber of Commerce. William S. Moorhead, lawyer, of Pittsburgh; member firm of Moorhead & Knox; member former Tax Simplification Board; member Pittsburgh Chamber of Commerce. Roy C. Osgood, banker, of Chicago; vice president First Trust & Savings Bank of Chicago; formerly president Investment Bankers Association of America; recently chairman inheritance tax committee, American Bankers Association. H. H. Rice, manufacturer, of Detroit; assistant to the president General Motors Corporation; member board of directors National Automobile Chamber of Commerce, and chairman of its committee on taxation. George M. Shriver, railroad executive, of Baltimore; senior vice president Baltimore & Ohio Railroad Co.; vice president Baltimore Association of Commerce. Carroll J. Waddell, banker, of Philadelphia; firm of Drexel & Co.; chairman committee on taxation, Investment Bankers Association of America.

Senator SHORTRIDGE. Could those gentlemen give very much individual attention to these matters?

Mr. REDPATH. They have.

Senator SHORTRIDGE. They are men of large affairs.

Mr. REDPATH. They have given attention to it, both in attending their committee meetings and going over the material prepared for them, which they asked to have prepared for them, and in discussing it at committee meetings and formulating the conclusions to which they came.

Undersecretary MILLS. Did that committee meet and approve this statement which has just been read?

Mr. REDPATH. No.

Undersecretary MILLS. Have any members of that committee considered this statement, and if so, how many?

Mr. REDPATH. I can not tell you how many. I know of one member who has.

Undersecretary MILLS. Is this not, in fact, a statement prepared by the staff of the chamber in the last few days?

Mr. REDPATH. That is substantially correct, but the statement itself was actually prepared under the supervision of the President, and the President has approved it. He was unable to stay here. He was here a part of the week, but was unable to stay this morning. He had expected this hearing to occur yesterday.

Undersecretary MILLS. Then, for all you know, this statement does not represent the views of the gentlemen whose names you have just read?

Mr. REDPATH. This statement is in the support of the propositions which they made in their committee report of last September. They have since indicated informally, when the question has been presented to them, that those are still their views, in spite of the information they have of what has happened since.

Senator SHORTRIDGE. Mr. Redpath, manifestly, as of last September, October, or November, that committee could not know, and did not know, what appropriations would be made by Congress.

Mr. REDPATH. May I speak to that?

Senator SHORTRIDGE. Your mind runs ahead, of course. Not knowing, how could you estimate the future expenses of Government, the demands that might legitimately and legally be made upon the Treasury, we will say, during 1929, if you catch what I am trying to elicit?

Mr. REDPATH. May I answer?

Senator SHORTRIDGE. You may answer.

Mr. REDPATH. At the time the committee agreed upon its report in September, having had meetings as early as May and June of that year—in other words, the committee did not come together for the first time in September at all, but it finally reached its conclusions in September—at that time it had before it the President's request to all of the spending agencies of the Government——

Senator SHORTRIDGE. Such as the Army, Navy, etc.?

Mr. REDPATH. Yes, sir. The committee had before it the President's request of all the spending agencies of the Government that for the fiscal year 1929 the estimates of expenditure be kept down to a total of $3,300,000,000, with certain exceptions to which he referred. When the Budget was actually presented in the Budget

message in December, the Budget of expenditures there proposed was in fact, under that figure, and that circumstance, and the Budget as presented in December, was before our committee on taxation, which saw no reason why it should submit a further report by reason of what was presented at that time.

Senator SHORTRIDGE. Did you take into account appropriations for flood control?

Mr. REDPATH. That was not taken into account; no, sir. That is new legislation. Of course, we have to have a datum point from which to start.

Senator SHORTRIDGE. Granted. Did you take into account in your tabulation and study, for example, demands that might be made upon the Government by increased appropriations under the estimates?

Mr. REDPATH. Congress has not, since budgetary procedure went into force, ever exceeded the estimates as presented by the Budget.

Senator SHORTRIDGE. But Congress may do so.

Mr. REDPATH. Yes, sir.

Senator SHORTRIDGE. For example, take the case of the Navy, the appropriation for the Navy.

Mr. REDPATH. Do you mean the construction bill or the ordinary naval bill?

Senator SHORTRIDGE. Take the ordinary naval bill. May we not go beyond the estimates?

Mr. REDPATH. You may in that particular case, but in other cases you may also go below the estimate. Of course, I am talking about the sum total.

Senator SHORTRIDGE. I understand.

The CHAIRMAN. The sum total of all the bills you speak of does not amount to very much, whereas the naval bill would.

Mr. REDPATH. I agree. So far as the amounts in all the regular appropriation bills this year are concerned, as the bills stand in their present legislative stage, I cast up the total this week and my recollection now is that they were under the Budget by about $11,000,000.

Senator SHORTRIDGE. I understand your calculations have been taking the Budget as made as a basis.

Mr. REDPATH. Yes, sir; the Budget on existing legislation.

Undersecretary MILLS. May I ask another question?

Mr. REDPATH. Yes.

Undersecretary MILLS. Is it not true that your committee met last in August and signed their report?

Mr. REDPATH. No.

Undersecretary MILLS. When was the last meeting of the committee prior to the report going out?

Mr. REDPATH. I can not tell you that. Mr. O'Connor can tell you.

Mr. JOHN J. O'CONNOR. Subsequent to the final meeting of the committee, they had a drafting committee meet to look over the report. That committee not only reviewed the subject in September but also reviewed it in December, after the hearings before the Ways and Means Committee. The personnel can be stated, if you desire.

Undersecretary MILLS. Is it not a fact that the main committee, whose names were read a short time ago, met in August to prepare their report?

Mr. O'CONNOR. The report was prepared before August.

Undersecretary MILLS. When did the committee meet to approve it prior to the referendum?

Mr. O'CONNOR. They approved it by mail as of the date of the referendum.

Undersecretary MILLS. That is, the men whose names were read just now?

Mr. O'CONNOR. And that committee has since reviewed the question by mail and still support it.

Undersecretary MILLS. But that committee has not seen the statement submitted here this morning?

Mr. O'CONNOR. Obviously, in the very short time of four days, we could not get that committee together from all quarters of the country, and there has been no time in the hurried preparation and short notice to get them together and consider it.

Senator SIMMONS. Let me ask you a question. The data upon which this report was based had been theretofore submitted by mail to the members of the committee and read by them?

Mr. O'CONNOR. Yes, sir.

Senator HARRISON. Mr. Redpath, who are Mr. Ballantyne and Mr. Adams, members of that board? You said they were known to the committee, and they are, but for the benefit of the record, who are they?

Mr. REDPATH. I will give you the description of them placed in our pamphlet for the information of our membership. We always give such a description in anything in which the report goes out.

The description is made up by the staff, and while it may not be always just exactly as the committee members would put it themselves, it is our best endeavor to describe them correctly.

Dr. Thomas S. Adams is an economist of New Haven, Conn., professor of political economy in Yale University; formerly chairman of advisory tax board of the Bureau of Internal Revenue; formerly president National Tax Association.

Senator HARRISON. Who is Mr. Ballantine?

Mr. REDPATH. Arthur A. Ballantine is a lawyer of New York City; a member of the firm of Root, Clark, Buckner, Howland & Ballantine; formerly advisor on taxation of the Treasury Department and Solicitor of Internal Revenue.

Undersecretary MILLS. Doctor Adams is here. I should very much appreciate it if sometime during the morning the committee would call him and permit him to express his opinion as to the soundness of the Treasury's estimate.

Senator HARRISON. Mr. Redpath, in speaking of these estimates of the administration, do you recall how much the estimate of the Secretary of the Navy was for naval construction this year?

Mr. REDPATH. I can not give you that exactly now from memory. My recollection is it was a very considerable sum, and has been changed.

Senator HARRISON. It was something over $700,000,000?

Mr. REDPATH. It was a large sum of money.

Senator HARRISON. And the House passed something over $200,000,000.

Mr. REDPATH. Yes; that is my recollection.

Senator KING. It was $740,000,000, and the cost would have been over a billion.

Mr. REDPATH. That was merely the authorization requested. Even though the authorization became a law it would not be followed by such an appropriation in any one fiscal year.

Senator BARKLEY. The authorization was supposed to be spread over five or six years.

Mr. REDPATH. That is my understanding.

The CHAIRMAN. Yes; but the authorization, the first time an appropriation bill is passed, even though the bill is a deficiency bill, carries the amount that would be required for the next fiscal year?

Mr. REDPATH. My recollection is that it would be about $13,000,000 or $15,000,000 for the first fiscal year.

The CHAIRMAN. For what year?

Mr. REDPATH. 1929.

Senator KING. For naval construction?

Mr. REDPATH. Yes, sir.

Senator BARKLEY. Mr. Redpath, your total recommendations include the removal of automobile tax, the admission tax, the tax on stock transfers, and the whole category of nuisance taxes?

Mr. REDPATH. Yes, sir.

Senator BARKLEY. Those go into your total recommendations as to the amount you think the taxes should be reduced?

Mr. REDPATH. Yes, sir.

Senator SHORTRIDGE. Did you take into account all sources of revenue?

Mr. REDPATH. In what connection do you mean, Senator?

Senator SHORTRIDGE. Well, in thinking concerning the demands that might be made upon the Government and the sources of revenue to meet those demands.

Mr. REDPATH. My answer is yes.

Senator SHORTRIDGE. You took into consideration all sources of revenue?

Mr. REDPATH. Yes.

Senator SHORTRIDGE. And undertook to estimate all the demands that might be made upon the Government?

Mr. REDPATH. Yes.

The CHAIRMAN. You took into account the estimates of the Budget?

Mr. REDPATH. Yes. I wish to keep clear the distinction between appropriations for existing legislation and appropriations for new legislation.

The CHAIRMAN. Appropriations will be made that are not in the Budget?

Senator SHORTRIDGE. Certainly.

Senator SIMMONS. And there may be some parts of the Budget appropriation that will never be made?

The CHAIRMAN. That very seldom happens.

Senator SIMMONS. It generally happens.

Senator HARRISON. Is it not true that for the last five years Congress has appropriated less than the recommendations of the Budget?

Mr. REDPATH. Ever since budgetary procedure went into effect in 1921.

The CHAIRMAN. Only a small amount each year?

Mr. REDPATH. Yes; but always a step beneath.

The CHAIRMAN. That is true.

Senator KING. Assume that the Congress passes the McNary-Haugen bill for $400,000,000, and enters upon a program of enlarging the Navy and appropriates a considerable sum for it above the estimate of the Budget; makes an appropriation for Boulder Dam and other appropriations which we have before us now, and it is obvious before we adjourn that there will be a deficit if there should be any tax reduction, what would you say as to the course which should be pursued? Or, if it should be equivocal as to whether or not there will be a deficit, and there may be some reason to anticipate there would not be deficit, and might be warranted in passing a reduction of $100,000,000, where would you lay the ax with a view to reducing the revenue, if there should be a $100,000,000 reduction?

Mr. REDPATH. The point of view of the chamber's committee, which has been heretofore indicated, is that even if the Treasury's estimates are correct, there are means at the disposal of the Treasury during 1929 which would prevent that sort of thing happening. There is interest received on account of foreign debts. Our committee believes, after going into the thing, that that money is available for current expenses, if needed. There is no advocacy that it be definitely allocated now to current expenses, but our committee has taken the position, having gone into the whole matter, that that amount is available, if needed, for current expenses, instead of debt retirement.

The CHAIRMAN. What position does the chamber take in relation to the cancellation of war debts?

Mr. REDPATH. It has taken no position in favor of it.

The CHAIRMAN. What is the position of a great many of the officers as to the cancellation of the war debts?

Mr. REDPATH. None of our officers have advocated cancellation of those debts, so far as I know.

The CHAIRMAN. Then they have been greatly misquoted.

Mr. REDPATH. Yes; they have been misquoted.

The CHAIRMAN. Yes; I say they have been greatly misquoted.

Senator HARRISON. Even the chairman has been misquoted at times.

Senator SIMMONS. Of course, if the Congress were to appropriate all the money that Secretary Wilbur thought some months ago ought to be allocated or appropriated for the purpose of enlarging the Navy, amounting to some $700,000,000, and were to appropriate all the money asked for Boulder Dam, were to appropriate all the money asked for farm relief in case it is not vetoed, and appropriate all the money for flood relief in case it is not vetoed, appropriate all of this money for the next year or two years——

Mr. REDPATH (interposing). Assuming it is physically possible to spend so much money within such a period?

Senator SIMMONS. Yes. That would probably swamp the Treasury, anyhow.

Mr. REDPATH. Of course.

Senator SIMMONS. But that is not proposed by anybody, is it?

Mr. REDPATH. I have not heard of it.

Senator SIMMONS. I have not heard it proposed by anybody. The flood relief bill now carries, as it passed the Senate, an authorization of $325,000,000. Nobody has ever estimated, so far as I know, that if it passes the White House we will spend more than $30,000,000 in the next year. Likewise, if Boulder Dam goes through—and I suppose there is not much probability of that—and escapes the veto, which is very doubtful, indeed, only a small part of that would be appropriated in the next year. Likewise, if this farm relief bill is passed, there may be very little demand the first year or the first two years.

Mr. REDPATH. I did not make a complete answer to your former question. May I complete it?

Senator SIMMONS. Yes.

Mr. REDPATH. Our committee, after going into the situation, believed that it is also in the discretion of the Treasury—instead of using all the surplus in the 1928 fiscal year, to be determined on June 30 next—to carry over into the next year, merely hold available as a reserve for needed expenses of that year, if required, an amount up to, say, $200,000,000, perhaps more than that. Then, if not needed in that year, it again could be applied, if desired, to debt retirement. The Treasury has increased the balance in the general fund in earlier years by considerable amounts.

The CHAIRMAN. In other words, they would again have to increase it?

Mr. REDPATH. For a certain length of time.

The CHAIRMAN. Whatever that may be.

Mr. REDPATH. Yes, sir.

Senator SHORTRIDGE. What is the position of the chamber with regard to the retirement of the national debt?

Mr. REDPATH. The chamber has always advocated a liberal retirement, a generous provision for the retirement of the national debt. That question was before Congress, and Congress made a decision as to what the retirement of the national debt should be, 2½ per cent of the amount outstanding at the time Congress acted, less foreign loans, plus interest on the amounts retired by operation of the sinking fund. That provision of Congress is apparently generous. If Congress wishes to take the matter up, I am confident the chamber would not oppose a further provision for debt retirement, but this present provision provides for a sinking fund that will amount to something like $632,000,000 in 1942.

Senator SHORTRIDGE. Why is the credit of the Government now so good?

Mr. REDPATH. That is rather a complicated matter. There are many reasons.

Senator SHORTRIDGE. Is not the outstanding reason that we have always had ample funds to meet all demands, and never have repudiated?

Mr. REDPATH. I would not say that. Of course, repudiation is always fatal to public credit. There has been no repudiation.

Senator SHORTRIDGE. What is the interest rate now?

Mr. REDPATH. The average rate?

Senator SHORTRIDGE. Yes.

Mr. REDPATH. Mr. Mills would be able to give you that more accurately than I. I understand it is now about 3.80 per cent.

Undersecretary MILLS. The average rate is 3.88.

Senator SIMMONS. That is low, it is true, but not much lower than the rate of interest at which the Government bonds in North Carolina sold.

Senator SHORTRIDGE. North Carolina is a solvent State and a good State.

Senator SIMMONS. The United States is solvent.

Senator SHORTRIDGE. Indeed, it is.

Senator KING. Some of the consols of Great Britain have sold for 2 per cent.

Senator McLEAN. What percentage of the corporations of the country belong to your chamber?

Mr. REDPATH. I have no idea. I have no information to indicate the corporate membership. We have direct and indirect membership.

Senator McLEAN. Do you know how many corporations there are in the country?

Mr. REDPATH. I can only estimate from the Treasury's statistics.

Senator McLEAN. Do you know how many corporations belong to the chamber?

Mr. REDPATH. No.

Senator McLEAN. Have you any idea what percentage of the total number?

Mr. REDPATH. I never have attempted to find out. If we endeavored to find out the direct and indirect membership, we would have a very difficult task. I wish to point out that the chamber has but one class of governing members, only one class of members that determine its policies and elect its directors, and that class is entirely composed of organizations, local commercial organizations and trade associations that are more general in membership than local trade associations. When the structure of the chamber was originally determined in 1912, a merely local trade association was not considered sufficiently representative to be included among the governing members. If we come to the question of how many of the 850,000 or 900,000 concerns or associations that are members of our member organizations are in fact corporations, it would be a hopeless task to find out.

Senator McLEAN. You do not know how many corporations are members of the chamber?

Mr. REDPATH. No, sir.

Senator McLEAN. When you submitted your referendum, just what was the method of procedure? Did you prepare what you thought was a sound statement with regard to that subject and forward it to your members and ask them whether they approved it or not?

Mr. REDPATH. No.

Senator McLEAN. What did you do?

Mr. REDPATH. The process was this: The board of directors considered that the question of Federal taxation was an appropriate subject for consideration by the chamber. The board of directors is only administrative. It can not go further than to decide that a subject is appropriate for consideration, as of public interest and

of interest to our constituent members. The board then authorized the appointment of a representative committee, the membership of which you have before you. The members of that committee were chosen without any regard to what their own points of view may be on the questions coming before the committee. I want to point out that according to our procedure a committee is asked to arrive at an independent and impartial point of view on these matters, and that the members of our committees begin with very diverse points of view of their own.

This committee on Federal taxation with staff assistance in gathering material, arrived at its report. That report went to the board of directors for administrative action. The board of directors could not pass on the merits of the questions presented in the report. Our board of directors is expressly prohibited from passing upon the merits of reports coming before it. The board took the usual course with his report and ordered it submitted to referendum, deciding merely that the report seemed to be a comprehensive report. That was the extent of their decision.

Senator McLEAN. Let me interrupt you right there.

Senator SIMMONS. Senator, will you not let him finish? I would like to hear him.

Mr. REDPATH. I shall make it very brief, as brief as I can.

Senator McLEAN. All right.

Mr. REDPATH. Our by-laws require that when a committee's report goes out to referendum, there shall be placed in the pamphlet all considerations that seem to be fair to the executive officers of the chamber and that weigh against the recommendations in the committee's report, in order that we may go just as far as we can in our earnest and sincere desire to have the whole subject, both sides of it, spread out before our member organization when they come to a decision.

It happened to fall to me, as is usual in preparing the referendum pamphlet, to deal with the argument against the committee's report. In the pamphlet before you, you will find these negative arguments, for which I am personally responsible, although not officially, because they were accepted by the executive officers as proper arguments. I endeavored to go thoroughly into the negative arguments, and I hope you will find I did a fair job, using the arguments which you will hear here on the other side, and those arguments were, therefore, before our members.

Our members have 45 days in which to cast their ballot. In order that the result may be representative, no organization, no matter how large it may be, can have more than 10 votes, and no organization, if it is an honest-to-goodness organization, has less than 1 vote.

Senator McLEAN. I understand that. Did I understand you to say you argued against the report?

Mr. REDPATH. I personally prepared these negative arguments.

Senator McLEAN. You are opposed to it, yourself?

Mr. REDPATH. I am not.

Senator McLEAN. You argued against it.

Mr. REDPATH. I am a staff man. As I indicated before, I have only one job, and that is to put these things down for exactly what they are.

Senator McLEAN. Do you mean that you were outvoted, and that you now agree with the majority?

Mr. REDPATH. No, sir. I am not here advocating any personal point of view of my own.

Senator McLEAN. Now, Mr. Redpath, let us go back and ascertain, if we can, what sort of a report was submitted to the representatives of these corporations. I take it that you are familiar with that situation.

Mr. REDPATH. There was no report submitted to representatives of corporations.

Senator McLEAN. What was the nature of your questionnaire? What did you try to find out?

Senator BARKLEY. You simply, as I understand you, collated the argument against it, in order that the members, when required to vote on it, might have both sides of the question impartially stated

Mr. REDPATH. That was my function.

Senator BARKLEY. That did not necessarily represent your view, did it?

Mr. REDPATH. No, sir.

Senator McLEAN. I suppose you wanted to get the approval or disapproval of these corporations?

Mr. REDPATH. No, sir. You will have to forgive me if I say again there was no such intention. Nothing was submitted to corporations. The submission was entirely to chambers of commerce, local chambers of commerce, and trade associations of wide representation.

Senator McLEAN. You do not mean to say the corporations themselves or their management did not know anything about it, do you?

Mr. REDPATH. So far as they belong to our member organizations they had an opportunity, like other members of those organizations, to participate in the decisions of those organizations, as to how the organizations would vote.

Senator McLEAN. Do you know whether they did or not?

Mr. REDPATH. I do not.

Senator SIMMONS. Mr. Redpath I understand you to mean that in your presentation you thought it was your duty to present to the membership all the arguments that were used against this report?

Mr. REDPATH. Yes, sir.

Senator SIMMONS. And all the arguments that were made for it were presented by somebody else, if not by you?

Mr. REDPATH. Yes, sir.

Senator SIMMONS. But when you spoke about your argument against it, you were presenting to them not arguments that you had against it, but arguments that were made against it?

Mr. REDPATH. Yes, sir; including a very clear statement made by the Undersecretary of the Treasury, Mr. Mills, at the University of Virginia last August. Things of that sort were all brought together, and we endeavored to present from them all the arguments on both sides, so they could be before our members.

Senator SIMMONS. The effort was to get both viewpoints before the decision was rendered?

Mr. REDPATH. Yes, sir.

Senator EDGE. Does this document I hold in my hand contain the information that went out to the various local chambers of commerce?

Mr. REDPATH. Yes, sir.

Senator HARRISON. Let me ask you this: You said you presented arguments.

Senator SHORTRIDGE. He "argued," he said.

Mr. REDPATH. Pardon me. I presented arguments.

Senator HARRISON. Is this statement made to-day by the representative of the chamber of commerce your personal view with reference to this matter? Do you stand by that proposition?

Mr. REDPATH. I did not know that I was placed on the stand to express my personal views. I understood I was put on the stand to give you any information I could as to the facts. Do you wish me to answer that, Mr. Chairman? I have no particular objection.

Senator HARRISON. All the committee wants is just the situation, and we have some confidence in your ability as an expert.

The CHAIRMAN. You can answer the question, if you desire.

Mr. REDPATH. Personally I support the statement. I think it is a proper statement.

Senator HARRISON. You believe in its soundness, do you?

Mr. REDPATH. I do.

Senator SIMMONS. Mr. Redpath, I want to ask you one or two questions about some matters that you have been over. I want to ask you first with reference to this retirement of the public debt. The Congress has provided for a sinking fund for the amortization of that debt.

Mr. REDPATH. Yes, sir.

Senator SIMMONS. Yes. The Congress has also provided for the payment of the interest.

Mr. REDPATH. All interest; yes.

Senator SIMMONS. The money received from debts due us from foreign governments can also be applied, not necessarily must be, but can be?

Mr. REDPATH. So far as those receipts are on account of interest. But so far as they are on account of principal, they are to be applied according to the terms of the law.

Senator SIMMONS. That is true, under the Liberty loan act?

Mr. REDPATH. Yes, sir; that is, under the Victory loan act.

Senator SIMMONS. Now, in 1927 an effort was made to secure a reduction in taxes for that year, upon the basis of the big surplus that was shown, but that effort was unsuccessful. The surplus was not allowed to be used for the purpose of a reduction in taxation, but in that year, 1927, the last deficiency bill failed. That act carried something over $100,000,000. It failed. Now, at least, the surplus that had been accumulated ought to have been reserved in the Treasury for the purpose of meeting the demands of that deficiency bill, when it was passed, ought it not, in your judgment?

Mr. REDPATH. I believe it was possible to do that. However, with a large surplus that year, and a large estimated surplus for the current year, I should think the Treasury could properly proceed either way. If there has been any reason to expect that the Treasury surplus at the end of the fiscal year 1928 would come down to a narrow margin, however, the procedure you suggest would seem to have been available to the Treasury.

Senator HARRISON. Of course, that is what they could do next year if we do not pass the first section of this bill.

Mr. REDPATH. That is the opinion of our committee.

Senator HARRISON. Part would go over into next year, to make it safe, if there were any question about it.

Mr. REDPATH. Yes, sir.

Senator EDGE. Did you issue a referendum before the tax revision in 1926? Was there a similar referendum sent to your members at that time?

Mr. REDPATH. We have had a series of them, but not one at the time of each revision. Sometimes the decision of the committee was that the chamber's position had earlier been expressed and was still applicable and adequate and, therefore, it was not necessary to present a further report on the current situation: in that case there was no further referendum.

Senator EDGE. My question was propounded with the intention of asking another question. Have any of the results of any of these referendums been different than an overwhelming vote for a reduction of taxes?

Mr. REDPATH. Yes, sir.

Senator EDGE. In what case did they vote against a reduction of taxes?

Mr. REDPATH. There has not been a vote against reduction of taxes since the war period. As was said in the statement read to you, the Chamber advocated immediately after our entrance into the war—the report being made by a committee in April, 1917—a heavy increase in income taxes on individuals and corporations, a heavy excise tax, and an excess-profits tax, and we continued during the war period to advocate the highest possible taxation, for the purpose of making it practicable for the Government to reduce taxation as quickly as possible after the war and thus lighten the burden that would otherwise exist during the period of readjustment.

Senator EDGE. The referendums since that period immediately after the war have all resulted in overwhelming affirmative votes for further reduction in taxes, have they not?

Mr. REDPATH. That is substantially true. The recommendations of our committee have not always carried, but taking things by and large the answer to your question is yes. But in many of our referendums the membership has voted down the recommendation of the committee, taken a position in opposition to its recommendation.

Senator SHORTRIDGE. In respect to the reduction of taxes?

Mr. REDPATH. Not on reduction of taxes. There have been instances where the membership was so divided there was no decision.

Senator SHORTRIDGE. Everybody voted for a reduction in taxes, of course.

Mr. REDPATH. That is not true, Senator. I can answer such a question only in a general way. In our procedure we have no decision unless two-thirds of the votes are cast one way. It is not a 51-49 proposition. The men who were responsible for creating the United States Chamber of Commerce thought it unwise for the chamber to advocate a policy if the margin of opinion in the membership was only 1 or 2 per cent. We advocate nothing, unless in a referendum vote of the members, or in the annual meeting, there is an overwhelming majority of at least two-thirds.

Senator SIMMONS. Then your estimate of $400,000,000 reduction is the result of the approval of two-thirds of your membership?

Mr. REDPATH. Two-thirds of those who cast ballots, and over 75 per cent of the membership cast ballots.

The CHAIRMAN. I had a strange experience once in relation to a vote taken on a question submitted by your committee to a chamber of commerce. I asked the chairman of the chamber of commerce why he voted in favor of it, and this was his answer: "Well, the chamber of commerce committee recommended it, and I took it for granted it was all right and voted for it." In that statement you submitted this morning the committee recommended an immediate reduction. When that ballot goes out, there goes with it the committee's recommendation?

Mr. REDPATH. Yes, sir; that is considered only fair to the committee. There is no question that, of course, in some instances the vote is cast in the way you have suggested. We ourselves and our officers have always campaigned with our members to get them to express their real points of view.

The CHAIRMAN. In that case I refer to, of course, the chamber of commerce immediately, when their attention was called to it, said: "Certainly, we would not have voted that way if we had understood it."

Mr. REDPATH. Mr. Chairman, might I ask if you know how the commercial organization in Salt Lake City voted? It is our understanding it really takes an interest and works very hard to reach a real decision of its own.

The CHAIRMAN. It was not Salt Lake City I had reference to.

Mr. REDPATH. If you wish, I shall be very glad to give you the way in which members arrived at their votes in this tax referendum. We have information.

The CHAIRMAN. I understand that. There is no need taking time on that.

Senator SIMMONS. Did I understand you to say that, notwithstanding you sent out the recommendation of your committee, you also sent out a statement of the argument for the other side?

Mr. REDPATH. Yes, sir; in the same pamphlet, printed on the opposite page. Those arguments are here before you.

The CHAIRMAN. There is no question about it. Every recommendation you make you present the pro and con of that question.

Mr. REDPATH. Yes.

The CHAIRMAN. I am perfectly aware of that.

Senator BARKELY. I see the ballot is signed by Judge Parker, chairman of the board.

Mr. REDPATH. Judge Parker did not sign that. He is chairman of the board of directors, but this statement presented to you is signed by the president of the chamber.

Senator BARKELY. It is the same Judge Parker?

Mr. REDPATH. Yes, sir.

Senator BAYARD. Does the material you put before the committee show the detail method of arriving at a vote by the various members of the organization?

Mr. REDPATH. Yes, sir; the second pamphlet before you, respecting referendum No. 50, Federal taxation, shows in tabular form the name of each of the organizations that voted, and how it voted, together with the number of votes to which it is entitled by reason of its own membership.

Senator BAYARD. And the vote pro and con on the subject?

Mr. REDPATH. That is in the second pamphlet, which gives the information fully.

Senator BAYARD. But the complete tabulation of the votes of the individual members appears in that pamphlet?

Mr. REDPATH. The complete tabulation.

Senator EDGE. How much time do you give the local chambers of commerce in which to cast their ballots?

Mr. REDPATH. Forty-five days. We always give them advance notice that attention will be given by a committee to such a subject as Federal taxation, and that there may be a referendum.

Senator SIMMONS. Have you ever taken a referendum on this question before, or is this the first time?

Mr. REDPATH. We have had a series of referenda on Federal taxation.

Senator SIMMONS. In other years?

Mr. REDPATH. Yes, sir.

Senator SIMMONS. I want to ask you this question: Have you missed it as badly as the Treasury estimates have missed it?

Mr. REDPATH. Well, Mr. Chairman, as I said, I understood I appeared here to give facts. That question, of course, involves the expression of an opinion.

Senator SHORTRIDGE. No; it calls for a fact.

Mr. REDPATH. If I should express an opinion about the matter, I should have to say that all figures on tax reduction are artificial in a sense. If you care for my personal opinion in answer to the question, I believe we have never missed it by the amounts pointed out in our statement.

Senator SIMMONS. Do you know of any authorization to apply this current income to the public debt, any direct authorization of Congress made since the war to apply any portion of the current receipts of the year to the public debt, except as provided in the sinking-fund provisions, the interest payment, and in the foreign-debt provision?

Mr. REDPATH. I understand under the law the Secretary of the Treasury has the discretion to apply all or any part thereof which in his sound discretion he thinks wise.

Senator SIMMONS. Yes. There is an old statute passed long before the war that gives the Secretary of the Treasury some discretion about surpluses that might be accumulated.

Mr. REDPATH. It gives him entire authority, as I understand it.

Senator SIMMONS. But there have been no appropriations made since the war out of current expenses for the payment of this war indebtedness, except such as I have reviewed to you.

Mr. REDPATH. I am very sorry, Senator. I did not quite catch the point of that question.

Senator SIMMONS. You say there is an authority contained in a statute passed before the war by which the Secretary of the Treasury, when he finds an unneeded surplus, may in his discretion apply that surplus to the retirement of the debt?

Mr. REDPATH. That is true.

The CHAIRMAN. March 3, 1881.

Senator SIMMONS. Yes; before the war. But since the war, since that foreign debt has accumulated, foreign and domestic, there has been no legislation of Congress directing that the funds collected from the taxpayers for current expenses should be applied to those debts, except the sinking fund, and the interest.

Mr. REDPATH. That is true, and I have had a search made in the last few days on that subject.

Senator CURTIS. Why should there be, if the law authorizes it?

The CHAIRMAN. And has ever since March 3, 1881.

Mr. REDPATH. Of course, the legislation to which the chairman refers was away back in 1881. That was long before budgetary procedure was set up.

The CHAIRMAN. It never has been repealed.

Mr. REDPATH. It never has been repealed.

Senator SIMMONS. It never has been repealed, that is true, but in the exercise of that discretion it would be presumed that the Treasury would have in consideration always the requirements of the Treasury to meet ordinary expenditures.

Mr. REDPATH. Of course.

Senator SIMMONS. When there was a large surplus in the Treasury, and one of the appropriation bills, carrying $100,000,000, failed by reason of a filibuster, you would think, would you not, as I think you have expressed the opinion, that the Treasury at least ought to retain out of the surplus already accumulated enough to have met that burden whenever the Congress has an opportunity to pass that bill it failed to pass by reason of a filibuster, which provided for the expenditure of something over $100,000,000.

Mr. REDPATH. Well, as I said before, Senator, I personally think it is a matter for the exercise of sound discretion on the part of the Secretary of the Treasury. If there is a large current surplus, and another large surplus assured, I do not see why you should not apply part of the surplus to debt retirement.

The CHAIRMAN. There is no question about 1928.

Senator SIMMONS. What I want to know is, Should he not retain enough of that surplus to pay that appropriation that by accident did not pass, and which is throwing that burden on the taxpayers this year?

The CHAIRMAN. We are not legislating for 1928. We are legislating for 1929 and future years until this revenue act is amended again. What we have to take into consideration is not what we want by way of receipts of money in the present tax bill, but what bill we can pass to meet all the expenses hereafter. It is not 1928, because everybody knows that situation.

Senator EDGE. Mr. Redpath, I would like to know on what you based your opposition to the committee's report.

Mr. REDPATH. Senator, I have had legal training, and I suppose it is part of legal training to prepare one's self to state both sides of a case, and to state them as fairly and frankly as posible. To come to a decision as to which is right, which argument more than offsets the other, is a judicial function. In preparing those arguments I was not performing the judicial function.

Senator EDGE. You must have had some big reason for opposing the recommendation of the committee for a $400,000,000 reduction. I would like to know what it was.

Mr. REDPATH. I am sorry I have not made clear my job on the staff. When a report is sent to referendum—when this report was sent to referendum, I was assigned the task of bringing together all the arguments contra that could be fairly set down, and I did that as honestly and sincerely as I know how.

Senator COUZENS. What the Senator from New Jersey wants to know is, in this referendum No. 50, if you would summarize your opposition as you put it in the referendum. How would you summarize the opposition to that committee's report that went out in that referendum?

Mr. REDPATH. I would hestiate a good deal about trying to summarize it, off-hand.

Senator COUZENS. That is what he is asking you if you can state now.

Mr. REDPATH. This is a fairly long argument to summarize without any notice.

Senator EDGE. Even a lawyer is presumed to have convictions. The inference that I obtained from what you said a few moments ago was that your own conviction was that the reduction was too great.

Mr. REDPATH. No. If I used any such language as that, I certainly did not intend to. What I meant to say was that I did as honestly as I knew how the job given to me, and that was to put down the argument which should fairly be considered against the committee's report.

The CHAIRMAN. If that is all, Mr. Redpath, we will hear from Mr. Mills.

Senator SIMMONS. Mr. Chairman, I want to ask him one more question.

Mr. Redpath, I asked you those questions about the foreign debt and this discretionary power of the Secretary of the Treasury to apply any surplus in the Treasury that may not be immediately needed for the purpose of rather suggesting to the chamber of commerce, because I hope they will act upon it, that a referendum be taken with a view to ascertaining whether we ought not to determine definitely by law how much money we want to apply to the payment of this debt annually and take away from the Secretary of the Treasury the discretion to apply any more to the payment of that debt than the Congress determines should be applied to it.

Mr. REDPATH. That question has already been before our committee on Federal taxation, and that committee has expressed the view that the present provisions are liberal and generous. That committee has full jurisdiction, if it is so convinced, to make a recommendation that the annual amount should be increased. It has not made such a recommendation, although that kind of a recommendation is thoroughly within its jurisdiction. The amounts, of course, are very considerable. I do not need to repeat them before your committee.

Senator BARKLEY. Is it your view, or the view of the chamber, that the existence of this old statute, under which the Secretary may retire debts out of the surplus, offers any justification for permitting accumulations of surpluses and taking advantage of that old law?

Mr. REDPATH. You have asked two questions and I can answer them both: No.

Senator HARRISON. As I understand it, your judgment is that this report filed by Mr. McWhirter this morning is sound and correct.

Mr. REDPATH. Yes, sir.

The CHAIRMAN. You will hear from Mr. Mills of the Treasury Department.

Senator SIMMONS. Does anybody else want to be heard on the report of the committee?

The CHAIRMAN. This is all who have asked to be heard.

Senator SIMMONS. Is there anybody here representing the chamber of commerce that desires to present their views?

The CHAIRMAN. No. I understand that is all.

Senator HARRISON. Mr. Chairman, I think the same opportunity should be afforded to the members of the chamber of commerce to ask Mr. Mills questions as was afforded to Mr. Mills.

The CHAIRMAN. Certainly. There is no question about that

STATEMENT OF HON. OGDEN L. MILLS, UNDERSECRETARY OF THE TREASURY, WASHINGTON, D. C.

Undersecretary MILLS. Mr. Chairman and gentlemen of the committee, I would like to complete my discussion of the subject without interruption, if I may.

Senator SIMMONS. Mr. Mills, before you begin, I would like to know this: The Treasury Department has made a statement to this committee. The chamber of commerce has made a statement with reference to that matter to this committee. Now, you are going to answer the statement of the chamber of commerce. It seems to me that we ought to allow the chamber of commerce an opportunity, if they desire, to further answer your statement.

Undersecretary MILLS. That, of course, is a matter for the committee to decide.

Senator SIMMONS. I want to ask the committee if that course will be pursued.

The CHAIRMAN. I do not know what he is going to say.

Senator SIMMONS. I do not know either.

Senator CURTIS. Of course, if they want to answer him, they should be given the opportunity.

Undersecretary MILLS. Mr. Chairman, let us consider the situation. Along in the latter part of August or the early part of September of last year a committee composed of business men and some tax experts adopted a report which was submitted by referendums to the membership of the chamber of commerce. At that time the chamber of commerce took the position that there would be $400,000,000 of surplus available in 1929 for tax-reduction purposes. I take it that the majority of the members when asked, "Do you want a further tax reduction, which we believe is possible, answer yes or no," of course, said "Yes; you tell us we can have $400,000,000; we want it." I am not sure, because I have only glanced at this somewhat hastily, but a cursory glance at the pamphlet indicates that even when a member voted for $250,000,000 or $225,000,000, they were listed by the chamber as being in favor of a $400,-

000,000 tax reduction. That is something I think they should explain, but that is a minor matter.

Senator BARKLEY. May I interrupt you?

Undersecretary MILLS. Yes.

Senator BARKLEY. Ballot No. 1 calls for a flat expression for or against a reduction of $400,000,000.

Undersecretary MILLS. The fact is, some of them in answering it specified $225,000,000 and $250,000,000, and were listed under the straight statement of $400,000,000, which carries the implication that they favor a reduction of $400,000,000. However, as I say, that is a minor matter.

The CHAIRMAN. Yes; I think so.

Undersecretary MILLS. The point to be emphasized is that in August the chamber started out with the definite assertion that there were $400,000,000 available without disturbing the present fiscal practices of the Treasury Department. Their statement to-day is a complete confession of error in that respect.

Senator HARRISON. Why is it?

Undersecretary MILLS. It is a carefully masked retreat, but it is a complete retreat, nevertheless, because they say they still stand for a $400,000,000 tax reduction, but they no longer claim it is available from current revenue. They point out that the only way it could be achieved is by changing the policy of the Government with respect to its long-established practice of closing its books at the end of every fiscal year and making every year stand on its own legs; and, in the second place, they say it can only be achieved by liberal changes in the policy with reference to debt retirement.

Senator HARRISON. They point out that you were wrong in your estimates of back taxes.

Undersecretary MILLS. I will get to that in a minute, if you will pardon me, Senator.

It is therefore apparent that they have completely reversed their position. It is no longer their position that there will be available $400,000,000 of current revenue, but they say you can have $400,000,000 worth of tax reduction, providing you change the policy of the Government with reference to debt retirement and change the policy of the Government with reference to closing its books at the end of each fiscal year.

In respect of the charge of underestimating the surplus, the Treasury has repeatedly requested the representatives of the chamber of commerce to come here and frankly point out, not in general terms, not in terms of past years, but to come here and point out specifically what particular items were overestimated. It is all itemized. Is customs overstated? Is miscellaneous internal revenue overstated? Is the estate tax overstated? Is the corporation tax overstated? Is the income tax overstated? Is the back tax overstated? Here is a vast organization with a large staff which has been working for months, and very obviously has been scratching very hard for the last three months to attempt to justify their original estimate. And they come here this morning and are able to make only two criticisms of the Treasury estimates. They concede the correctness of our estimates in every particular, with two excep-

tions. One is in reference to current revenues from income taxes, and the other is with reference to back taxes.

Senator SIMMONS. Mr. Mills, you do not content, do you, that if the surplus in the Treasury were to justify a reduction of $400,000,000 or $300,000,000, the Treasury can say, "We want to take part of that surplus and apply it on the public debt, and Congress can not reduce taxes upon the basis of the surplus, because we want part of it for the public debt"?

Undersecretary MILLS. Senator, that is not the position of the Treasury Department. The position of the Treasury Department, as evidenced by the report made to this committee, is to apply every single penny of available surplus to tax reduction, not a penny for debt retirement. That is the position of the Treasury Department. We recommended to this committee that it apply every available penny to tax reduction.

Senator SIMMONS. Did you not take a surplus you had and apply it to debt retirement, when you knew that by an accident a bill carrying $100,000,000 had failed, and you ought to have retained enough of that surplus to meet it?

Undersecretary MILLS. I am afraid, Senator, with all due respect, that that question does not bring out clearly, to say the least, the fiscal practices of the Treasury Department in carrying on its current operations.

Senator SIMMONS. Does it not mean that the Treasury Department is determined to exercise its discretion and use that surplus, notwithstanding Congress has made it clear that it wants to use that surplus to reduce these taxes that are abnormal, with a view to getting as near to a normal basis of taxation as possible?

Undersecretary MILLS. Senator, if you will let me answer the question without interruption, I should like to do so, because it is a little complicated.

Senator SIMMONS. I will not interrupt you, if you do not want me to.

Undersecretary MILLS. No; it is not that so much, but it is very complicated and has to be explained very fully to be understood.

There is outstanding at all times, and has been since the war, a certain amount of floating debt. The very able gentleman who managed the Treasury Department during the war time devised a very ingenious and sound method of meeting the very heavy tax payments that fall due every quarter day. We receive anywhere from $400,000,000 to $500,000,000 in taxes four times a year, either on a quarter day or in the course of three or four days. The withdrawal from the market of $400,000,000 or $500,000,000 four times a year would at once create a violent disturbance in the money market, and a violent disturbance to the business and trade of the country.

Since, therefore, there was in existence by reason of the war a floating debt, the maturities of that floating debt were so fixed that a certain part of it would fall due on every one of the quarter tax days. In other words, on the 15th of March, when we expect something like $500,000,000 in tax receipts, we have $500,000,000 of certificates or notes falling due. The result is that the taxes received in the Federal reserve banks are immediately paid out to the holders of the maturing certificates, the two transactions balance, and there is

no disturbance to the money market. It was by means of that method that a year ago on the 15th of March the Federal reserve bank in the city of New York, one bank alone, handled $2,000,000,000 worth of Treasury business in a single day without the slightest disturbance to the money market.

Senator SIMMONS. Let me ask you this question.

Undersecretary MILLS. Please, Senator, permit me to complete this explanation without interruption.

Senator SIMMONS. Very well.

Undersecretary MILLS. Now, it is perfectly obvious that if we have $500,000,000 of tax receipts and have $500,000,000 of maturing certificates the two transactions wash. But we have completely used up all of our tax receipts, some of which at least should be available for the expenses of the Government over the succeeding three months. Therefore, the Treasury Department, in addition to its tax receipts issues a new lot of certificates or notes which will mature at a future quarter day, when the operation will be repeated. The amount of notes and certificates which it issues on that particular quarter day is governed entirely by the cash requirements of the Government over the next three months.

The result of that system which has been set up is that these surpluses of which you talk are book surpluses. They are not cash surpluses. The Treasury Department never has on hand more money than is actually necessary to finance it for the current three months' period from quarter day to quarter day.

Now, there has been a good deal of public discussion of surpluses. If those surpluses were in actual cash, were cash surpluses in bank, and that is what is always discussed, what would it mean? It would mean that we would issue for that cash surplus of $100,000,000, $100,000,000 of certificates. These certificates bear 3¼ to 3½ per cent interest. We only get 2 per cent on our bank balances. For every day that unnecessary $100,000,000 was carried the Government would be losing from 1¼ to 1½ per cent.

It is sound business practice for the Treasury Department to keep its cash requirements at all times to a minimum, and that inevitably means that the surplus which accumulates during the course of a year is automatically used up in reducing the floating debt, so that at the end of the year there is no such thing as a cash surplus. There is simply on hand on the 30th of June the cash necessary to carry the Government from the 15th of June to the 15th of September. The surplus is automatically applied to debt reduction, and it seems to me there is no other practice which could be justified by sound business principles.

Senator SIMMONS. Now, Mr. Mills, may I interrupt you?

Undersecretary MILLS. Yes.

Senator SIMMONS. I think most of the members of this committee understand pretty thoroughly that it is perfectly justifiable and has been absolutely necessary for the Treasury Department to issue these certificates of indebtedness in anticipation of taxes to come in during the year, and so much of these certificates as are issued for that purpose, of course, ought to be paid out of the revenues derived for that year. But this is what I have in mind, and it seems to me to be a controversy largely between the Treasury Department and the Congress. The Congress has made it very clear that it is

exceedingly anxious as soon as practicable to reduce taxes to a normal basis. reduce war taxes to a normal basis, and I think it has made it very clear that it wants all the funds that are not necessary for the meeting of our foreign indebtedness, the interest upon it and the sinking fund, to be used for the purpose of bringing about this reduction in taxation.

Undersecretary MILLS. We are in complete accord.

Senator SIMMONS. Now, if the Treasury should take any part of this fund that otherwise would remain in the Treasury and apply it on the principal of that debt, in order to more rapidly reduce the principal of that debt, then the Congress has specifically provided in legislation since the creation of the debt, there is a conflict between the desire of the Congress with reference to the reduction of the debt and the funds that shall be used as a basis of that reduction, and the Treasury Department.

Undersecretary MILLS. Let me make it entirely clear that there is no difference, no controversy between us. We both want to apply every penny of surplus to tax reduction. If, however, in any given year there happens to be a surplus in excess of the estimate, what would you do, Senator? Would you carry that surplus in bank and lose 1¼ to 1½ per cent a day on it, or would you retire certificates and save that money?

Senator SIMMONS. I would let the Congress reduce taxes. We wanted to reduce taxes in 1927, and you would not let us do it, because you said you thought it better to take that surplus and apply it to the debt than to reduce taxes.

Undersecretary MILLS. Senator, I would prefer, if you would let me, to complete my statement with reference to the chamber of commerce. They made a complete and continuous statement, and no questions were asked until they had completed their statement.

Senator SIMMONS. I thought we did ask them some questions, but I will not interrupt you any more if you would rather not be interrupted.

Undersecretary MILLS. I would rather point out, if I may, the errors in that statement.

Senator SIMMONS. I really do think, Mr. Mills, and have thought for some time, that there was a fundamental disagreement between the purpose of the Congress, as indicated in the debate and by the action of Congress, and the Treasury Department, with reference to the use of these annual surpluses for debt purposes instead of for tax-reduction purposes.

Undersecretary MILLS. Senator, I am very glad to have an opportunity to correct your impression in that respect, so far as the Treasury is concerned.

Senator SIMMONS. Do you mean to tell me that of that large surplus, out of which we wished to make a reduction in 1927, and the President said, "No: do not do that, but refund part of it"—do you mean to say you did not use any part of that surplus for the purpose of reducing the public debt?

Undersecretary MILLS. We unquestionably did, but we were confronted with an existing situation. The only problem before us was whether to carry excessive bank balances or reduce the debt. When Congress does reduce taxes, there will be no surplus. When Congress does not reduce taxes, and we are confronted with a surplus,

the question which arises then is whether we are to carry idle bank balances or apply it on the outstanding debt.

Incidentally, may I remark that that very surplus of last year enabled us to a very large extent to undertake a colossal refunding operation, refunding the second Liberty loan, amounting to $3,000,000,000, and by that operation we saved $75,000,000 in interest, which is now available for tax reductions.

Senator EDGE. What was the approximate amount of debt reduction in the four quarters of last year?

Undersecretary MILLS. We exhausted the entire surplus.

Senator EDGE. How much was it?

Undersecretary MILLS. There was a very large surplus—over $600,000,000—and with the exception of $24,000,000 that entire surplus was exhausted during the course of the year.

Senator SIMMONS. Did you put any part of that $600,000,000 into the payment of the principal of the debt?

Undersecretary MILLS. Of course we did, Senator. If we had not we would have just had it in the bank.

Senator SIMMONS. Here is what I wish to ask you: You say you should not carry a large amount of money in the Treasury because you lose interest by doing it, and yet I understand from your statement that generally you do not have very much money in the Treasury that you have no immediate use for. But you knew in the last session of Congress, when that bill failed by an accident, that the next Congress would pass that bill immediately upon reassembling. Why would it have been a great hardship upon the people if you had retained enough of that surplus to have settled that, instead of carrying that over?

Undersecretary MILLS. It would not have affected this year's surplus in any event. We would have carried more cash than we needed and lost 1¼ per cent on it.

Senator SIMMONS. I understand you have practically changed the whole system of bookkeeping.

Undersecretary MILLS. No. As far as I know, from time immemorial they have closed the books at the end of each fiscal year. We do not merge fiscal years.

Senator SIMMONS. Have you not, since you went up there, very materially modified the system of bookkeeping, so as to make a different showing of the surplus from the one that would have obtained under the old form of bookkeeping?

Undersecretary MILLS. No. I found in existence as perfect a system as I can well imagine, and Senator, with full credit to your party, that system was established by them during the war, and it is an admirable system.

Senator SIMMONS. I am glad to know you are retaining it. I had been advised that you had changed the system of bookkeeping.

Undersecretary MILLS. I would like to take credit for all the changes that may have been made by me, but that is not one of them.

Senator SIMMONS. And that affected the showing of the surplus very materially?

Undersecretary MILLS. No, Senator, that is not the case.

Now, if you will permit me, while the Senators are still here, I will answer the more recent statement of the chamber of commerce.

I say it is a complete confession of error in their original estimate, and a complete confirmation of the Treasury figures, with two exceptions. They say we underestimated current income taxes by approximately $122,000,000. How did they reach that figure? Back in December some of their experts took the statistics of income, and they took the total net income reported by corporations and applied 13½ per cent to that, and said that would yield more than the $1,120,000,000 which the Treasury assigned to corporations. There are two figures you can take to estimate the yield of current income taxes. One is the statistics of income, and the other is actual collections. Which is the more reliable of the two? Actual collections did not give them the figures they wanted, so they turned to statistics of income and arbitrarily assumed that the Government would realize 13½ per cent on the net income of all the reporting corporations.

Now, had they bothered to consult the Treasury, they would have known the situation from beginning to end. There has never been a time when our books have not been open to the chamber of commerce, but they have carefully refrained from coming to the only source where they could obtain original figures, and have taken statistics of income and then applied a theoretical basis in order to reach the possible revenue.

Senator HARRISON. Would you have any objection to their letting us know if they agree with that proposition?

Undersecretary MILLS. They do not disagree with it. They can not disagree with it, because in their most recent statement they discussed the method of arriving at their conclusion. They apply 13½ per cent to the 1925 income, and say that the 1926 and 1927 income would certainly be larger than that of 1925. If their theory of using statistics of income instead of collections had been a true one, we should have had $122,000,000 more for the fiscal year 1928.

Senator HARRISON. Let me ask you a question there.

Undersecretary MILLS. Senator, I must insist that I be permitted to make a continuous statement.

Senator HARRISON. I think the chamber of commerce denies that statement; and we are left up in the air about it.

Undersecretary MILLS. The chamber of commerce can not deny it.

Mr. REDPATH. The chamber of commerce does deny it. It is not a true statement. Those figures were taken from Treasury statistics for tax liability actually shown upon returns, and were not obtained from the application of 13½ or 13 per cent, arbitrarily or otherwise, to total net income. The figure taken was the figure shown by the Treasury itself as taken from the income-tax returns of corporations filed.

Undersecretary MILLS. That confirms exactly what I said. I say they have made a complete reversal in their statement just submitted.

Senator SIMMONS. What I want to say is this——

Undersecretary MILLS. I think I should be permitted to continue without interruption. I will answer you when I am through.

Senator SIMMONS. I want to say the chamber of commerce has presented its view and has made a statement here; and you, instead of making a statement, are making a speech and argument.

Senator EDGE. I think Mr. Mills has made a fair statement.

Senator SIMMONS. I do not want argument; I want facts.

Undersecretary MILLS. Here are the facts: On page 3 of this report just submitted to you in this statement:

CORPORATION INCOME TAX

We find that corporations showing any net income for 1925 had an aggregate of $9,340,000,000 in taxable income and showed on their returns a tax liability of $1,170,000,000, at the rate of 13 per cent. Through data published by the Treasury in December, 1927, it is demonstrated that the total taxable income shown by corporations for 1926 taxable year was increased over 1925 by at least $200,000,000, or to $9,540,000,000. On this figure therefore, at the rate of 13½ per cent, the total corporate tax due, according to the 1926 returns, would seem to be at least $1,242,000,000. It has now become evident that the tax liability shown by corporations upon their returns for 1927 will not vary substantially from the tax liability for 1926.

In other words, they took the statistics of income, showing net income for 1925. They then said that since income as returned for 1926 was in excess of the income in the returns filed by the corporations for 1925 applying 13½ per cent to the income as revealed by the returns, would yield an increase in revenue of approximately $122,000,000 over the Treasury figures. As a matter of fact, collections do not come up to the amount indicated by the original returns, and the Chamber of Commerce could have found this out with the greatest of ease had they taken the trouble to consult the Treasury Department. Moreover, the statement of the chamber is silent as to revenue from the individual income tax, which if the corporation figure is increased must be correspondingly decreased to make the total conform to actual collections.

Senator EDGE. What was the difference?

Undersecretary MILLS. It varies from year to year. It is very difficult to say, Senator. The great difficulty in making these estimates is that up to July of last year corporation and individual income-tax collections were not seggregated. Therefore, it is impossible to tell just how much was collected from corporations and how much from individuals. But the fact is that the method which they adopted was demonstrated to be palpably false by the March returns, because collections corresponded with the March collections of last year. The March collections of last year were based on the net income of corporations for 1925 and 1926, and the March collections of this year were based on the net income of corporations for 1926 and 1927.

The collections were identical, in spite of the fact that the statistics of income showed an increase. In other words, on finding out that the figures of collection, which are the only reliable ones, would not sustain their contention, they deliberately turned to statistics with the arbitrary assumption that you could apply 13½ per cent to the net income reported, less deductions, and that would be the revenue which you would receive. If they were correct, the figures for 1928 income collections would have been $122,000,000 up, because they estimated that the income returned for the calendar years 1927 and 1926 was so much above that of 1925 that it should yield $122,000,000 more this final year than last year.

It seems clear, therefore, that their method of estimating revenues from statistics rather than collections can be demonstrated by actual experience to be unsound.

That is their major criticism of the Treasury estimates. They first come here in the face of March returns, with a theory that has been exploded by those returns, in an attempt to show you how you can get an additional $122,000,000. They then talk about our back-tax collection estimates. We took their own figures which they put out on January 3. They said at that time that our estimate of $180,000,000 was $40,000,000 or $50,000,000 too low. We said, "All right, we will raise it $40,000,000." We raised the figure to meet their estimate of January 3, and yet on April 3 they come before this committee and say they want to raise the ante another $50,000,000.

Senator HARRISON. Mr. Mills, let me ask you this question.

Undersecretary MILLS. Now, Senator, if I may, I would very much prefer to conclude this without interruption.

Did they offer anything to support that additional increase of $50,000,000? What do they say? Some one of their members informed them that his firm had $100,000,000 before the Internal Revenue Bureau. That is their basis for criticizing our estimate. They have some vague notion in the back of their heads—and they certainly did not get it from any official figures—that there is a vast accumulation of cases in the Internal Revenue Bureau. Three or four months ago they said there were $600,000,000 or $700,000,000 tied up in the Board of Tax Appeals that would yield a large amount next year. We pointed out that out of that $600,000,000 in eight months we only realized some $33,000,000, and a good many of those cases will be appealed to the courts. When it had been demonstrated that there was not such a fruitful field in the Board of Tax Appeals, they now say there must be a vast accumulation of cases in the Internal Revenue Bureau.

Now, let us see whether this second theory of the chamber of commerce is sound and what the facts are. On June 30, 1923, there were 3,000,000 cases on hand in the bureau: on June 30, 1924, 2,430,000: on June 30, 1925, 2,011,000: on June 30, 1926, 487,000: on June 30, 1927, 154,000: on March 30, 1928, 66,000 on hand in the bureau. What is more, it is common knowledge that all the big back tax cases, the war cases, excess-profit tax cases, have been disposed of, and we are doing business on a current basis. According to their own estimate in January our present estimate is correct. They do not tell you why they have changed it except one of their members told some one his firm had $100,000,000 tied up in cases before the department. Well, what of it?

Except for those two criticisms, neither of which has any basis of fact or reason, they accept the Treasury's estimates. That is the plain truth of their statement. It sounds very plausible, but with the exception of the use of income statistics for estimating current tax receipts, instead of using collections, and except for the fact that they have increased their own estimate of back taxes by $40,000,000 since January 3, they accept the Treasury figures in toto.

Now, let us see just what this means. They have completely abandoned the statement they made to their own members and to the country last fall that there were $400,000,000 of current revenue available for tax-reduction purposes, an estimate which they are not able to make good in the face of the March collections.

Senator HARRISON. Mr. Chairman, the bell is ringing in the Senate. Can we not have a meeting this afternoon?

Senator SIMMONS. I will stay here, Senator. I am interested in hearing Mr. Mills's speech.

Undersecretary MILLS. It does not have the advantage of being a prepared speech, because I only saw this statement five minutes before I came in.

Senator SIMMONS. I understand that. I heard you criticising the chamber of commerce, and I recall that in every tax bill we have made the Treasury Department has been likewise criticised very severely, and its estimates have been disregarded. We have raised our reduction in every one of those bills far above the estimate of the Treasury Department. Every time we were threatened with a deficit, and not a single time has there been a deficit, but every time a large surplus.

The CHAIRMAN. We have the March returns now and know what they are.

Senator SIMMONS. I suppose we will hear some more when it gets upon the floor of the Senate, just as we have ever since I have been here and ever since we have been making tax bills.

The CHAIRMAN. Of course, we expect that.

Senator SIMMONS. We have every time made reductions far in excess of what the Treasury Department said would be sure and safe, and in the face of pronouncements by the department that a deficit would be inevitable if we did it. The last deficit was to be $51,000,000 unless we raised the tax on corporation incomes from 13 to 13½ per cent, and we had a very quick emergency meeting to do that to meet the threatened deficit. We did it, and in that year I think there was a surplus, instead of a deficit, of $600,000,000. I am merely saying to Mr. Mills that the Treasury Department estimates are not sacrosanct.

Undersecretary MILLS. Oh, no.

Senator SIMMONS. They have been found to be unreliable in every instance where we have undertaken to pass tax-reduction bills.

Undersecretary MILLS. Well, let us take the chamber's statement, then, Senator. Let us take their statement, and throw our estimate out. How do they tell you that you can get $400,000,000 tax reduction, and the only way you can get it? By two very important and fundamental changes of policy. The first change is to suggest that the United States Government should not close its books at the end of the fiscal year, but should merge the two fiscal years by carrying over the surplus. Whether they know exactly what they are advocating is not entirely clear, because after advocating that on page 8 they make this rather surprising statement on page 9:

> The chamber has always contended that the revenue side of the Budget of the National Government should each year properly provide for the expenditure side.

That there should be a balanced budget in each year. Yet they are suggesting that in 1929 we have an unbalanced budget, because the only means of making it balance is to carry over some surplus from 1928. In one breath they say the practice always followed by this Government of balancing its budget is sound, and in the next

breath they say we should discard it and recommend that we carry over the surplus from 1928 to 1929 and incur a deficit in 1929. That is what they recommend on one page, and condemn it on the following page.

Now, let us see what that means. In the first place, I think it is the soundest budgetary practice to treat each fiscal year as a single economic unit, close your books at the end of the year, and see that revenues and expenditures balance in that year. To attempt to carry over a surplus from one year to another is to break down that system, because it is very obvious that if you can carry over a surplus you can also carry over a deficit. We would be very soon, if we adopted the principle they recommend, budgeting on a deficit basis, because the anxious gentlemen who want tax reduction would say it is all right to incur a deficit because the following year will make it good.

In the second place there is no justification in this particular case for carrying over this particular surplus. It does not represent a surplus of current revenues over current expenditures. It represents a surplus of approximately $200,000,000 of current revenues over current expenditures and of something like $189,000,000 received from capital assets.

Take the $162,000,000 of repayment of railroad loans. During the war we borrowed money through Liberty bonds from the people and loaned it to the railroads. Now the railroads are repaying that money. The total is $162,000,000 this fiscal year. What is the most legitimate way in which to apply the payments on those loans? Why, to retire the loans that made them possible. We issued $162,000,000 of Liberty bonds and loaned the money to the railroads, and they are repaying it. It is not proper practice to apply the repayments to those bonds? Of course, it is. That is the surplus they are asking you to carry over into next year and make available for current expenditures.

What is the next vice in their proposition? Inasmuch as this surplus, to the tune of about $189,000,000, is the result of receipts from capital assets, and therefore can not recur, it is obvious that if you obtain a tax reduction of $400,000,000 in 1929 by carrying over the receipts from capital assets from this year to the next, when actual current revenues will only yield $200,000,000, in 1930 you will have a deficit of approximately $200,000,000. And when the Congress meets in December you will have to raise the tax rate in order to make good the deficit in the year 1930.

These gentlemen are telling you to carry over 189,000,000 of funds received from capital assets this year, in order to reduce taxes by $400,000,000 next year. There will not be capital assets receipts in 1929 to carry over into 1930. Having reduced taxes by $400,000,000, you would have to raise them in December in order to balance the Budget in 1930.

The CHAIRMAN. Put in the record what the capital assets amounted to.

Receipts from railroad and other securities and from capital assets, fiscal year 1927, and estimates for 1928 and 1929

	1927	1928	1929
Railroad securities	$89,000,000	$162,000,000	$30,000,000
Farm-loan bonds and other securities, etc.	63,000,000	5,500,000	4,000,000
War Finance Corporation	27,000,000	3,500,000	
Sale of surplus war supplies	8,000,000	5,000,000	4,000,000
Navy oil judgment	[1] 5,000,000	13,000,000	
	192,000,000	189,000,000	38,000,00
Surplus	635,000,000	401,000,000	212,000,000

[1] Exclusive of amount paid in Liberty bonds aggregating $5,500,000 principal amount.

Undersecretary MILLS. $162,000,000 from the railroads.

Senator SIMMONS. I understood Mr. Mills to say we borrowed this money on Liberty bonds.

Undersecretary MILLS. Yes. It was borrowed during the war.

Senator SIMMONS. When are these bonds payable?

Undersecretary MILLS. $1,500,000,000 are payable next September, third Liberty bonds.

Senator SIMMONS. I am speaking of these particular bonds.

Undersecretary MILLS. I may say a great part of the railroad receipts for this year have been applied directly to the payment of third Liberty bonds.

Senator SIMMONS. That is true of all the money we borrowed. We borrowed it and sent it right away, one way or another. But we issued bonds for it, and provided for the payment of those bonds by a sinking fund and interest charges.

Undersecretary MILLS. Leaving all that aside, it is the most extraordinary suggestion I ever heard coming from business men, that $189,000,000, representing extraordinary and nonrecurring receipts from capital assets which happen to come in in 1928 should be carried over to 1929 in order to enable you to reduce taxes by $400,000,000 next year, when in the face of their own figures they would have to increase them again by $200,000,000 in December. It is fantastic.

In the third place, the carry-over does not mean anything as a practical matter. I have already explained to you that we absorb all excess tax receipts currently, by not issuing more notes and certificates than we actually need. We will continue to do that. That is practical business and you certainly will not quarrel with the saving of 1¼ to 1½ per cent. What we will do is to retire securities with excess cash in the fiscal year 1928, and then if you instruct us to do it, carry over a bookkeeping surplus from 1928 to 1929, and then during the year 1929 increase the public debt by $189,000,000 by selling the necessary securities in order to furnish the cash to make good the book surplus which you have instructed us to carry over.

In other words, the proposition they baldly make to us is this: There will not be current revenue enough to afford $400,000,000 tax reduction in 1929, but if you issue $200,000,000 more securities and increase the public debt you can, of course, reduce taxes. We do not need experts from the chamber of commerce to tell us that. We all know that if we issue enough securities we can do away with all taxes next year. They suggest that we increase the public debt by

$200,000,000 in order to reduce taxes by $400,000,000. Why not increase the public debt $800,000,000 and decrease taxes by $1,000,000,000?

Now, let us come to the second change in policy, which is based in part on misinformation. They are evidently under the impression that all interest from foreign loans is applied to debt reduction. If they had asked a few questions from those who know they could have gotten correct information. All interest is not so applied. All of the interest received in cash at once goes into the general fund under miscellaneous receipts and forms part of the surplus, but you gentlemen will remember that in the debt agreements which were ratified by Congress it was provided that the debtor nations could pay principal and interest in securities. Now, when a foreign nation avails itself of that privilege and pays the interest in securities, there is nothing for the Treasury to do but to cancel those securities. We have no authority in law to reissue them. And when they are canceled, to that extent they constitute additional debt reduction.

Now, get this, Senators: All of the cash received for interest goes into the miscellaneous fund, and under the law is not applied to debt reduction. When interest is paid in securities that constitutes increased debt reduction, because there is nothing to do except cancel those securities.

Now, you can say "That is all very true. We are not questioning the fact that the Treasury is acting under the law as it exists, but what reason is there why Congress should not change the law, and why the Congress should not instruct the Treasury that if by chance any foreign debtor pays interest in securities those securities should at once be reissued and so diminish the amount of debt reduction that takes place each year." I say such a proposition is unsound, in my judgment, though I recognize that opinions may differ on matters of policy.

The CHAIRMAN. Will you yield just a moment? I want to put this information into the record at this place.

The vote on Senate Resolution 236 was 52 to 28, and this is the resolution offered by the Senator from Nebraska:

Resolved, That it is the sense of the Senate that any surplus now in the Treasury arising from taxation should be applied toward the payment of the national debt.

The roll was called and the result announced as follows: Yeas, 46; nays, 33.

Senator SIMMONS. What was the date of that?

The CHAIRMAN. February 4, 1927.

The following Senators voted yea: Bingham, Blease, Cameron, Capper, Couzens, Curtis, Dale, Deneen, Edge, Fess, Frazier, Goff, Gooding, Greene, Hale, Howell, Johnson, Jones of Washington, Keyes, La Follette, Lenroot, McLean, McMaster, McNary, Means, Metcalf, Moses, Norbeck, Norris, Nye, Oddie, Pepper, Phipps, Pine, Reed of Pennsylvania, Robinson of Indiana, Schall, Shipstead, Shortridge, Smoot, Stanfield, Stewart, Wadsworth, Warren, Weller, and Willis.

The following Senators voted nay: Ashurst, Bayard, Bratton, Broussard, Bruce, Caraway, Dill, Ferris, Fletcher, George, Gerry, Glass, Harris, Harrison, Hawes, Heflin, Jones of New Mexico, Ken-

drick, McKellar, Mayfield, Neely, Overman, Pittman, Robinson of Arkansas, Sheppard, Simmons, Smith, Steck, Stephens, Trammell, Tyson, Walsh of Massachusetts, and Walsh of Montana.

Undersecretary MILLS. If I may resume, Senator, you will remember that the proceeds from Liberty bonds were applied to two purposes. One was our own war expenses, and the other was making extensive loans to foreign governments. According to the terms of the original Liberty loan acts, provision was made for a retirement of that portion of the debt representing foreign loans, as the Liberty loan acts required that the repayment by foreign governments should be applied to the retirement of a corresponding amount of the domestic debt. The original Liberty loan act also provided that foreign loans should under no circumstances bear a lower rate of interest than the corresponding domestic debt. It was very clearly the idea of the Congress that the money repaid by foreign governments, both principal and interest, would take care of the corresponding amount of domestic debt.

Senator SIMMONS. There is a difference of opinion between you and me about that. I think you are mistaken about that. I think that ought to be applied in that way.

Undersecretary MILLS. There was a contract between the United States Government and its bondholders, and the bondholders had every reason to believe that the foreign government loans would take care of an equal amount of Liberty bonds.

The CHAIRMAN. With the rate of interest which the foreign countries paid.

Undersecretary MILLS. When it came to the Victory loan act, we undertook to take care of the domestic part of the debt by providing a sinking fund.

Senator SIMMONS. That is what the chairman is talking about.

Undersecretary MILLS. It does not just apply to the domestic part. The rate, however, was figured on the basis of the domestic end of the debt, while the repayment of foreign loans was expected to retire the balance. Again that constitutes a contract with the bondholders.

Senator SIMMONS. I want to be very frank about this. I was chairman of the committee at the time those Liberty loans and Victory loans were being made, and we were getting money to lend to our allies. We provided in those bills that the money that was paid in by the foreign governments on their indebtedness, principal and interest should be applied to the payment of that amount of our debt.

Undersecretary MILLS. Yes.

Senator SIMMONS. But I do not think that applies to that part of the debt which was the domestic part.

Undersecretary MILLS. That is entirely correct.

The CHAIRMAN. The 2½ per cent applies to it.

Undersecretary MILLS. But this is what happened. We made a certain number of debt settlements with these foreign debtors, and when we did we broke our contract with our own bondholders, because we agreed to allow these foreign governments to repay a certain amount, which would not repay the loan in full, principal and interest, by any manner of means. We diminished the security to that extent.

Now, as a practical matter from the standpoint of the foreign governments when they make a certain fixed payment every year, it is of no consequence to them whether you label that payment principal or interest. As a practical matter, it is of no consequence to this Government, except that by labeling it principal we apply it to the reduction of the debt, whereas, by labeling it interest we use it for current expenditures. In the case of Great Britain, she pays $25,000,000 of principal and $135,000,000 of interest. If we only apply the principal which we receive from foreign governments to retiring the corresponding part of our domestic debt, it is very obvious that it will take 62 years to retire it. During those 62 years the rate of interest which we will pay on that domestic debt will be infinitely higher than that which we receive from the foreign governments, because we have compromised on the rate of interest and in some cases we only receive a fraction of 1 per cent.

The CHAIRMAN. And in some cases no interest at all.

Undersecretary MILLS. And in some cases no interest at all. For every year that we allow our domestic debt to remain outstanding, we lose the difference between the interest which we pay to our bond-holders and that which we receive from the foreign governments. Therefore, it is very obviously to the benefit of the United States Government in some measure to forget that part of the payments are named interest and part are named principal, and to apply some of the interest we receive from foreign governments, which might just as well have been labeled a repayment of principal, to the reduction of our debt. I submit that is sound.

Senator SIMMONS. I want to ask you if the amount appropriated annually by Congress for the payment of interest does not cover all this bonded indebtedness?

Undersecretary MILLS. The amount we pay out every year? The $670,000,000 we pay as interest?

Senator SIMMONS. Yes.

Undersecretary MILLS. Yes.

Senator SIMMONS. That applies to the whole of it?

Undersecretary MILLS. Yes.

Senator SIMMONS. And with this sinking fund we would pay off that debt in 25 years?

Undersecretary MILLS. Not the whole debt, no. We would pay off the domestic part of it in less than 25 years.

Senator SIMMONS. Did we not provide interest on the bonds from which we received money to lend to foreign governments?

Undersecretary MILLS. Yes. Assuming that we retired the corresponding part of the American debt, entirely from repayments of principal from foreign governments, it would cost us at 3½ per cent interest, which is less than we are paying now, over a period of 62 years, approximately $28,000,000,000. We would receive from the foreign governments during that same period $22,144,000,000. So we would lose $6,000,000,000.

Senator SIMMONS. I want to understand this. Let me ask you this question. When you paid this interest on this bonded indebtedness, and you got Liberty bonds and the sinking fund, did you not continue to pay interest on the bonds you bought?

Under Secretary MILLS. No; We add that to the sinking fund the next year so that fund increases every year.

Senator SIMMONS. Thereafter you have to pay it?

Under Secretary MILLS. Oh, yes. The sinking fund payments do not in a sense reduce interest charges, because the law provides that interest saved swells the sinking fund for the following year.

Senator SIMMONS. If that sinking fund is not sufficiently large, leaving out the accumulation as a result of adding that interest from year to year, if that is not large enough it ought to be increased, so that we could retire all of our indebtedness, both domestic and foreign, within a given time.

Under Secretary MILLS. I agree with you there, but the situation is not anything to complain of. I am simply pointing out that as the interest received in cash from foreign governments goes into the general fund as miscellaneous receipts and constitutes part of the surplus, to that extent the chamber is wrong. I am pointing out that a certain proportion of the interest paid in the last four years has been paid by the British Government in securities. Since we could not reissue them, they had to be canceled. I am further pointing out the fact that this interest applied to debt reduction is nothing to be deplored. We have a debt of about $18,000,000,000, and we are reducing it on the basis of the Treasury figures by about $535,000,000 this year. I do not think $535,000,000 debt reduction on a debt of $18,000,000,000 is excessive. It is not out of line with the historical policy of our Government. Yet the chamber is saying that $535,000,000 is too rapid debt reduction, and we should steal $140,000,000 of that and apply it to tax reduction.

Senator SIMMONS. I do not understand them to mean that. I understand them to mean that only the interest received should be applied to the indebtedness.

Under Secretary MILLS. That is conceded, Senator, as interest goes into the general fund, except where it is paid in securities.

Senator SIMMONS. But they do not say the principal received should not be applied to the payment of foreign indebtedness.

Under Secretary MILLS. No, but the fact is that if we take the principal repayments from foreign loans, plus the British interest, which they have been accustomed to paying with securities, and add that to the sinking fund, it would constitute a debt reduction of about $535,000,000. That is what the Treasury estimates allow for. If you want to increase the Treasury estimate of tax reduction by some $200,000,000, it obviously means that instead of having $535,000,000 of debt reduction, you will have $335,000,000 of debt reduction. And that is what the chamber suggests, though they do not come out and say it in so many words. If they did come out and say they are advocating a debt reduction of $350,000,000, I venture to say they would hear from their membership in mighty quick order.

Senator SIMMONS. I would like to know what the Chamber of Commerce has to say with reference to your construction of what they said.

Under Secretary MILLS. I am not construing their statements. I am pointing out what their figures mean. Their figures are not accurate at all, because they have included all interest, whereas all interest is not applied to debt reduction. So their figures can not be used. You can not use the figures in their statement, because they are not correct figures. They are $25,000,000 to $30,000,000 off.

That may seem an inconsiderable item, I will admit, but $25,000,000 or $30,000,000 do mean something when you are trying to present correct estimates. To apply all of the interest, including that paid in securities, to tax reduction would mean that the debt reduction next year would be for all practical purposes limited to the sinking fund and to the fairly small amount paid on the principal of the foreign debt. The Chamber of Commerce in effect is recommending that we reduce the debt at the rate of about $400,000,000 each year.

Senator SIMMONS. Including the amount of interest applied to foreign debts and the amount applied to principal, how much will you reduce the public debt?

Undersecretary MILLS. We are recommending $541,000,000 next year.

Senator SIMMONS. Both principal and interest?

Undersecretary MILLS. No. The interest on our debt will amount to $670,000,000. We are recommending the retirement of approximately $541,000,000 of the principal.

Senator SIMMONS. Of the principal?

Undersecretary MILLS. Yes. Those are approximate figures.

Senator SHORTRIDGE. Which would leave an outstanding national debt of how much?

Undersecretary MILLS. About $17,000,000,000.

Senator SHORTRIDGE. And your interest amounts to about $670,000,000?

Undersecretary MILLS. It will be $670,000,000 next year. We are carrying on refunding operations constantly. If we retire $1,500,000,000 of 4¼ per cent bonds in September we will be reducing the interest. That will be an increased saving. It is difficult to say what it will be in 1930.

Senator SHORTRIDGE. If you apply the interest upon the whole indebtedness and apply $535,000,000 to the public debt—how much is the public debt at this time?

Undersecretary MILLS. A little under $18,000,000,000 to-day. Roughly speaking, $18,000,000,000.

Senator SHORTRIDGE. How long do you think it will take to pay the debt?

Undersecretary MILLS. We calculate it will take until about 1950.

Senator SHORTRIDGE. About 20 years?

Undersecretary MILLS. Yes, 22 years.

Senator SHORTRIDGE. To retire the whole debt?

Undersecretary MILLS. Yes. That is the policy recommended by the Treasury Department.

Senator SHORTRIDGE. We are giving our foreign debtors 62 years.

Undersecretary MILLS. Yes, but on what terms, Senator?

The CHAIRMAN. That is it.

Undersecretary MILLS. That is the trouble. It is 62 years in some cases without interest, but interest is running against the domestic debt every day, Sunday included.

Senator SHORTRIDGE. And some gentlemen want them canceled?

Undersecretary MILLS. And some gentlemen want them canceled.

Senator SIMMONS. The Treasury Department is in favor of paying off that debt in 20 years?

Undersecretary MILLS. Just about 20 years.

The CHAIRMAN. And those other gentlemen are very influential in the United States. I saw a letterhead the other day with both sides filled with names of prominent citizens of the United States who belong to an organization the avowed purpose of which is to secure the cancellation of the foreign debt. The propaganda is going on every minute of the 24 hours.

Senator SIMMONS. There is propaganda going on in favor of all sorts of things in this country, but I think the propaganda in favor of canceling our foreign indebtedness entirely represents a very small part of the citizenship of the United States.

Senator SHORTRIDGE. I hope you are right, Senators.

The CHAIRMAN. I think that is true to-day. I do not know what it will be in a little while.

Undersecretary MILLS. There are a number of minor matters which I could take up and criticize, but I do not think it would get us anywhere. I want simply to deal with the main points of this most recent chamber of commerce program.

Senator MCLEAN. Your idea is that when you reduce taxes you want them to stay reduced?

Undersecretary MILLS. Yes. When we cut, we want them to stay cut. In the second place, the Treasury believes very firmly that a program of reducing a debt of $18,000,000,000 by $541,000,000 next year is not excessive. It also believes it is thoroughly unsound to carry over a surplus of one year, resulting from the receipt from capital assets, into another year, and thus break down the system which has existed for all time of closing the books at the end of each year. It further believes that it is equally unsound to reduce taxes by $400,000,000 when you have only got $212,000,000 surplus in sight from current revenues, the result of which will be an increase of the public debt by $200,000,000, which is the net effect of this proposition. I want to say in conclusion that after the smoke has blown away and you analyze this statement carefully, you will find the Chamber of Commerce has completely abandoned the position it took in the fall that $400,000,000 are available for tax reduction, and it now says you can get $400,000,000 tax reduction, but you will have to resort to two new devices. You will have to deliberately slow up the debt-reduction program by $140,000,000 a year, and in the second place, they suggest we carry over a surplus from one year to another. Those are two important changes in the fiscal policy of the United States Government. It is conceded, of course, that by using those devices you can increase the tax reduction. But the chamber of commerce comes in here to-day and takes this unsound position, which represents a complete abandonment of their original position that there was available $400,000,000 in current revenue for tax reduction. They now say we can have it by tapping the surplus in 1928, or by slowing up the rate of debt reduction.

Senator SIMMONS. I want to ask if there is any objection to the actuary of the Treasury preparing a statement and presenting it to this committee, estimating how long it will take to pay our entire indebtedness if there is applied to it only such funds as are specifically provided for by the law, outside of the application by the Treasury Department of any part of the surplus.

Undersecretary MILLS. What you would like is the length of time it will take to retire the whole debt, with sinking fund and principal repayment.

Senator SIMMONS. Sinking fund we have provided, and interest payments that we have provided, with the application to that debt of such receipts as we may obtain from foreign debtors?

Undersecretary MILLS. On account of principal.

Senator SIMMONS. On account of principal and interest. I want a statement from the actuary of the Treasury advising us how long it will take to pay off the public debt if that method is followed.

Undersecretary MILLS. All right. We will get that.

Senator SIMMONS. I understand the chamber of commerce will be given an opportunity to reply to Mr. Mills.

The CHAIRMAN. Yes. We will hear from them now.

STATEMENT OF FRANK C. PAGE, ESQ., REPRESENTING THE UNITED STATES CHAMBER OF COMMERCE

Mr. PAGE. I am afraid that I can not be as eloquent as the Undersecretary of the Treasury was in making his statement regarding what he called our misstatements, and in presenting to you our interpretation of the facts as we understand them.

Senator SIMMONS. Mr. Page, I do not think the committee wants any eloquence about it; it wants simply facts.

Mr. PAGE. I want to ask Mr. Redpath again, who has taken some notes of Mr. Mills's statement, to reply to them, if I may. I want to bring up just one point, and then I will ask that Mr. Redpath be heard again.

I want to refer to the first thing that Mr. Mills mentioned. In the tabulation of the votes on this referendum only those votes which were cast for the total $400,000,000 reduction are listed in the pamphlet as having voted for it. It states there 131 votes cast qualifying their opinion on the tax reduction, and those are not included in the tabulation as shown here of those voting for the full $400,000,000 reduction, but are included in the addenda to the list which shows exactly the opinions of those chambers of commerce.

I think that is the only point which I wish to take any time on, and I would like to ask Mr. Redpath, if I may, to give the chamber's point of view of Mr. Mills's statement.

STATEMENT OF JOHN M. REDPATH, ESQ., MANAGER RESEARCH DEPARTMENT, UNITED STATES CHAMBER OF COMMERCE—Resumed

Mr. REDPATH. I understand Mr. Mills takes the position that the chamber of commerce has altered its attitude. As to that the Senate committee is thoroughly competent to judge. It has before it the full text of our committee's report, the referendum, the result of the referendum, and the statement made to-day. I submit there has been no change of any kind in the chamber's position. There is not, so far as I am aware, and I believe I am very familiar with the whole matter. Is that sufficient on that particular point, Mr. Chairman?

The CHAIRMAN. State whatever you want to state.

Senator SIMMONS. He said you had surrendered your position, or changed your position, or both.

Mr. REDPATH. The position of the chamber is set out in the committee's report, and there has been no change.

The CHAIRMAN. In the position taken by you last November you included this $160,000,000?

Mr. REDPATH. Yes. That is in the report. Also the surplus carried over.

Undersecretary MILLS. Is it not a fact that you claimed a surplus of $400,000,000 last fall, independently of those items?

Mr. REDPATH. No; if I understand what you mean.

The CHAIRMAN. I am glad that information came out. I was of the same opinion as Mr. Mills. You never said $400,000,000.

Mr. REDPATH. Our committee's report is before you. You can there find just what it said.

Undersecretary MILLS. I have no desire to misrepresent the position of the chamber.

Mr. REDPATH. I do not assume you do.

Undersecretary MILLS. The chamber has never claimed there would be a surplus of $400,000,000 available for tax reduction for 1929, except by drawing from these two items?

Mr. REDPATH. I would have to say it has. Of course, the answer to the question put in that way is yes.

The CHAIRMAN. These two items would have to make up the $400,000,000, the items referred to by Mr. Mills?

Mr. REDPATH. No.

The CHAIRMAN. Then how do you make up the $400,000,000? I can not understand that. If you will submit the figures, showing how you make up that $400,000,000 without the two items referred to by Mr. Mills, I will see that they get in the record. I can not figure out how you can do it, but maybe you can.

Mr. REDPATH. Would you like them for the record?

The CHAIRMAN. Yes. I would like to have you hand them to me.

Senator SIMMONS. Let us have them in the record.

The CHAIRMAN. They will be in the record.

The statement for the record is as follows:

In a public statement issued under date of January 3, 1928, copies of which were sent to members of the Senate Finance Committee, it is observed that to the $252,000,000 of surplus then officially estimated for June 30, 1929, there should be added an amount on account of the conservatism of that estimate. It was suggested that the corporation income tax would yield about $135,000,000 more than the Treasury estimated and that back taxes would yield about $50,000,000 more than the Treasury estimated. These two items added to the surplus of $252,000,000, the official estimate, made a total of $437,000,000.

The Treasury has not yet made any specific allowance for increased yield in the corporation income tax, but it has added $5,000,000 from current income tax of both kinds, and $40,000,000 to its estimate of yield from back taxes, offsetting these amounts by $85,000,000 on the expenditure side, although that total sum has not yet been voted by Congress. By this calculation it now reduces the surplus earlier estimated at $252,000,000 to $212,000,000 for June 30, 1929.

In support of the proposition that the official estimate of the 1929 surplus is too low, we desire to refer also to the assertion that, since the March collections from income tax are now known, the collections for the remainder of the calendar year—including the first two quarters of 1929 fiscal year—are known. Collections for the March quarter in recent years have varied from 32.2 per cent of the total for the four quarters of the calendar year to 26.5

per cent. Last year the percentage was 27.6 per cent. Any calculation based upon the collections in the March quarter of 1928, therefore, may prove to be wide of the mark by an amount running into the hundreds of millions.

Apparently some confusion has arisen from the circumstance that the chamber has said, and believes that the Treasury estimate for June 30, 1929, of a surplus of $212,000,000 is still too low and repeats that statement in to-day's presentation. It has to-day made the further explanation that, wholly disregarding any possible increase in yield over the Treasury estimate of surplus, the whole chamber program of tax reductions and repeals could be allowed.

This is clear by reason of the discretionary power resting with the Secretary of the Treasury to carry over, say, $251,000,000 from the surplus of the current fiscal year (now estimated at $401,000,000). This $251,000,000 added to the $212,000,000 estimate of 1924 gives a total of $463,000,000, while in that year, without allowing for any increase for growing taxable income of the country, the chamber's program would not reduce public revenues by more than $394,000,000. The further point is made that if need be the power rests with the Treasury to devote up to $160,000,000 of foreign interest payments as an offset against the interest which our Government is paying to the American holders of Government securities, thereby reducing the charge on current taxes by that amount.

It is obvious that there has been no shift in the argument, but simply two separate presentations.

Undersecretary MILLS. Mr. Page calls my attention to the fact that it was not in the original statement, but in the January 3 statement, that the claim was made there would be $400,000,000 available exclusive of those items.

Mr. PAGE. I am not able to state exactly when that was made, if it was made. I know it was not made in the referendum. I do not know that it was ever made, but I know it was not made in the referendum.

The CHAIRMAN. What I have been figuring on is trying to arrive at the $400,000,000.

Undersecretary MILLS. Mr. Chairman, here is the flat statement of the chamber made in January:

Therefore, even if it be assumed that the Government's earnings upon which receipts from the corporation income tax for the fiscal year ending June 30, 1929, will be based will only equal those of 1925, and that the 1929 receipts from that tax will be only $230,000,000, the receipts from all other sources are sufficient to allow the 1929 surplus to be about $430,000,000.

Here is another made last fall:

While tax reductions are always acceptable to taxpayers, yet revenues must be sufficient to support the Government on a reasonable basis. During the fiscal year ending June 30, 1927, the Federal Government not only paid expenses, including the sinking fund of over $333,000,000 for the retirement of the national debt, but there was a huge surplus of over $635,000,000. Analysis of the pertinent facts indicates that the tax reductions advocated above—the reduction of the corporate income tax to 10 per cent, the repeal of the Federal estate tax, and the abolition of the war excise taxes on particular businesses—could all be accomplished without interfering with the normal fiscal operations of the Government.

* * * * * * *

Taking all facts into account and making allowance for the normal expansion of business reflected in increased earnings which in turn would yield additional taxes, the reduction of rates advocated herein would, it is estimated, result in an annual decrease of revenues ranging from $350,000,000 to $400,000,000, of which about half might be applicable to the fiscal year 1928. In view of these data, there appears no doubt that the reductions are well within practical possibilities.

* * * * * * *

While no deficit is anticipated should the rate reductions advocated herein be made effective, it is obvious that in view of the excellent credit standing of the Government and the low interest rates at which it can borrow money, there

would be no great cause for alarm even though a deficit should, through unexpected developments, arise in any year. Budgets should therefore be framed with proper but not undue caution based upon reasonable expectations and not upon pessimistic appprehensions of the worst that might happen.

The CHAIRMAN. I would like to have the figures you have. I would like to have you figure that out some way. I can not figure it out, unless you take those two items referred to by Mr. Mills. I may be wrong and you may be right.

Mr. REDPATH. I am trying to state the definite facts. The committee's report and the referendum thereon is our starting point.

Senator SHORTRIDGE. What was the date of the committee's report?

Mr. REDPATH. September, 1927.

Senator SHORTRIDGE. And the referendum followed?

Mr. REDPATH. The referendum followed, the date being October 7, 1927.

Senator SHORTRIDGE. I notice that the Palo Alto Chamber of Commerce voted no on your first proposition.

Senator SIMMONS. Go ahead with your statement.

Mr. REDPATH. Another point made was that the surplus was merely a book surplus. I think I spoke to that sufficiently before. The surplus has in the other years been carried forward. The Treasury's own statements show it, and the point made by our committee was that part of it could now be carried forward.

Reference was made to the method of computation, and some criticism was made of the use of the statistics of income as published by the Treasury for the taxable year of 1925. The statement was made that we got the figure by taking the net income shown and applying the tax rate to it. We did not.

The CHAIRMAN. No. The statement was made that it was an estimated amount and not the actual amount.

Mr. REDPATH. Yes.

The CHAIRMAN. That it was the statistical figures, rather than the actual amount.

Mr. REDPATH. The Treasury published the amounts of tax liability of corporations shown when the returns were filed. That is, the figure that appears and the figure with which we started, for lack of any other figure as to corporations in the possession of the department, according to their own statement to us.

Senator SHORTRIDGE. You took the figures as they were made from the returns, rather than the actual collections?

Mr. REDPATH. In view of the lack of any other figures segregated for corporations. We were informed on inquiry, and the inquiry was confirmed by Mr. Mills himself, that the Treasury does not have a record over recent years showing the collections in a fiscal year against the tax liability shown on the returns of corporations, or a record of the amount of the taxes shown on returns of corporations which became delinquent in any fiscal year. These delinquent current taxes at present enter into the figures for back taxes. Therefore, since these merely delinquent taxes reported on the returns of corporations appear in the figures for back taxes, the figures for back taxes do not show the amount of additional taxes assessed on corporations upon audit of the returns. As the records are kept those figures are impossible of ascertainment. Members of our staff worked earnestly on that, feeling that figures of that kind were necessary,

if estimates of sound character are to be made as to probable receipts from the corporation income tax.

The CHAIRMAN. Do you claim your estimates were made upon the only information you could procure?

Mr. REDPATH. Yes, sir. And that same information has been used by the Treasury in estimating its $90,000,000 as the loss to be expected from reduction in the rate of corporation income tax by one point, as from 13½ per cent to 12½ per cent.

Undersecretary MILLS. Which was corrected, though.

Mr. REDPATH. May I ask when it was corrected?

Undersecretary MILLS. The figures submitted to the Senate committee do not estimate $90,000,000 in that case.

The CHAIRMAN. He has the actual amounts now.

Mr. REDPATH. We started with the only figures they could give us, and since there is a delinquency each year in what they call current taxes there is a compensation each year from the preceding year. That is, if from the tax liabilities shown for 1925 there were $100,000,000 of taxes not collected within the year when due, obviously there are uncollected current taxes for earlier years received in that year, and these amounts offset each other. That is the basis of the calculation, and we have gone at it as earnestly as possible and felt it was a fair basis of calculation, in view of the absence of other figures of the kind I have mentioned.

Senator SHORTRIDGE. You based your estimate as to the future upon figures in the returns. Is that right?

Mr. REDPATH. Yes, sir; taken from the returns by the Treasury Department. Nobody else has access to the returns.

Senator SHORTRIDGE. Exactly. You did not know at that time how much would be collected?

Mr. REDPATH. No; but we considered it a fair basis, with their most extraordinary provisions for collecting, reducing losses to a minimum.

Senator SHORTRIDGE. As you stated, and perhaps it was the only method you could adopt, you started out with the sum total of the exact liabilities as evidenced by the returns?

Mr. REDPATH. That is correct.

Senator SHORTRIDGE. But you did not know and could not know then how much would be paid. Is that correct?

Mr. REDPATH. That is correct. Nobody knows.

Undersecretary MILLS. We know now, because we have the actual figures of collection.

Senator SHORTRIDGE. That is what I was coming to. Now we know.

Mr. REDPATH. You have figures of collections of current taxes of corporations, for the current corporate tax due within the year when collected and, separately, corporate tax receipts, delinquent tax from earlier years, and in addition to that there are figures for the same years showing the additional taxes collected from corporations?

Undersecretary MILLS. May I answer that question?

The CHAIRMAN. He asked you the question.

Undersecretary MILLS. This is what we have. We have the actual figures of collections for March from corporations and individuals. The distinction which bothers Mr. Redpath is largely academic from

the standpoint of revenue. It is interesting to know the total amount received from corporations and the total amount received from individuals, and those are the statistics which we should have, and we have got them now. We have not got them for the earlier years, but from a revenue standpoint the important figure is the total amount received from both individuals and corporations, and the total amount to be received from both individuals and corporations is now absolutely known, because the March returns give us the collections.

Senator SHORTRIDGE. And, of course, it is less than the original returns?

Undersecretary MILLS. Yes. The Government does not collect all the taxes due any more than a merchant collects all the outstanding liabilities that may be owed to him. But it is fantastic to go back to statistics of income, when we have the actual collections to give us definite figures.

Mr. REDPATH. I do not want to prolong this matter, but may I point out that all Mr. Mills knows now is the combined collection of current taxes from corporations and individuals. There is no proper segregation.

Undersecretary MILLS. There is to-day. Get that straight in the record. There is to-day.

Mr. REDPATH. There may be recently, but there was no segregation over recent years which can serve as a basis for estimating the receipts.

Undersecretary MILLS. There is complete segregation beginning July 1, 1927. Those figures are available and have been available to you right along, if you wanted to get the facts. You did not have to go to statistics of income. We would have given you the record of collections.

Mr. REDPATH. I do not want to dwell on this unduly, but merely wish to indicate our understanding that there are not even to-day records of the kind I mentioned a moment ago.

Undersecretary MILLS. I make the positive assertion that there are.

Mr. REDPATH. The current taxes which are delinquent are necessarily a large amount. Therefore, to-day there is no way of estimating accurately the real back taxes that are actually collected.

Senator SHORTRIDGE. There is no way of determining what comes from corporations and what comes from individuals?

Undersecretary MILLS. There is to-day. There was not formerly.

Senator SHORTRIDGE. It is either a fact or it is not a fact.

Mr. REDPATH. There is not a basis to estimate the full amount of the true back taxes.

I understood Mr. Mills to say that 85 per cent of the cases in 1926 have now been closed.

Undersecretary MILLS. Closed for all time, too.

Mr. REDPATH. That means that the important cases may all still be open. If you took all the individual returns showing $25,000 or more each in net income and all the corporation returns showing net income of $100,000 or more, you would have the entire remaining 15 per cent. The income-tax structure is such that the sizable returns, while producing by far the greater part of the receipts, are numerically a small percentage of the total number of returns.

I might refer to a number of other things, but I wish to refer to only one or two. There is the suggestion our figures mean that we propose a part of the present national debt shall be outstanding for 62 years. I would like to point out that in view of the debt retirement already made, the sinking fund alone would take care of the domestic part of that debt well before 1942. Besides, between now and 1942 there would be received under the debt settlements something like $4,000,000,000.

Undersecretary MILLS. Principal and interest.

Mr. REDPATH. Yes; being applied now.

Undersecretary MILLS. Oh, no. I must correct you.

Mr. REDPATH. Pardon me. I refer to the budget. The Budget state how receipts from that source for the current year are applied.

Undersecretary MILLS. That is not true.

Senator SHORTRIDGE. What part of the national debt will be retired by 1942?

Mr. REDPATH. Through the sinking fund, and through the application of receipts from abroad, about $11,000,000,000.

Senator SHORTRIDGE. In 14 years?

Mr. REDPATH. Yes.

The CHAIRMAN. If the foreign debts are paid?

Mr. REDPATH. If the foreign payments are kept up.

Undersecretary MILLS. And if all the interest is applied.

The CHAIRMAN. And if all the interest is applied.

Mr. REDPATH. That is correct, and it has been so applied up to the present time.

Undersecretary MILLS. Let me make this statement for the record, and I will correct the figures afterwards. My recollection is that of the total interest paid $785,445,274 of interest has gone into the general fund, and only $631,434,150 has been applied to debt retirement. The flat statement was made that all the interest has been applied to debt retirement, whereas as a matter of fact $785,445,274 have gone into the general fund and only $631,434,150 have gone to debt retirement.

Mr. REDPATH. I think the Budget will answer that question. It shows the exact receipts and the amounts applied.

I might mention a number of other matters, but I will stop at only one. That is that all receipts on account of assets, like railroad securities, were acquired from money borrowed. I have referred before to the position the chamber took in asking for heavy taxation and supporting it in every possible way. Taxation was in fact very heavy. In 1920 the Secretary of the Treasury set out in his annual report an estimate of the cost of the war. He took out what he assumed would have been the cost of the Government if there had been no war, trying to get at the war cost separately, and he showed $33,000,000,000 as the total net war cost. That included the amount against which obligations of foreign governments has been received to the extent of about $9,500,000,000. He showed against this total of $33,000,000,000 over $10,000,000,000 of receipts from war taxes. Therefore, on that showing alone it appears that at least one-third of that money came, not from borrowing, but from taxation. Of course, if we omit the amount of the obligations taken from foreign

governments, with the understanding they would be paid, the percentage of the war cost met from taxes was much greater.

Undersecretary MILLS. Will you permit an interruption?

Mr. REDPATH. Yes.

Undersecretary MILLS. The total cost of the war, as estimated by the Treasury in last year's report, was $47,000,000,000.

Mr. REDPATH. Of course, I was talking of the net cost of the war, over and above the cost of the Government if there had been no war. I am using the Secretary's report for 1920 in that connection. The recent figures are not on the same basis.

Senator SHORTRIDGE. Under the debt settlement with foreign nations, what is the sum total due us now?

The CHAIRMAN. A little over $11,000,000,000.

Mr. REDPATH. On account of both principal and certain interest that was funded.

The CHAIRMAN. The English will pay out in 62 years about $11,000,000,000.

Undersecretary MILLS. All governments will pay about $22,000,000,000 in 62 years, assuming that they pay it.

Senator SHORTRIDGE. Mr. Redpath, did I understand you to say that your calculation was that the sinking fund would pay off the domestic debt in about 14 years?

Mr. REDPATH. Yes; earlier than that. It was originally calculated that the sinking fund each year would pay it off by 1942, but large surpluses have been applied in addition.

The CHAIRMAN. Do you mean to state that only the sinking fund will pay it off by 1942?

Mr. REDPATH. The domestic part.

Senator SHORTRIDGE. What do you mean by the "domestic part"?

Mr. REDPATH. The part not offset by obligations received from foreign governments.

The CHAIRMAN. I think you are right about the domestic part of it.

Senator SHORTRIDGE. I understand you to say if you leave out the domestic debt it would leave about $7,000,000,000 unpaid. If the domestic debt is paid off by 1942 and $7,000,000,000 are left unpaid, will the receipts from foreign indebtedness be applied to that $7,000,000,000 unpaid?

Undersecretary MILLS. It will leave a good deal more than $7,000,000,000 unpaid. The domestic debt to-day is about $8,062,000,000. The estimate of the Treasury is that at a rate of interest of 3¾ per cent and the sinking fund as now provided by law it will take about 16 years to retire approximately $8,000,000,000, whereas the total debt is $18,000,000,000. So the sinking fund will retire $8,000,000,000 out of the $18,000,000,000 in 16 years from June, 1927.

Senator SHORTRIDGE. I understood Mr. Redpath to say that by 1942 the sinking fund would liquidate the domestic debt and leave about $7,000,000,000 still unpaid.

Mr. REDPATH. The operation of the sinking fund and the application of the payments received meanwhile on the foreign debts would do it.

Senator SHORTRIDGE. I understand that, but at the end of that time we would only owe about $7,000,000,000 in 1942?

Mr. REDPATH. Not in excess of that.

Senator SHORTRIDGE. The foreign debt would not have been paid by that time?

Mr. REDPATH. Not all of it.

Senator SHORTRIDGE. And the receipts from foreign indebtedness after 1942 would be applicable on this $7,000,000,000 remaining unpaid?

Mr. REDPATH. Certainly.

Senator SHORTRIDGE. How long would it take us to pay off the entire indebtedness under the present system, eliminating any application by the Treasury for the payment of that debt out of accumulated surplus, except as provided by legislation since the war?

The CHAIRMAN. You mean at the 2½ per cent?

Senator SHORTRIDGE. That is about what it amounts to.

Undersecretary MILLS. About 22 years.

Senator SHORTRIDGE. About 20 years?

The CHAIRMAN. Yes.

Undersecretary MILLS. I think it is about that. It certainly would not be before that.

The CHAIRMAN. We will adjourn now, and meet at 2.15 in the committee room in the Capitol.

(Whereupon, at 1.15 o'clock p. m., the committee adjourned for the noon recess, to meet again at 2.15 p. m. in the committee room in the Capitol Building.)

AFTER RECESS

The hearing was resumed at the expiration of the recess, at 2.15 o'clock p. m.

The CHAIRMAN. If the committee will come to order we will proceed with the hearings.

At the request of Arthur A. Ballantyne, chairman of the committee on taxation of the Association of the Bar of the City of New York, I submit for the record a brief prepared by him and ask that it be put in at this point.

(The brief referred to is as follows:)

(Mr. Arthur A. Ballantyne of New York, chairman of the committee on taxation, association of the bar of the city of New York, appeared before the committee and submitted the following report:)

REPORT UPON THE REVENUE BILL OF 1928, AS PASSED BY THE HOUSE OF REPRESENTATIVES

NEW YORK CITY, *April 2, 1928.*

The special committee on taxation of the Association of the Bar of the city of New York respectfully submits this report for consideration in connection with the Federal revenue bill of 1928, now pending before the Senate Finance Committee. The report deals with the questions relating to matters of legal right and procedure and administrative features of the bill, rather than with questions of policy.

1. *The retroactive provisions of the bill which destroy vested rights, or impose tax liability on transactions which gave rise to no tax liability under the laws in force when the transactions took place, should be eliminated from the bill.*—Title I of the bill, the income tax title, takes effect generally as of January 1, 1927. Other provisions of the bill are retroactive in effect to an earlier date. In those cases in which these retroactive provisions destroy vested rights or create tax liabilities which did not exist under the laws in force when the transactions occurred, your committee believes that the changes are highly undesirable, and that the provisions, if retained in the bill, should be modified so that

they will apply only to transactions taking place after the bill becomes law, and so that they will not destroy vested property rights. The principal provisions to which this recommendation applies are as follows:

(*a*) Distribution of installment obligations (sec. 44 [d]): Section 44 of the bill contains an entirely new provision with respect to the ascertainment of gain or loss upon the disposition of installment obligations by those reporting on the installment basis, and makes this applicable to 1927 transactions. Under this provision taxable income would be realized even if the installment obligations were given away or distributed to stockholders. In so far as this provision imposes new burdens with respect to past transactions, your committee feels that it is undesirable. In some of its aspects, this provision seems to be of doubtful validity, even as applied to the future.

(*b*) Basis for gain or loss (sec. 113): Section 113 of the bill, which embodies generally the basis for gain or loss provisions of section 204 of the revenue acts of 1924 and 1926, omits in paragraphs 7 and 8 of subdivision (*a*) the parenthetical clause "(other than stock or securities in a corporation a party to the reorganization)" which appeared in both the 1924 and 1926 acts. By these changes transactions had in 1927 in reliance upon the provisions of the 1926 act will be subjected to substantial additional taxes, and, in fact, transactions originating as far back as 1918 and 1921 may be adversely affected. Your committee believes that changes such as this, materially affecting the amount of taxable income realized from classes of transactions involving many taxpayers, should not have retroactive application.

(*c*) Dividends out of earnings accumulated prior to March 1, 1913 (sec. 115): Section 115 defines a dividend as meaning any distribution by a corporation to its shareholders out of earnings or profits. All prior revenue acts since the 1916 act have permitted the distribution of earnings accumulated prior to March 1, 1913, free from tax. Distributions made in 1927 from earnings accumulated prior to March 1, 1913, were entirely free from tax under the laws in existence when the distributions were made, and this had been the law for 10 years. This retroactive change would, therefore, impose a wholly unanticipated tax liability on distributions which were tax-free under the long-established laws in force when they were made. Your committee believes that this change in the law, if adopted, should not apply retroactively.

(*d*) Validation of waivers filed after expiration of period of limitation (sec. 506): Under existing law there is serious doubt whether waivers filed after the statute of limitations had run against the Government are of any effect. Section 506 of the bill proposes to remove this doubt by providing retroactively that such waivers are effective, thus, perhaps, destroying vested rights which taxpayers are now asserting in pending litigation. Your committee feels that this provision of section 506 of the bill should be eliminated and the validity of such waivers left for judicial determination.

(*e*) Retroactive invalidation of refunds and claims for refund (secs. 608, 610): In the past it has been the practice of the Treasury Department to allow refunds based on court decisions affecting large classes of cases, if the claims for refund were filed in time, even though the time for bringing suit in that particular case had expired. Section 608 would make such refunds in the future invalid and thus invalidate many good claims now pending in the department, and makes necessary a suit in each individual case. Furthermore, section 610 (b), although not clear, apparently gives the Government the right to recover any refunds made in the past, where the taxpayer had not actually begun suit within the statutory period. These provisions not only destroy generally recognized rights but adopt a policy for the future which will greatly and unnecessarily increase the volume of litigation. It will no longer be possible to settle large classes of cases by the judicial determination of a test case, but suit will have to be entered in each individual case.

(*f*) Collection of barred taxes (secs. 611, 612): Section 611 would authorize the Government to collect taxes assessed prior to June 2, 1924, where claims for abatement were filed, although the collection of such taxes is now barred by the running of the statute of limitations, and would authorize the Government to retain collections of such taxes although such collections were entirely illegal and improper when made and the taxpayers are entitled to recover them. Furthermore, the bill proposes to repeal section 1106 (a) of the revenue act of 1926 as of February 26, 1926 (sec. 612). Section 1106 (a) provides that the running of the statute of limitations against the Government not only bars the remedy but extinguishes the Government's right. These changes are sought to be justified largely because of the large amounts of

money involved, but the fact that the legislation would destroy vested property rights to large amounts of money and thus cause much rather than little destruction of property rights, can hardly be urged to justify such action. These extremely drastic provisions will operate most prejudicially upon purchasers of property and corporate stock who justifiably relied on the statutes and decisions indicating that the collection of these assessments was not only barred but that the Government's right to the tax was entirely extinguished. Congress has for a number of years adopted the wise policy of placing a limit upon the time within which the Government may enforce tax liabilities. Such limitations entrap rather than help business men if the running of the statute of limitations does not close the matter and furnish a basis upon which large business transactions can safely be transacted without fear of retroactive legislation reviving extinguished rights of the Government. Your committee believes that this provision reviving extinguished liabilities and destroying vested rights is unwarranted.

(*g*) Deduction of estate and inheritance taxes for 1926 and prior years (sec. 705): By section 705 it is proposed to amend all of the prior revenue acts with respect to the deductibility of estate and inheritance taxes. Under prior laws such taxes were deductible only by the person upon whom they were imposed, and there has been much litigation as to whether particular taxes were deductible by the estate, or by the heir or legatee. The bill proposes to allow the deduction to the person claiming it, if only the estate or only the heir or legatee claimed it; and to allow the deduction only to the person who actually paid the tax if both or neither claimed it. But this provision is not to apply to any particular case in which a decision has been rendered by a court or by the Board of Tax Appeals prior to the passage of the act, even though the time to appeal from such decision has not expired. This peculiar provision does not even have the merit of laying down a uniform logical rule to be retroactively applied, but first, settles all cases where any court or the board has rendered a decision on the basis of that decision, even though the decision is wrong and subject to reversal on appeal, and second, settles all other cases by a retroactive rule of thumb having no logical basis whatever as an interpretation of the prior laws and operating in an entirely haphazard manner. Your committee thinks that this provision should be eliminated from the bill entirely, and that the prior laws should be allowed to remain as they are with respect to this question.

Irrespective of the merits of these various provisions as applied to future transactions, your committee believes that it is highly undesirable to give them retroactive operation, thus destroying existing rights based in many cases on court decisions and on express statutory provisions now in effect, and attaching new and unexpected tax consequences to transactions which occurred in 1927.

2. *Personal exemptions* (*sec. 52*).—The committee renews its recommendation that in the interests of administrative simplicity the complicated provision appearing in section 25 (e) (2) of the bill, requiring the personal exemption to be prorated if the status of the taxpayer changes during the year, be changed so that such exemption will be based upon the status of the taxpayer at the close of the year.

3. *Capital gains* (*sec. 101*).—The committee renews its recommendation that the capital-gains provision, section 101 of the bill, be modified to make it clear that income resulting from the redemption or retirement of corporate securities constitutes "capital gain." If corporate securities have been held for investment for over two years, it certainly should not make a difference in the taxation of any gain whether the security is sold or whether it is retired or redeemed by the corporation. For every other purpose in the law, the retirement or redemption of corporate securities is treated on exactly the same basis as a sale or exchange of such securities. All of the reasons for granting special treatment to capital gains from the sale or exchange of property apply with equal force to gains from the redemption or retirement of corporate securities.

4. *Computation of gain or loss by executors or administrators* (*secs. 113, 704*).—The House bill, in section 113 (a) (5), adopts for the future the provision recommended by your committee, making it clear that in the case of the sale of property by an executor the basis for loss or gain shall be the value of the property at the date of the decedent's death.

Instead of making the same rule applicable for the past, as was recommended, the bill, in section 704, provides, first, that where any return was made in accordance with the regulation in force at the time when the return was

filed, and no claim for refund has been filed, the basis used in the return shall be adopted; and, second, that in all other cases the matter shall be left for judicial determination.

The committee renews its previous recommendation that the statutes be amended to make it clear, for the past as well as the future, that the value of the property at the date of decedent's death is the basis for loss or gain where property is sold by the executor or administrator. This will validate the interpretation of the statutes, which the Bureau of Internal Revenue uniformly followed up to April, 1927, under which the great majority of cases were settled. It will conform to the probate accounting which must be made in all cases on the basis of values at the time of decedent's death. This construction of the statute has been adopted by the Board of Tax Appeals and by the District Court of the Southern District of New York. (See Bankers Trust Company *v.* Bowers, January 30, 1928.)

If the bureau's original interpretation of the statutes on this point ultimately prevails in the courts, the effect of the bill will be to give an advantage to a special class of taxpayers who filed returns in accordance with erroneous regulations of the Bureau of Internal Revenue, which were in force but a short time, and were vigorously contested from the outside. The committee thinks it would be better to make no amendment of past laws than to adopt section 704 in its present form.

5. *Consolidated returns (sec. 141).*—The bill omits any provision for the filing of consolidated returns by affiliated corporations after the taxable year 1928.

Your committee believes that the abolition of consolidated returns is unwise and will cause great administrative difficulties.

In many cases, it is necessary and proper, for legal and business reasons, that large businesses be conducted through the medium of several corporations. This is the case with many of the largest taxpayers in the country. These corporations constitute a single business, beneficially owned by the same stockholders and hence intercompany transactions are often conducted on a basis which is not the same as would prevail between independent concerns. The abolition of consolidated returns will immediately place upon the Bureau of Internal Revenue the difficult and extensive task of determining whether such intercompany transactions should be adjusted in any respect. (See sec. 45 of the bill.)

Furthermore, the abolition of consolidated returns will give rise in a great many cases to difficult and unsolved questions as to the effect of the breaking up of an affiliated group. These questions now arise only in isolated cases. The bill does not attempt to lay down the principles which shall govern in such cases, except for the provision of section 113 (a) (12) with respect to basis for loss or gain of property acquired during affiliation in an intercompany transaction.

The abolition of consolidated returns will have the undesirable effect of making it possible for a corporation holding property which has depreciated in value to deduct the loss merely by transferring the property at its market value to a subsidiary or affiliated corporation. Such intercompany transfers will be freely made where the result would be a loss, but will not be made where the result would be a gain, and this may have a serious effect on the revenue.

Your committee therefore renews its recommendation that the statute continue to permit consolidated returns by affiliated corporations.

6. *Jeopardy assessments (sec. 273).*—The committee renews its recommendation that some provision in the statute should be made for controlling the use by the Commissioner of Internal Revenue of jeopardy assessments as a means of extending the statute of limitations and that some method of reviewing the commissioner's decision as to the existence of such jeopardy should be provided.

We believe the jeopardy assessments should be used only in cases where they are necessary to secure the revenue, in cases of threatened insolvency, or inability to pay, and should not be used by the commissioner as a method of extending the statutory period of limitations. It has undoubtedly been the practice of the Bureau of Internal Revenue at times to make extensive use of jeopardy assessments merely to avoid the running of the statute of limitations where there was no evidence of real financial jeopardy. In many such cases experience shows that the amount assessed is determined without a careful audit of the case and is consequently likely to be substantially too large. The making of such an assessment, with the necessity of filing a bond, if it is to be contested, or paying the assessment, may work a very serious hardship on the taxpayer

and may cause great loss. The commissioner can always protect his rights by mailing a 60-day letter, which is less likely to cause hardship than a jeopardy assessment; and in view of past experience we believe that some provision is necessary in the statute whereby the commissioner can be required to confine the use of jeopardy assessments to those cases where he believes, after investigation, that there is financial jeopardy.

7. *Claims in abatement (sec. 273 [j]).*—Section 273 (j) of the bill, like section 279 (k) of the revenue act of 1926, abolishes all claims in abatement, and thus makes it necessary for a taxpayer to pay the full amount of the tax shown by his return, even though he discovers an obvious error therein before all of the installments are paid. The committee believes that this is an unnecessary and undesirable hardship on taxpayers, and renews its recommendations that section 273 (j) be amended so as to permit claims in abatement to be filed under proper safeguards with respect to the amount of tax shown on the original return.

8. *Statute of limitations on assessments against fiduciary (sec. 275).*—In section 275 of the bill the House has adopted the committee's recommendation that provision should be made for a short statute of limitations to become operative upon written request in determining the income of the estates during the period of administration and dissolved corporations, and by section 503 the 1926 act is amended to the same effect. The committee renews its recommendation that this provision should be further extended so as to apply not only to executors or administrators but also to other fiduciaries. It is often just as important for trustees in certain types of trusts, or a committee of an incompetent, to be able to have the tax liability determined within a comparatively short period, as it is to have such a short period in the case of estates. We believe that such a provision is necessary for the proper protection of fiduciaries. The definite determination of the liability of such fiduciaries would not mean that the tax, if actually due, could not be collected at a later date from the beneficiaries, or out of any assets remaining in the hand of the fiduciary.

9. *Statute of limitations on collection after assessment (sec. 276 [c]).*—Section 276 (c) of the bill, like section 278 (d) of the revenue act of 1926, gives the commissioner six years from the date of assessment within which to begin proceedings for collection by distraint or otherwise. The committee renews its recommendation that this provision should be amended by reducing the period to two or three years with a proviso that such period shall not run while the taxpayer is out of the jurisdiction. There appears to be no sound reason for giving the commissioner as long a period as six years after assessment within which to begin proceedings for making collection. The commissioner has three years after the return is filed within which to determine and assess the tax (sec. 275 [a]) and an additional period of two or three years after assessment should be ample to protect the revenue. We believe that this suggestion is in line with the general policy adopted by Congress of providing that tax liabilities shall be finally determined and settled within a reasonable period of time and that such provisions are necessary to protect business generally against the enforcement of stale obligations.

10. *Statute of limitations on assessments after an appeal to the Board of Tax Appeals (sec. 277).*—Under the bill the statute of limitations on the making of additional assessments, without any limitations as to amount, is suspended by the sending of a 60-day notice, and remains suspended until after the appeal is decided (sec. 277). The Board of Tax Appeals is expressly given power to increase the deficiency over that shown in the 60-day letter, if claim therefor is asserted at or before the hearing (sec. 272 [e]). As a result of these provisions an appeal on any question with respect to any amount of tax holds the entire case open and makes it possible for the commissioner in his answer, or by an amended answer, at the hearing, to assert deficiency in excess of that shown in the 60-day letter, even though the normal statutory period of limitations has long since expired. With the present congestion of cases in the Board of Tax Appeals, the filing of an appeal thus operates to hold the entire case open for a very long period, without any limitation of the maximum liability of the taxpayer, and thus largely defeats the purpose of the limitation provisions of the statute. In ordinary litigation a complaint or counterclaim can not be amended after the statute of limitations has run so as to set up new causes of action, and the same rule should, we believe, apply here.

The committee, therefore, renews its recommendation that the statute be amended to provide that the sending of a 60-day notice shall suspend the statute of limitations only with respect to the amount of the deficiency set

forth in the letter, and that after the normal period of the statute has run the Government be barred from asserting an additional deficiency, but allowed to support the asserted deficiency on any ground.

11. *Claims against transferred assets (secs. 311, 605).*—By section 311 of the revenue bill substantially all of the provisions of section 280 of the revenue act of 1926 have been continued, with certain amendments designed to protect the Government's rights against the transferee of a transferee. By section 605 the committee's recommendation that the commissioner be given the option of proceeding in equity rather than under the transferee section has been adopted.

The committee renews its recommendation that the provision for enforcing claims for taxes against the transferee of the property from a taxpayer by summary proceeding of assessment and collection be eliminated from the statute. Your committee believes that this novel procedure for the collection of taxes by assessment and distraint from some one other than the taxpayer has not worked well in practice and has given rise to many cases of hardship. In practice the commissioner rarely, if ever, investigates the question as to whether there, in fact, exists any liability at law or in equity upon the transferee for payment of the taxes of the transferor. In most cases the first notice which the transferee receives of the proceedings is a 60-day letter, which contains no explanation of the basis or reason for holding the transferee liable for the tax, but merely explains, usually in very summary form, the basis for the assertion of a deficiency against the transferor.

Your committee believes that in the vast majority of cases the rights of the Government can be amply protected and the cases can be more satisfactorily handled by a proceeding in equity.

If Congress determines that some provision for summarily enforcing the tax liability of the transferor against the transferee must be retained, your committee renews its recommendation that the procedure set forth in the bill be modified in the following particulars:

Where there are a number of the transferees or distributees, it has been the practice of the commissioner in many cases to assert the entire deficiency due from the transferor against each transferee, irrespective of the value and amount of the property transferred, although the liability in law or in equity would not exceed the value of the property received. Such procedure may cause a hardship to the transferee, and it is believed that the statute should be amended to provide that in no case shall the assessment against a single transferee exceed the value of the property received by him.

Your committee believes that the limitation for assessment against a transferee or fiduciary is very unsatisfactory. Under the bill the liability may be asserted against the transferee after the rights of the Government against the transferor have been barred, although the transferor is the party primarily liable for the tax. In case of suit against the taxpayer or any preceding transferee, thte statute provides for an extension of the period of limitation until one year after the return of execution in the court proceeding. These provisions may hold open the liability of the transferee for very long periods, making the running of the statute of limitations depend upon facts which may not be within the knowledge of transferee, and make it difficult for transferees and their counsel to determine when the statute of limitations has run. Your committee believes that in no case should the commissioner be permitted to proceed against the transferee when his rights against the transferor are barred, and that there should be some absolute limit on proceedings against the transferee, irrespective of extensions of time for proceeding against the transferor resulting from the filing of waivers or the pendency of cases before a board of tax appeals and the courts.

If Congress adopts the committee's recommendation that the commissioner should be given the option of proceeding under section 311 or by a proceeding in equity, your committee believes that it should be made clear in the law that under either mode of procedure a transferee will have an opportunity to contest the merits of the proposed additional assessment against the transferor, an opportunity which he may not have had in equity proceedings.

12. *Recovery of overpayment determined by Board of Tax Appeals (sec. 322).*—The committee renews its recommendation that the Board of Tax Appeals be given jurisdiction not only to determine the amount of overpayments in cases pending before it, but also determine whether the taxpayer has complied with all the necessary conditions to entitle him to the refund or credit of the overpayment. Under the present statute (sec. 284 (e)), as amended by

section 507 of the bill, and under section 322, which applies to the future, it seems clear that the Board of Tax Appeals will hold that it is without jurisdiction to determine statute of limitations questions with respect to overassessments found by the board, thus making necessary additional litigation to collect overpayments found by the board.

13. *Extension of time for refunds where cases are held open by waivers (sec. 322).*—Your committee renews its recommendation that the time for filing claims for refund should continue as long as a case for a particular year is held open for the making of additional assessment by the filing of waivers or otherwise. This general principle was roughly adopted by Congress in section 284 (a) of the revenue act of 1926, but the revenue bill of 1928 makes no provision for any further extensions of time for filing refunds of taxes for prior years, even though cases may be held open by waivers; and section 322, applicable to 1927 and later years, contains no provision for extending the time for filing claims of refund for taxes for those years even though cases are held open by waivers.

So long as it is open to the commissioner to assert a claim for additional taxes for any year, it is only fair that it should also be open to the taxpayer to assert a claim for refund for the same year.

14. *Effect of running of statute of limitation (sec. 607).*—Section 607 of the bill substantially adopts the committee's recommendation that the provisions of section 1106 (a) of the revenue act of 1926 be clarified so as to make it entirely clear that taxes paid or collected after the running of the statute of limitations may be recovered by the taxpayer solely on that ground, and makes such provisions retroactive. The committee is in favor of the adoption of this provision. As previously stated, it does not believe that section 1106 (a) should be repealed as of February 26, 1926, in so far as such repeal destroys vested rights of taxpayers.

15. Your committee is pleased to find that nine of the recommendations made in its report of October 25, 1927, are adopted in whole or in part in the revenue bill as it passed the House.

This report is necessarily confined largely to those matters with respect to which the committee believes that further changes should be made in the bill, and space does not permit a discussion of the many changes which have been made which the committee highly approves.

Respectfully submitted.

ARTHUR A. BALLANTINE, *Chairman*,
STUART CHEVALIER,
HENRY G. GENNERT,
EDWARD H. GREEN,
ROLAND J. HAMILTON,
EDWARD HOLLOWAY,
GEORGE E. HOLMES,
CHARLES E. MANIERRE,
ROBERT H. MONTGOMERY,
WALTER S. ORR,
LOUIS H. PORTER,
HENRY M. POWELL,
HUGH SATTERLEE,
MARTIN SAXE,
STAFFORD SMITH,
CHARLES A. VILAS,
JOHN F. WHARTON,
HENRY J. WOLFF,

Special Committee on Taxation,
Association of the Bar of the City of New York.

The CHAIRMAN. I have also a statement from Harry C. Kinne on subdivision (a), with regard to limiting the payment of judgments of courts to actions begun prior to February 28, 1927.

(The statement referred to is as follows:)

CHICAGO, *April 13, 1928.*

Hon. REED SMOOT,
Chairman and Members of the Finance Committee,
United States Senate.

GENTLEMEN: I represent the National Battery Manufacturers Association, composed of approximately 100 battery manufacturers and other allied industries. We object to section 424 of the revenue act (H. R. 1) passed by the House for the following reasons:

Subdivision (a) limits the payment of judgments of courts to actions begun prior to February 28, 1927, for taxes illegally collected, and which were imposed on manufacturers by subdivision 3 of sections 900 and 600 of the revenue acts of 1918, 1921, and 1924, while judgments secured by manufacturers covered

by 20 other subdivisions of the same section may receive refund in actions begun after February 28, 1927.

Our association has relied upon the provisions of the various revenue acts of 1924 to 1926, which provided for the recovery of taxes illegally collected through the courts. No claim of any member of this association is barred by the statute of limitations either before the Commissioner of Internal Revenue, or the Federal courts for recovery of such taxes claimed to have been illegally collected.

The revenue acts of 1924 and 1926 provide that claims for refund of taxes illegally collected under subdivision (c) of said sections 600 and 900 of the revenue acts of 1921 and 1924 may be filed with the commissioner within four years of the date of payment. If the claims are rejected by the commissioner, the taxpayer has two years within which to file petition in the Federal court, under sections 1112 and 1113 of the respective acts.

Although all of these manufacturers have complied with the various revenue acts in regard to filing claim for refund with the commissioner, and thereafter with the Federal courts, yet subdivision (a) of section 424 of the 1928 revenue act as passed by the House singles out one class of manufacturers from 21, upon whom this tax was imposed by the said revenue acts, and in effect says to them, "We will pay the judgments secured by all manufacturers except those listed under subdivision (c) of sections 900 and 600."

Subdivision (a) is retroactive. We have every right to expect the Government to pay judgments secured under the existing revenue laws.

A large majority of these manufacturers were negotiating with the Treasury Department under the impression that their claims would be paid. I have a letter here addressed to me in September 1927, as attorney for over 50 manufacturers, wherein the Treasury Department acknowledges liability and authorizes settlement provided the taxpayers will allow a discount of 5 per cent.

We had every reason to believe that the Government would deal fairly with us, and would pay the claims that the Treasury Department acknowledged to be just. Many of these claims were pending in the Treasury Department, awaiting the outcome of similar cases filed in the courts. Many of such claims were not rejected by the Treasury Department until the summer and fall of 1927, and petitions could not have been filed with the court prior to that date.

Most of these claims were originally filed with the Treasury Department early in 1924, and the claimants continued to pay taxes until the 1924 act was repealed in 1926. Claims were not filed for taxes illegally collected during that period until 1927. These claims would not be barred by statute until 1929, two years after the date designated in subdivision (a).

Subdivision (b) limits the right of any manufacturer applying for refund of taxes illegally paid to such sum as was paid in excess of the amount properly payable upon the sale of an article subject to tax, and makes no provision for the refund of taxes illegally collected upon an articles not subject to tax.

Even though subdivision (b) does authorize the commissioner to refund taxes illegally collected where such taxes have not been collected by the manufacturer from the purchaser, yet if the commissioner should hold, contrary to the actual facts, that the tax was indirectly passed on in the price of the article, subdivision (a) would prevent a refund pursuant to a judgment of a court in a case begun after February 28, 1927. This would make a judgment of a court inferior to the decision of the commissioner.

Section 424 throughout its provisions discriminates so severely against those manufacturers who were illegally taxed upon the theory that their product came within the provisions of subdivision (3) of sections 900 and 600 of the 1918, 1921, and 1924 revenue acts, that the entire subdivision (a) read with (b) will entirely destroy the taxpayers' rights before the courts where the commissioner rules against him, irrespective of how unjust that ruling may be, because (a) limits the time when a court action may be brought to February 28, 1927.

We contend that under the law, this tax was assessed against the manufacturer; the manufacturer was forced to provide the funds for its payment; the manufacturer never passed it on to the consumer; in numerous instances the manufacturer lost the entire sales price of the articles due to poor credits, and the tax therefore was not collected by the manufacturer, but was paid to the Government. By reason of the fact that many of these manufacturers were losing money at the time the tax was assessed against them, such tax resulted in an additional expense and loss to them, which could not be added

to the price of the artcle and collected from the consumer. Furthermore, competition prevented the addition of the tax to the price of the article. Many of these manufacturers paid the tax under duress.

The majority of our members did not increase the price of their batteries at the time the tax was assessed, and it can not, therefore, be contended that they added the tax to the price of their product or that they collected it from the consumer.

If the taxpayer does not get the benefit of the tax when it is taken off and the price remains the same, then when the tax is added and the price of the article remains the same it is not passed on.

Considering subdivision (a) of section 424 as it now reads, it would prevent all claims for refunds, who were first definitely informed of their rights by the decision of the United States district court in the Philadelphia Storage Battery Co. case, in August, 1927, from obtaining any refunds whatever by reason of the fact that they had not brought their action previous to a time fixed retroactively some six months prior to the date when the decision was handed down. The fact that such claimants did not bring action for refund previous to that time should not militate against them by reason of the fact that the statute of limitations existing at that time gave each of such claimants four years from the date of payment to file claim with the Commissioner of Internal Revenue five years from the date of payment or two years from the date of rejection by the commissioner in which to file suit in court.

Finally we ask that you amend section 424, subdivisions (*a*) and (*b*), as follows:

"(a) Except pursuant to a judgment of a court ~~in an action duly begun prior to February 28, 1927;~~ or

"(b) Unless it is established to the satisfaction of the commissioner that such amount was in excess of the amount properly payable upon the sale or lease of an article subject to tax or that such amount was *collected on an article not subject to tax* (and was not directly or indirectly *invoiced to and* collected from the purchaser or lessee *by the manufacturer, producer, or importer*), or that such amount, although collected from the purchaser or lessee, was returned to him prior to February 26, 1927; or"

If these subdivisions (a), (b), and (c) of section 424 were applied to all taxes illegally collected and not merely restricted to subdivision (c) of sections 900 and 600, there could be no refunds whatever of any tax, however unjustly collected.

We are not asking for a special provision in the law which will grant us some particular privilege. We are only asking that we be allowed to secure refund under the same uniform provisions that apply to all other taxpayers.

Yours very truly,

HARRY C. KINNE.

Amendment to House revenue act No. 1, section 424, subdivisions (a) and (b), page 188, to read as follows:

[NOTE.—Strike all the words after "court" in subdivision (a), as indicated below. In subdivision (b) insert the words in italics.]

(a) Except pursuant to a judgment of a court ~~in an action duly begun prior to February 28, 1927~~; or

(b) Unless it is established to the satisfaction of the Commissioner that such amount was in excess of the amount properly payable upon the sale or lease of an article subject to tax or that such amount was *collected on an article not subject to tax* (and was not directly or indirectly *invoiced to and* collected from the purchaser or lessee *by the manufacturer, producer, or importer*), or that such amount, although collected from the purchaser or lessee, was returned to him prior to February 28, 1927; or

The CHAIRMAN. I have also a brief on section 114–B, in behalf of the metal-mining industry of the United States, submitted by the American Mining Congress, as well as a memorandum in relation to the brief. They will all go into the record at this point.

(The statements referred to are as follows:)

STATEMENT IN BEHALF OF THE METAL MINING INDUSTRY OF THE UNITED STATES

MARCH 23, 1928.

To the honorable chairman and members of the Committee on Finance in the Senate of the United States:

GENTLEMEN: At a hearing held on November 4, 1927, before the Committee on Ways and Means of the United States House of Representatives, on the proposed revision of the revenue act of 1926, the American Mining Congress, representing the operators of metal mines of this country, proposed the following amendment to section 204 (c) of the revenue act of 1926 to be incorporated in the proposed revenue bill for 1928:

SECTION 204 (C)

(Changes shown in italic)

(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

(1) In the case of mines discovered by the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within 30 days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. The depletion allowance based on discovery value provided in this paragraph shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value. Discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February 28, 1913, if the vein or deposit thus discovered was not merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit. *This paragraph shall not apply to metal mines discovered after approval of this act.*

(2) *In the case of metal mines the allowance for depletion shall be 15 per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.*

(3) In the case of oil and gas wells the allowance shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property except that in no case shall the depletion allowance be less than it would be if computed without reference to the paragraph.

NOTE.—The above amendment in italics would be added to section 114, H. R. 1, on page 79, after line 24.

It will be noted that the language of the proposed new paragraph as to metal mines follows that of the provision relating to depletion of oil wells which has been said to be satisfactory.

HISTORY OF PROPOSAL

When the 1926 revenue bill was being considered in the conference committee of the House and Senate, on or about February 15, 1926, it was reported that a percentage-of-income basis for depletion of mines was being considered. As the bill was to be agreed upon by the conference committee within a period of four or five days from that time, representatives of the American Mining Congress advised members of the conference committee that it would be impossible for the industry, on such short notice, to prepare and consider the data necessary to an intelligent conclusion respecting any plan of this nature that might be proposed. It is understood that a report was made to the conference com-

mittee by a representative of the Treasury Department on or about February 18, 1926, to the effect that it would be impracticable to provide in the 1926 bill for percentage depletion in the case of mines, as it would be impossible to determine within the time available what percentage rate or rates should apply to different branches of the mining industry. Therefore no action was taken, but it was understood by those interested that the subject would be considered by the Joint Committee on Internal Revenue Taxation created by the revenue act of 1926.

Shortly after the organization of the joint committee in 1926, an announcement was issued from the office of that committee that depletion would be one of the first subjects taken up for study. During June, July, and August, 1927, a letter and questionnaire were sent to metal-mining taxpayers throughout the country by the Commissioner of Internal Revenue. The following are copies of letters received by the American Mining Congress showing the scope and purpose of the investigation of depletion allowances in the mining industry initiated by the Commissioner of Internal Revenue in order to comply with a request from the joint committee for information:

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, August 3, 1927.

AMERICAN MINING CONGRESS,
Munsey Building, Washington, D. C.
(Attention Mr. Bailey, counsel).

SIR: There is inclosed herewith a copy of the letter and form which is now being sent to various mining companies of the country.

You can well realize that the task of gathering this data from all the mining companies is a large one. In order to secure as representative a survey of the field as possible and at the same time involve the least work, requests of this nature are only being made of 200 of the largest bituminous coal mining companies in the United States. While there are over 8,000 coal-mining companies, the 200 which have been selected as being representative produce over 50 per cent of the product mined.

It seems desirable to secure figures from as many companies as possible, and therefore figures compiled along the lines outlined from all taxpayers who desire to submit information will be gladly accepted. Your help in notifying the various companies to this effect will be greatly appreciated by the bureau.

Respectfully,

C. R. NASH,
Assistant to the Commissioner.
By S. P. HATCHETT,
Chief of Section.

"COPY OF LETTER SENT BY REVENUE BUREAU TO MINING COMPANIES

"SIRS: The Joint Congressional Committee on Internal Revenue Taxation has begun a study of the depletion question in order to determine whether or not a percentage of income basis, similar to that now in effect in the oil and gas industry, can be applied to the other natural-resource industries. In making this study the joint committee has requested from the Treasury Department data showing what percentage of income had been allowed as depletion under the present bases for the years 1922 to 1926, inclusive. It is impossible for the Treasury Department to gather this information with any degree of accuracy from the tax returns, and inasmuch as future legislation may be based on these figures, it seems advisable to secure the cooperation of all taxpayers in gathering this data. Furthermore, all parties concerned—namely, the taxpayers, the Treasury Department, and the joint committee—will then draw their conclusions from the same set of facts.

"The task of gathering such information with respect to all the natural-resource industries is a large one, and therefore you are requested to compile the desired information with reference to your company or companies at as early a date as possible. All information should be furnished strictly in accordance with the outline shown by the inclosed form.

"Separate and distinct compilations are desired according to the method upon which the depletion has been computed, as follows: (1) Cost; (2) March 1, 1913, value; (3) properties upon which no depletion has been allowed.

"The information desired at this time is only that covering your properties. Somewhat similar data may be requested at a future date with reference to other natural-resource industries.

"All information furnished is strictly confidential and will be considered in a manner as though forming a part of the tax return. The joint committee has not requested the names of any of the taxpayers or their mines.

"Replies as well as inquiries or questions should be addressed to the Treasury Department, Bureau of Internal Revenue, Washington, D. C., for the attention of IT:CR:EN-CJR.

"Respectfully,

"C. R. NASH,
"*Assistant to the Commissioner.*
"By ——— ———,
"*Chief of Section*"

In order to expedite the preparation by the bureau of the information desired by the joint committee, the metal-mining industry cooperated almost 100 per cent, and supplied all the information requested. It is understood the coal-mining industry cooperated in the same manner. In the meantime, believing that the matter was certain to be taken up in this Congress, and in order to render all possible assistance to the joint committee, and to other committees of Congress, and to arrive at a satisfactory solution of the question, numerous meetings were held in the metal-mining industry during August, September, October, November, and December, 1927, at which the subject was given thorough consideration by representatives of all branches of the metal-mining industry.

CONCLUSIONS OF THE METAL-MINING INDUSTRY

As a result of the study made by the metal-mining industry, the conclusion was reached that the application of a percentage-of-income basis for the determination of depletion allowances in the case of metal mines is practicable. From the best information available to the industry, it was found that the average of depletion deductions in the case of metal mines allowed by the Treasury Department under existing law during the five years, 1922 to 1926, inclusive, was in excess of 15 per cent of gross income. Therefore, representatives of the metal-mining industry decided that 15 per cent of gross income would be a fair basis for the future, provided it shall be enacted and applied without abrogating or disturbing any basis already established or allowable under existing and prior acts.

It is believed that many mines with claims still pending under existing and prior acts would be willing to take advantage of the percentage system, even though the rate may be less, in order to obtain prompt and final settlement of their tax liabilities; but for those who have an allowed basis on cost, March 1, 1913, value, or discovery value, established at great expense, and adjusted to their entire business and financial structure, the compulsory elimination of such basis for the future would be unjust. Under existing established bases, bonds have been issued, dividends declared, operating programs inaugurated, stock issues sold, and accounting systems built up. It is the conclusion of the metal-mining industry that it would be unfair and discriminatory, and in the nature of retroactive legislation, to eliminate and thus destroy any basis already granted, unless the taxpayer voluntarily waives his existing basis or his rights under the 1926 and prior acts; but, for the future, discovery value in the case of discoveries made after approval of this act, may be eliminated upon the adoption of an adequate percentage-of-gross-income basis; and, eventually, practically all mines will be taking depletion on the percentage basis.

The provisions of existing and earlier revenue acts employing a basic date method of valuation for the computation of depletion are and always have been based on sound economic principles, and for lack of any experience as to means and results, it would have been unwise, if not impracticable, to have employed at the beginning any other method. None the less, it always has been desirable to reach the same result by a shorter and simpler method. And now as a result of a practical experience of more than a decade in computing depletion on a valuation basis, it has become possible to propose a definite rate of depletion for metal mines to govern in the future that will give assuredly a result fairly comparable to that obtained by valuation, and without disturbing those valuations already agreed upon with the Treasury Department. Because of this experience, the rate proposed has a background of statistical authority.

INTERPRETATIONS OF PREVIOUS AND EXISTING DISCOVERY PROVISIONS OF THE REVENUE LAW

The so-called discovery clause was first enacted into law in the revenue act of 1918. (See Addenda, p. 12, infra.) Prior to this act, only those taxpayers whose mines were discovered prior to March 1, 1913, and those whose mines were acquired subsequent to March 1, 1913, by purchase, were entitled to the "reasonable allowance for depletion according to the peculiar conditions of each case" in determining taxable net income. The taxpayer who discovered his mine subsequent to March 1, 1913, was left without the "reasonable allowance" granted those whose discoveries were made prior to that date; and therefore was required to pay income tax upon the present worth or capital value of his mineral in place as well as upon the profit derived from its extraction and sale.

It is believed Congress intended that the discovery clause of the revenue act of 1918 should apply to all minerals discovered after March 1, 1913, regardless of whether or not the discovery was made in virgin territory as the result of prospecting and exploration from the surface, or in an existing mine or mining tract as the result of prospecting, exploration, and development at depth.

In other words, Congress surely intended that the discovery of any minerals in commercial quantities that were not included, and that could not be included, under the department's regulations, in any prior valuation as proven or probable ore, should entitle the discoverer-taxpayer to a valuation of such discovery as a basis for depletion. It was understood by Congress, when the 1918 act was passed, that discovery value, under this clause, is merely the present value of the mineral in place, and that this provision would not have the effect of relieving from the income and profits taxes any part of the net profit derived from the extraction and sale of such mineral.

The effect of the discovery provision, had it been applied to all minerals discovered after March 1, 1913, would have been to allow as a deduction from gross income of the mine taxpayer the present value in place as of date of discovery of such mineral or that capital value which was property. In other words, Congress, by enacting the discovery provisions, recognized a fundamental right of private property in this country, that whatever of value is inherent therein belongs to the owner thereof and is his capital.

However, the administration of the discovery clause led to interpretations by the Bureau of Internal Revenue that, in the case of mines, so restricted its application that only a few of the discoveries made subsequent to March 1, 1913, were valued by the bureau as discoveries.

Discovery value was denied on ore discovered after March 1, 1913, in the following instances to which exception is taken by the mining industry:

1. Where the newly discovered ore was part of an existing mine, and was to be developed and extracted through existing workings.

2. Where the newly discovered ore was an extension of a previously known vein or deposit.

3. Where ore existed but was held by the department not to be well enough defined to justify its inclusion in the original valuation.

Consequently, the taxpayer was allowed discovery value as a basis for depletion only in a case where the discovery was made in virgin territory, and the value allowed by the department in all cases was ultraconservative, because expected profits were very conservatively figured, and then extremely high discount rates were used to reduce such estimated expected profits to a present worth. It is unnecessary to discuss the bureau's analytic methods of mine valuation, as these are not at issue.

The situation was further aggravated by the fact that the bureau in many instances used the newly discovered ore to dilute values established as of March 1, 1913, cost bases, or discovery value previously allowed. This was accomplished by revising original estimates of tonnage to include the new tonnage discovered without revising the original valuation. Thus, a taxpayer would find that his discovery had the effect of increasing his income tax on account of the resulting reduction of his unit rate of depletion. As a typical example, the taxpayer may have claimed 2,000,000 tons of ore as a basis of valuation as of March 1, 1913, set up as follows: 500,000 tons proved ore, 1,500,000 tons probable ore; basing the estimate of probable ore on geological conditions and past experience in the district. He would be allowed 500,000 tons proved ore, and only 500,000 tons probable. He would be denied the addi-

tional 1,000,000 tons as probable ore; and, therefore, would be allowed a valuation based on only 1,000,000 tons, or just one-half of the amount claimed. When afterwards he developed and proved the additional 1,000,000 tons, he would be denied discovery value thereon, and would be unable to secure a revaluation on the basis of his original claim. But the 1,000,000 tons would be used to dilute the original value allowed, and his depletion rate would be reduced to one-half or less of the rate previously allowed per unit of extraction.

REVIEW OF AMENDMENTS PREVIOUSLY OFFERED

These conditions caused the mining industry to urge an amendment to the discovery clause of the revenue act of 1924, as follows:

"Discoveries shall include ores or minerals, discovered in any mine or mining tract, after February 28, 1913, not included in any prior valuation."

This amendment was inserted in the bill by the Senate, but was omitted by the conference committee on the revenue act of 1924. It is believed that the conference committee rejected this amendment solely because its purpose and application was not clearly understood.

This amendment was again urged when the 1926 act was under consideration, and was included in the House bill; but it was stricken out in the Senate, and the following amendment, although not satisfactory to the mining industry, was adopted in the revenue act of 1926:

"Discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in any mine or mining tract by the taxpayer after February 28, 1913, if the vein or deposit thus discovered was not merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit."

This amendment has been found to have limited application in certain districts, notably the Tri-State district of Missouri-Kansas-Oklahoma, and certain districts in Utah. However, it does not at all meet the needs of the lead-zinc mines of Idaho and the gold mines of California; and small mining taxpayers in other States find themselves unable to bear the expense necessary to prove up sufficient quantities of ore, within the time limit fixed by law, to establish an adequate basis for a discovery valuation.

CONFERENCES WITH THE TREASURY DEPARTMENT

Several conferences have been held with officials of the Treasury Department culminating in a general conference on February 1, 1928. Some questions had been raised by engineers of the department with respect to methods of arriving at the 15 per cent rate proposed. At this conference it was demonstrated that as to ores valued in the past by the department engineers, the rate of depletion in relation to gross income was in practically all cases in excess of 15 per cent.

It was contended by representatives of the mining industry that in determining what per cent of gross income should apply as a basis for the depletion allowance, only ores valued in the past should be taken into account. It is conceded by all who are familiar with the depletion question that if ore reserves could have been accurately determined in all cases, as they have been in some, the taxpayer would receive the depletion allowance on every unit produced until the mine is exhausted. Inasmuch as it has been impossible to accurately estimate ore reserves in all cases, it is only fair that the statistical background we now have should be used in providing for a fair allowance representing the value of the mineral in place on a percentage of gross income basis.

The 15 per cent of gross income proposed merely means that 15 cents out of each dollar received from the sale of ore represents what has been determined in the past to be a conservative approximation of the present worth as of the basic date of ore in place. While this amount is somewhat lower than the average for ores valued in the past, the mining industry has agreed that it will be a satisfactory basis to apply to new ores developed or discovered in the future, and it eliminates the necessity for estimating tonnage to be valued.

These arguments are supported by the Supreme Court of the United States in the case of United States *v.* Ludey, decided May 16, 1927. In this case Mr. Justice Brandeis had the following to say:

"The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed. The fact that the reserve is hidden from sight presents difficulties in making an estimate of the amount of the deposits. The actual quantity can rarely be measured.

"It must be approximated. And because the quantity originally in reserve is not actually known, the percentage of the whole withdrawn in any year, and hence the appropriate depletion charge is necessarily a rough estimate. But Congress concluded, in the light of experience, that it was better to act upon a rough estimate than to ignore the fact of depletion."

It is believed that officials of the Treasury Department are satisfied that the 15 per cent rate proposed is reasonable as a basis for depletion allowances in the case of all metals. As the result of these conferences with the Treasury, we are of the opinion that little question will be raised by the department concerning the matter of the rate. The real issue that will be presented to your honorable committee will be the question of how the percentage plan is to be applied, if adopted.

APPLICATION OF THE PERCENTAGE PLAN

In view of the history of the discovery provision and its administration, and the amendments thereto urged by the mining industry, we believe your honorable committee will wisely discern that the percentage proposal, especially if it is to be simple of administration, must be given a broader application than the present and prior discoverey provisions of the law have had. In other words, it is perfectly plain that a large amount of ore has been and will be discovered on which the taxpayer should have the depletion allowance if he is to continue the exploration and development work necessary to promote the mining industry and maintain mineral production up to the increasing requirements of this country and of civilization.

The records of the Treasury Department will show that in the case of certain metal mines it was possible to obtain a fairly accurate estimate of ore reserves. In such a case the taxpayer has under existing law the "reasonable allowance for depletion" which the law states shall be granted him as a deduction. But the records also will show that in other classes of mines reasonably correct estimates of ore reserves were not obtainable. In many of these cases the taxpayer finds himself without depletion. The situation in the Coeur d'Alene district of Idaho is a typical example. Ore reserves are being developed in that district far beyond the estimates calculated as of March 1, 1913. In most cases in this district the geological conditions preclude the allowance of discovery value under the department's present rulings and regulations.

The situation in the Coeur d'Alenes is typical of other districts, particularly where the mines are being developed and operated by individuals and small companies. A taxpayer with large resources can go on to a new prospect with a fleet of drills and prove up a sufficient tonnage to give a fair basis for valuation under the discovery provision. The small taxpayer does not have the resources with which to do this and therefore either is denied discovery value or is limited to a comparatively low valuation on but a small portion of the ore reserves that actually exist in his property.

The percentage of gross-income plan can not be adopted as a substitute for any existing basis without imposing great hardship upon large groups of taxpayers that now have adequate bases established under existing and prior laws. As we have pointed out, the 15 per cent of gross-income basis is in practically all instances less than existing bases as to ores valued in the past. Therefore, to substitute this percentage plan for existing bases would have the effect of imposing an increase in taxes on such taxpayers just as surely as if these taxpayers were singled out for an increase in the tax rate. This would be a gross discrimination. Such action also would disturb financial commitments, operating programs, and other business adjustments, and would result in great hardship upon any taxpayer thus concerned.

However, the mining industry is willing to accept the 15 per cent of gross-income basis for depletion allowances as a substitute for discovery value in the case of discoveries made after the approval of this act. The mining industry also contends that the percentage plan should be adapted to the situation in such a manner as to automatically correct underestimates of ore reserves; that is, where in prior valuations the estimates of ore reserves are clearly inadequate and the taxpayer has discovered and developed new tonnage ,the percentage basis should apply to such tonnage irrespective of whether or not he would be entitled to discovery value on such tonnage under the existing rules and regulations of the department. In other words, the mining industry urges that the percentage plan be applied as the discovery provision should have been applied—to entitle the taxpayer to the "reasonable allowance for depletion" on the entire mineral contents of his mine.

FIFTEEN CENTS OUT OF EACH DOLLAR RECEIVED FROM THE SALE OF ORE BECOMES THE FIXED VALUATION OF ALL ORES NOT PREVIOUSLY VALUED

This precludes future errors in valuation such as underestimates of tonnage and errors of judgment in the application of the various factors involved in estimating the present worth of such tonnage as of a basic date, and avoids the enormous expense entailed by both taxpayer and Government in making valuations. We believe the statistical compilations made by the department and the Joint Committee on Internal Revenue Taxation with respect to ores valued in the past will show conclusively that 15 cents out of each dollar received from the sale of ore is less than the average depletion allowance, not only in the case of each metal, but as to all metals averaged together.

The mining industry cooperated in the investigation initiated by the joint committee and the Bureau of Internal Revenue, and showed the utmost good faith in this matter; and we believe that your honorable committee and this Congress will consider favorably the percentage plan as proposed by the American Mining Congress on behalf of the metal-mining industry as a cure for the administrative ills that have been complained of in the past in connection with the administration of depletion allowances.

The percentage plan proposed unquestionably will be simple of administration, and will tend to equalize conditions as between different taxpayers in the metal-mining industry.

EFFECT UPON REVENUE

We feel certain that the adoption of the percentage plan proposed will not materially affect the public revenue. It will be apparent that in the future, discovery value will become more and more important. Discoveries are absolutely essential to the existence of many of the important branches of the metal-mining industry. Without discoveries in the future, this country would have to depend upon foreign ores. Full discussion of this phase of the subject will be found in the addenda following this statement.

It is believed, therefore, that discovery depletion allowances will increase as the result of future discoveries of new mineral deposits, which will take the place of existing deposits as they are exhausted. In any event, the proposed percentage plan will not materially affect the present amount of income taxes derived from the metal-mining industry; but, due to the limitation to 50 per cent of net income, may eventually result in an increase in such revenue.

Under this percentage plan in all cases where the metal-mining taxpayer has an operating profit the Government will derive a tax, since, no matter how small the profit, at least 50 per cent of the net income, before deducting depletion, will be subject to tax. This plan embodies a double limitation that is advantageous to the Government; first, in the case of high profits the maximum allowance is limited to 15 per cent of gross income; second, in the case of low profits the maximum is 50 per cent of net income. Thus, so long as mines make any operating profits the Government will derive a continuous revenue therefrom.

Respectfully submitted.

McKINLEY W. KRIEGH,
Chief Tax Division, The American Mining Congress.

ADDENDA

EXTRACTS FROM AMERICAN MINING CONGRESS BRIEF FILED WITH THE SENATE COMMITTEE ON FINANCE, 1926

HISTORY OF THE DEPLETION PROVISIONS

Prior to the 1913 revenue act there was no allowance for depletion. The Supreme Court held in a series of opinions that depletion is not a necessary deduction from gross income in determining the Federal corporation excise tax act of 1909. (See Goldfield Consolidated Mines Co. *v.* Scott, 247 U. S. 146; Stratton's Independence *v.* Howbert, 231 U. S. 399; Von Baumbach *v.* Sargent Land Co., 207 U. S. 503; Stanton *v.* Baltic Mining Co., 240 U. S. 103.)

The 1913 law provided:

"G. (b) (3) (c) In the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the time of the output for the year for which the computation is made."

In the 1916 law, section 12 (a) second (3) (a):

"In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year, for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchases made prior to March 1, 1913, the fair market value as of that date, no further allowance shall be made."

Although not generally understood, this is the first recognition by Congress of the discovery depletion principle.

The depletion allowance in this law not only insured a return of the original capital investment (cost), but was extended to cover the appreciation in value in excess of cost, due to the discovery of mines and oil wells prior to March 1, 1913, and a similar base was granted for determining profits on sales of mines and oil wells. (See 1916 law.)

While the Supreme Court had held in the La Belle Iron Works *v.* United States (256 U. S. 377) that this appreciation in value up to March 1, 1913, due to discovery was not technical invested capital of the mining industry, yet Congress recognized that it was true capital by basing the depletion allowance in the 1916 law thereon. Congress likewise in the case of corporate owners treated distribution from the depletion reserves based on a March 1, 1913, value as capital in the hands of stockholders. (See law, 1916, sec. 2; 1917, sec. 31 (a), continued in 1918 and 1920 laws; sec. 201 S9b (a) in 1924 laws.)

This places the stockholders and corporate owners of mines on a parity with individual owners.

The 1918 law contained the following provisions:

"SEC. 234 (a) (9). In the case of mines, oil and gas wells, other natural deposits, the timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as a result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee."

Here again Congress stamped its approval on the discovery principle and extended it to all mines and oil and gas wells discovered after March 1, 1913, and in this act in harmony with other provisions limiting the tax on

capital gain. Congress limited the surtaxes to a maximum of 20 per cent on gains on a sale of mining or oil property where a discovery had been made. (See sec. 211 (b).)

The provision in the 1921 act is identical with that contained in the 1918 law, section 234 (a) (9) except for the following proviso:

"*And provided further*, That such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the commissioner with the approval of the Secretary."

In this law Congress limited the surtaxes on the sale of discovered mines and oil wells to 16 per cent. (See 211 (b) of 1921 act.)

The 1924 law continued the discovery principle.

It provided both for individuals (sec 214 (a) (9)) and corporations (sec. 234 (a) (8)), "a reasonable allowance for depletion."

The base for this was the same as for gains or losses (sec. 204 (a)), i. e., cost if acquired after February 28, 1913, or if acquired before that date, cost or value on March 1, 1913, "whichever is greater."

But this act (sec. 204 (c)) provided:

"(c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (2) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that in the case of mines, oil and gas wells discovered by the taxpayer after February 28, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter; and such depletion allowance based on discovery value shall not exceed 50 per centum of the net income (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value."

Distributions from all depletion reserves were capital in the hands of stockholders and applied on determining gain or loss against the individual stock base (sec. 201 (b) and (d)) and surtaxes on gain from sales of discovered mines and oil and gas wells were limited to 16 per cent.

The limitation of discovery allowance to 50 per cent of the net income was inserted in the 1924 act to meet the criticism that, in some cases, the discovery values allowed during the war years of expected high prices and profits, when projected into future normal years tended to excessive allowances.

Unquestionably this limitation more than met such objections by arbitrarily limiting the discovery value to a maximum of 50 per cent of the net income. Whether Congress, in its effort to take care of a few exceptional cases, was fair to the industry as a whole remains an open question.

(The amendment to the revenue act of 1926 is quoted and discussed on page 8, supra, and therefore is not repeated here.)

Let us turn from the legislative history of depletion to its economic base and justification.

DEPLETION BASED ON SOUND PRINCIPLES—THE MAINTENANCE OF A CAPITAL RESERVE BASED ON THE VALUE OF ORE OR MINERAL IN PLACE REPRESENTS A SOUND FINANCIAL PRINCIPLE, IS AN ECONOMIC NECESSITY TO THE CONTINUANCE OF THE INDUSTRY AND ITS RECOGNITION IN THE FEDERAL TAX LAWS IS FULLY JUSTIFIED

The meaning of the word "depletion is to reduce, lessen, exhaust, or empty, and, therefore, when the term "depletion" is applied to a deposit of any character, it means that it is being or will be, reduced, lessened, exhausted, or emptied.

In connection with income tax, depletion means a deduction from gross income to arrive at taxable income. It is measured by the amount of capital represented by that portion of the mineral deposit removed and sold. Thus depletion represents the conversion of capital from ore or natural deposits to money and a depletion reserve in the books of account records this fact.

In the case of purchase of a proven or developed property, the capital to be returned is the cost, but when mining property is still owned by the party who discovered or developed its mineral, the cost thereof seldom bears any real financial relation to the capital invested in such property. A depletion allowance, therefore, based on cost alone would in no way recompense such owner or insure a return of his true investment as distinguished from that small portion measured by the money outlay. The value of a mining property, when it is discovered and developed, is a realizatoin of hope, faith, efforts, and expenditures extending back to the beginning of prospecting.

The discovery provision was inserted into the law for two main reasons. The first was to stimulate prospecting for and development of natural resources. The other reason was to avoid confiscating the capital of one who had borne the burden, expense, and risk of bringing the property to the production stage, thus depriving him of what was rightfully his capital. A discovery represents time, enterprise, efforts, and ability, as well as capital expended over a long period of time, often resulting in fruitless effort and search. To limit the "capital" invested to the out-of-pocket cost alone is to ignore the facts.

THE EXTRAORDINARY HAZARD INHERENT IN THE INDUSTRY JUSTIFIES A DEPLETION BASIS THAT CAN BE APPLIED FAIRLY FROM THE BEGINNING TO THE END OF A MINING OPERATION

Congress is not required under the law to levy the maximum tax on all net income permitted by the sixteenth amendment to the Constitution. The Supreme Court has recognized its right to set up a "statutory net income" embodying the congressional idea of justice and expediency. (Brushshaber *v.* Union Pacific R. R. Co., 240 U. S. 1.)

It is elementary that different taxpayers obtain income under different degrees of hazard. That high risk is an element that should be considered in arriving at true net income is universally recognized. Hazard is but another name for liability to extraordinary losses. Wherever this extra risk is covered by insurance premiums they are therefore an allowable deduction in determining taxable income. In most extra hazardous businesses the losses incident thereto enter into the determination of the gross profits and so are automatically taken out of the taxable income. But in the mining industry the extra risk of the business is not taken care of in arriving at the operating profits in any one year.

To levy taxes in disregard of this fundamental relation between risk and return in particular industries is not only unjust but discriminates against those industries where the risks and hazards are greatest. Congress, therefore, in its improvement of the income tax laws, properly took cognizance of the high degree of hazard in certain lines of industry by proper deductions.

The hazards incident to the mining industry and to the discovery of new mines are too well known to need enumeration here. However, some of these may be mentioned.

A sustained output of basic ores necessitates vigorous extensions of productive territory; that is, continuous discoveries. This requires for the industry as a whole annual large expenditures in exploration work which may have no results. Most, if not all, of this exploration is individualistic, and is prosecuted mainly by so-called prospectors. The chances against a discovery of new ore bodies are great, and therefore a large part of their effort, time, and money is wasted. They are spurred on by the notable gain attaching to the final discovery and their risk and hazard of failure is in great measure compensated for by the large gains resulting from the final strike. The cost of negative exploration—that which produces no material result—is not recorded in the books of the industry proper, being borne by the prospectors. There are no records for establishing the cost of this exploration in the aggregate, as it does not enter into the cost sheets of the successful operator. Unless, therefore, this high risk of failure and prior losses are taken care of in measuring the profits due to the final success, the real cost is not considered, and the industry is being taxed upon what is in truth a capital investment. Moreover, being a distinct operation, the loss if recorded could not be availed of, because not occurring in a profits year, but during a period of development and prospecting. Concretely, a prospector may have carried on work at great expense of time and loss on a number of separate properties; all of these are failures. Should he later discover a mine, he can not deduct from the profits of the successful operation the prior losses, because (1) not occurring in the profits year or an adjacent year, and (2) not part of development cost of the successful venture.

This applies whether the prospector is an individual or corporation. The loss and the success must concur in the same year.

Again, not only is there a risk or hazard in the discovery of mines but there are also extraordinary hazards in the operation itself after the discovery. Among these are:

(*a*) The continuance of the ore bodies or deposits. Usual practical results do not warrant, in most cases, the attempt to block out the entire ore body. In many cases it is impracticable, if not impossible. Therefore part of the value of the discovery lies in the reasonable estimate of engineers, and these estimates may contain errors that the operators must take into consideration.

(*b*) Not being able to ascertain the geological situation of the deposit, the operator runs into unexpected formations that render extraction of the deposit commercially useless. For example, water, fire, caving, and shifting, and all the other dangers incident to the extraction of the ore body itself. This is especially true of mines of great depth.

(*c*) The competitive feature.

Operators in natural resources have no way of accurately forecasting or gauging the future supply. They can make estimates of the demand but their calculations of future supplies are liable to be entirely upset by new and unprecedented discoveries not only in this country but in foreign lands. The timber reserves are known. In manufactured articles the cost of production can be estimated with reasonable certainty and this places a limit on the supply. But the mines and oil wells have the extraordinary risk of unknown and undreamed of competitive supplies which may be uncovered after the operation has been started. An illustration of this fact from the copper industry is the discovery of huge deposits in South America and Africa, which were commercially unknown when our major copper mines began operations.

(*d*) The necessity of continued production, even at a loss.

This is a special hazard in the mining industry. In bad times operating mines can not be entirely closed down. They would fill with water or cave in. Many mines have smoldering fires which are kept blocked off only by continuous operations. All these facts and many others combine to prevent the closing down of mines.

The same is true of oil wells, with the added fact that oil is migratory. If a well is closed down, it is more than likely to lose the deposit by the continued operation of adjoining properties or by the flooding and encroachment of salt water. Therefore, these industries have no safety value as the merchant or manufacturer, who in times of oversupply may save themselves by closing down.

(*e*) A special risk is also due to the large reserves which mining companies must hold for long periods of time for future use.

Reserves are not a commodity that a mining corporation can buy in the market at any time that its supply is in danger of exhaustion. They must be developed and blocked out often years in advance. Their estimated extent in part determines the character of the operation and size of the plant and equipment to be erected. Sound mining principles require such companies to have large reserves sufficient to meet the needs of the business for a long period in the future before embarking on the venture. The first result of this is that a supply of raw material has to be acquired by a mining operation many years in advance of its use or resale; this imposes a special risk or hazard due to unforeseen market conditions at remote periods in the future. Unlike the merchant, who purchases his stock of goods only for the next season, the mine operator has to estimate and take into consideration the future price for many years. Price reductions for short periods in advance are difficult and uncertain, but this difficulty and uncertainty is multiplied when extended into the future.

(f) Loss of time and return upon investment. We can not express this matter better than by quoting the following remarks on the subject taken from a paper entitled "Protection against unjust taxation of mines," read by Mr. T. O. McGrath before the American Mining Congress in November, 1919.

"DETERMINING INCOME

"Second. The income of a mine is determined principally by the amount that the net value of the ore discovered is in excess of the investment in mining claims, development, and equipment, while the income of other industries is determined by the price at which the article can be sold above the cost of production and the quickness with which the investment is turned.

"Third. It takes from three to seven years, as a rule, after the necessary development equipment has been installed on a mineral property to prove the value of the property, during which time the investor stands to lose not only the interest on his money, but all or part of his principal, depending upon the amount of the net value of the commercial ore, if any, that may be discovered.

"Other lines of industry have the value of their investment established immediately upon the acquisition of their stock, and are able, as soon as equipment necessary to handle the business can be installed, to offer their product for sale at as high a figure above the investment cost as competition and the law of supply and demand, etc., will allow.

"Fourth. Mining, in taking the risk involved in proving its initial investment, as well as being deprived of any return on its investment during this period, besides being a wasting industry, must obtain a higher rate of income after the mine has been proven to be income-earning property than is obtained by other business in order to insure before exhaustion the same average return of income as other lines of industry.

"EXHAUSTING RESERVES

"Fifth. To operate a producing mine requires extraction of ore and sale of its recoverable contents, which eventually exhausts the property of all commercial contents. Therefore, to continue the life of the business and keep the organization intact requires that the same risk and uncertainty and delay in return on investment as in the beginning of the business must again be taken in the case of new properties before the exhaustion of each proven property.

"In the case of other lines of business that have an established trade it is simply a question of reinvesting the liquidated capital that was invested in stock in the purchase of new stock of finished or raw materials, which in the case of successful commercial enterprises is done three or more times during each year's operation without any hazard whatsoever.

"In addition to the main points set forth above, mines are subject to accidents by fires, flood, and cave-ins of greater magnitude than in the case of other lines of business, which at times result in an operating loss even after the mine has been proven to be an income-earning property, and against which there is no insurance except in the case of accident to employees.

"A proven property has not only to assume the risks and uncertainties above specified, which are not assumed by other lines of business, but must also bear the risks common to all business of fluctuations in the price of materials, wages of labor, and cost of supplies, as well as strikes and acts of nature, which at times may result in a proven mine operating at a loss for any one period."

The foregoing, which are a few of the extraordinary hazards of the industry, are sufficient. If discovery depletion is not allowed, then no consideration has been given to this extraordinary hazard of the wasting industries in levying taxes. The allowance of depletion based upon the cost or actual investment does not cover the extraordinary hazard involved.

IN ORDER TO SURVIVE AND CONTINUE THE MINING INDUSTRY MUST MAINTAIN A FUND FOR REPLACEMENT OF ORE BODIES

It is characteristic of the wasting industries that they live by consuming their capital. Mining operations necessitate the ultimate exhaustion of the mine itself. If the industry is to continue and be permanent, it must continually find new sources of supply. In order to do this a properly managed mining operation must maintain a fund or reserve for replacement of exhausted ore bodies. It must do this in advance of exhaustion, otherwise it would end in cessation of operations for lack of deposits. Obviously, the mine operator, either individual or corporate, must set aside from the operating income derived from the mine a reserve for the replacement of the ore extracted. This reserve must be sufficient in amount to cover not only the contingencies of this hazardous and uncertain business but to insure the replacement, either by purchase or discovery, of a new ore body when the particular mine is exhausted. To treat all of the operating profits as net income and to distribute them as dividends without proper reserves for replacement would lead to eventual bankruptcy or complete liquidation of the mining industry.

It is a fair and reasonable assumption that this cost of replacement will approximate the average value of the discovery of a like amount of ore in the

ground. This value is not equal to the particular cost of making the particular discovery because it does not take into consideration the cost of innumerable failures not reflected in that particular cost. In other words, a fair fund for replacement may be considered as the cost necessary to purchase an amount of ore discovered by others equal to that mined. A replacement of depletion reserve, to be adequate, must therefore be equal to the purchase price of properties discovered by others. Otherwise it would not take care of the contingency that the mine operators might be forced, in order to maintain production, to acquire new ore reserves by purchase.

It was upon this ground, among others, that in 1919 Congress authorized the discovery value of a property to be the basis for depletion deductions. Many of the criticisms of the discovery depletion provisions arise from a false viewpoint. The great mining and oil industries of this country are likened to the old "Forty-niners" of the California gold rush—fortune hunters—having no more capital investment than a pick or shovel—out to find a treasure trove, on or near the surface, easily uncovered, to mine it as soon as possible and return home with the proceeds. These critics of the discovery depletion provision argue that such profits, being "found money," should pay taxes on the full find.

Such is not the nature of the mining industry as it exists to-day. As Senator Reed Smoot stated in an article appearing in the Mining Congress Journal in December, 1925:

"The mineral industry is no longer an isolated mining operation. It is no longer a pick-and-shovel business which can be exemplified by a prospector and a burro. It is in itself a huge manufacturing operation. The heretofore simple process of taking ore from the hills and sending it off to smelters for refining is being largely replaced by mining methods which in themselves are so complex as to constitute the manufacture of metals and mineral compounds from the true raw material; that is, ore in place. The huge mills in which copper is concentrated from low-grade ores, the refineries which recover not only the metals sought from the ores, but all by-products of metallic recovery from fumes, dust, and slime, and the mills which, in turn, produce not only bar metal but rods, sheets, tubes, points, pigments, fertilizers, acids, abrasives, and similar articles ready for intermediate and final consumption make up an intricate industrial operation with ramifications into every part of our industrial fabric.

"There is also a highly important advantage to the user for whom these products are designed in the type of production which will insure continuous operation. Statistics over a period of years have shown that in a group of protected mineral industries, as contrasted to a group of unprotected mineral industries, the range of price fluctuation in those industries which were protected is much less than in those which were unprotected. This is of advantage not only to the producer of the minerals, but also to the ultimate consumer."

The mining industry is a great industry requiring extensive operations conducted over long periods of years with large plant and equipment investment. It is not evanescent or fleeting, but permanent and stable. Its object is not distribution and dissolution, but construction and continuance. It is and plans to continue a permanent part of the great industrial wealth of this country. Unless the search and discovery of new reserves keeps apace with extraction and sale the industry will inevitably die. And to insure this continuous search and discovery of its reserves the industry must maintain a fund therefor, annually set aside from its current profits. This annual fund is a true cost, and therefore a proper deduction from its operating profits in arriving at the taxable net income.

MEMORANDUM RELATIVE TO QUESTIONS RAISED BY DEPARTMENT OFFICIALS CONCERNING THE PROPOSED AMENDMENT TO THE REVENUE BILL TO PROVIDE FOR DEPLETION OF METAL MINES ON A PERCENTAGE-OF-GROSS-INCOME BASIS

1. *Application of the proposed amendment.*—The Treasury may object on the ground that the proposed amendment would allow depletion on ores not included in any prior valuation, and not allowed depletion under the Treasury's interpretation of the existing statute.

Answer: The real question here is not as to the existence of ores at the basic dates, but as to whether they were so proven that the Treasury would include them as ores to be valued. Smaller taxpayers have been at a decided disadvantage because of their inability to assemble and present the data necessary to meet the technical requirements of the department.

It is understood that the Treasury Department recognizes that the 15 per cent of gross (subject to the 50 per cent limitation of net) is a "reasonable allowance." The proposed amendment would give the right to this "reasonable allowance" to all taxpayers alike.

Errors in estimates of tonnage are inevitable. The proposed amendment would automatically correct such errors.

The principles of percentage depletion have had congressional approval as applied to the oil industry in the act of 1926, and retained in H. R. 1.

The proposed plan will simplify administration. Some questions must be decided by new department rulings and regulations, but the procedure once established will be simple and will relieve smaller taxpayers particularly of the great burden they now have in trying to meet the technicalities of the present system.

2. *Option to change from year to year from a valuation basis to the percentage basis, and vice versa.*—The Treasury may point out that under the wording of the pending amendment the taxpayer could change for a March 1, 1913, cost, or past discovery basis, to the percentage basis and change back again from year to year.

Answer: The opportunity for such a yearly option does exist in the heretofore proposed amendment, but this is not considered by the metal-mining industry as an essential feature. To meet this criticism the metal-mining industry has no objection to a provision which would require that as to any property the taxpayer adopting the percentage basis should thereafter be held to that basis. Appropriate language to make this effective is included in the suggested revision of such amendment as hereinafter set forth.

3. *Bases for application of the percentage rate.*—The Treasury may say that the proposed amendment is not sufficiently specific in its language to furnish a definite basis for determination of the amounts to which the 15 per cent and the 50 per cent are to be applied.

Answer: The determination of 15 per cent as a fair average rate applicable to the different divisions of the metal mining industry took into account the various practices which were customary within each division in disposing of ores, concentrates, or metals. The department seems to feel that the wording of the heretofore proposed amendment would not enable it to recognize these variations as to the different divisions of the industry.

To meet this objection, the changed wording set forth in the revised form of the amendment submitted herewith is suggested. With this wording and the general power which the commissioner has under the law to prescribe regulations, it is believed all requirements are met.

Attention is called to the fact that certain mining companies do not actually dispose of their products in the open market, but transfer them to related or affiliated companies on a cost-plus or other intercompany basis. Authority probably is necessary in the law to allow the commissioner properly to deal with such situations and the last sentence of the suggested revised amendment covers these situations.

PROPOSED AMENDMENT AS NOW REVISED

Add to section 114, H. R. 1, page 79, after line 24, the following:

"This paragraph shall not apply to metal mines discovered after the approval of this act."

And add a new paragraph, as follows:

"(3) In the case of metal mines, if as to any ores or metals no depletion is allowable under the preceding paragraphs, or if the taxpayer shall waive as to any property for the taxable year and all subsequent years the right to any depletion allowance under the preceding paragraphs, the depletion allowance shall be 15 per centum of the total receipts from the sale or other disposition of the ores or metals from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income (computed without allowance for depletion) from the property. Where products are transferred on an intercompany basis at a price greater or less than the market value, the total receipts and the net income subject to the percentage depletion reduction shall be constructively computed on the basis of current market value for the product so transferred."

The CHAIRMAN. Doctor Adams, are you ready to proceed?

STATEMENT OF T. S. ADAMS, NEW HAVEN, CONN.

Mr. ADAMS. Mr. Chairman, I am not certain that I have anything that I especially want to say. There are a number of questions in which I am interested that arose this morning. I shall comment on one or two of them very briefly.

First. Mr. Ballantyne asked me to say—and I ought to say for him—that he had not seen the report of the chamber of commerce at all, and would not wholly subscribe to it. I would say with respect to most of the so-called experts who served on that committee, including Mr. Ballantyne, Mr. May, and myself and others, that we practically never agree with the entire committee report. It is much like the votes of you gentlemen on a bill in Congress. You have to vote on some things at times, and you are not necessarily behind every detail of every bill for which you vote. I myself, for instance, am very deeply opposed to certain of the important proposals of the chamber of commerce. It never occurred to me that my name behind one of those committee reports had any particular significance, or I should have taken occasion to formally dissent from it, but that seemed to exaggerate the importance of the whole situation.

We work on those things at a good deal of cost and sacrifice to ourselves, in an effort to get things as nearly right as they can be made, but we do not exaggerate the importance of our own names. I think that might be said in behalf of all of us. We should not be thought to be unequivocally behind every detail of these recommendations.

I do believe this. I believe that the participation of the chambers of commerce of this country in revenue legislation is a very indispensable element. You gentlemen want to know what the chambers of commerce and the business community think. The apparatus by which they can be given a voice is necessarily rough and necessarily inexact; but, nevertheless, you can not legislate wisely, and the Treasury Department can not legislate wisely, unless those gentlemen think these problems over and state their position and their opinion definitely.

As a matter of fact, this whole subject should be taken out of the domain of controversy into which it has gotten, and it should be recognized that the Treasury Department and the chamber of commerce alike are fulfilling as best they can a function that is very necessary to fulfill in a democracy.

I have served on these committees of the chamber of commerce since before the war. I have served on their tax committee. I want to state this one thing, which you gentlemen may not know but which you ought to know. Repeatedly, again and again, that committee and the chamber of commerce have refrained from urging tax cuts which would be to their selfish advantage, and which they wanted, and which they thought possible, in deference to the recommendations and estimates and conclusions of the Treasury Department. It is a serious matter with them to oppose the Treasury Department, and they do it only reluctantly.

I want to say that in the past they have acquiesced in tax rates which they thought unduly high, out of deference to the Treasury Department, and the events have shown that those tax reductions might properly have been made. That factor in the situation must be considered.

I do not want to make a speech. I want to pass on now to one or two other matters. Mr. Mills asked me to state what I thought about the Treasury estimates. I happen to be intimate with most of the gentlemen on both sides of this controversy, and I respect both sides. I respect them not only as honest and sincere men, but as able men.

I know from past experience, and personally, that the Treasury Department estimates this year have been made absolutely honestly. Not only have they been made after great care and thought, but they have been made as optimistically as the Treasury Department can make an estimate. They put their figures as high as they dared. They have given more thought and time to these estimates than they ever gave before, and, as a matter of statistics, I see nothing about the conclusions of the Treasury Department which I could dispute, although I should differ in the interpretation and meaning of those statistics, as I shall point out in a moment.

The CHAIRMAN. They have this advantage, however, this year that they have had returns from March 15?

Mr. ADAMS. Yes.

The CHAIRMAN. Which they have not had in any other estimate that was ever made.

Mr. ADAMS. They have had that advantage. This aspect of the whole situation should also be noted, that what has been done this year is also true of the past. Mr. McCoy is here. I do not see Mr. Hand, but those two men, in my opinion, are the truest experts on that situation in the United States. Those men have been making these estimates for many years, and they have been just as able and just as honest in the past as they are now. Those estimates have proved off in the past, and you can not forget that. That is a very necessary and essential element in the situation.

It means this to me. I am talking for myself now. It means that you ought to have some machinery to take due account of estimates which, by reason of nobody's fault but on account of the inherent difficulty of the situation, go markedly wrong. They are likely to go markedly wrong, and I do not believe you are going to get a sound financial policy until you consider that possibility.

I want to pass on and amplify that a little. I said a moment ago that I should be forced to differ a little from some of the interpretations of the Treasury Department. I believe, for instance, that in the conditions which we have had in this country it is at times absolutely legitimate and desirable and expedient to do what was characterized this morning as carrying over a surplus from one year to another. I want to illustrate that.

In some of the discussion it was stated that the position of the chamber of commerce was that we should run, during the fiscal year 1929, at a deficit of $200,000,000. I do not agree at all with that interpretation of the situation. That seems to me an erroneous interpretation.

This is the situation, as I see it. Here I want to pause to get one fact in the situation clear. I may appear to be digressing, but I want to say this: I do not believe there is any clear thinking possible about this subject unless we start with some understanding of the debt-retirement policy of this country. We have a debt-retirement policy. On the whole it strikes me as a wise policy. It provides, for instance, in the year 1929, for the retirement of about $541,000,000,

as I recall, of debt through the sinking fund and the application of the payments from foreign governments. It provides this year for something in the neighborhood of $535,000,000. It provided last year something in the neighborhood of $510,000,000, as I recall. My figures are what might be called approximate.

If we never had a dollar of surplus, we should retire over half a billion dollars of debt in those years through the ordinary channels. As I figure it out, I may be wrong about this and Mr. McCoy can answer it better, but I figure out that from now until about 1942 we shall, on the average, without counting any surplus at all, extinguish about $750,000,000 of the debt per year. That is generous debt retirement. I believe in generous debt retirement. I believe in it so much personally that I rather hope this Congress will set at rest the question which occupied so much time this morning, as to whether the interest on the foreign debt should be devoted to debt retirement, and say that it should, under all circumstances. I am heartily in favor of that. In all the figures I use, or in any arguments I shall make, I shall assume that the full payment of interest on foreign debts is devoted to debt retirement.

We have had that program of debt retirement. It has been skillfully and ably, and, as I think, wisely and prudently adopted, and I hope it will be adhered to. It means at the present time materially over half a billion dollars of debt retirement. It will mean on the average, in the next 15 or 20 years, three quarters of a billion.

Here is my own personal position, the chamber of commerce or anybody else to the contrary notwithstanding, that the part of wisdom is to come as near as is humanly possible to extinction and retirement of debt, as laid down in that program, and if the difficulties of estimates and difficulties of statistics, and all the other practical difficulties of the situation should bring it to pass that you run for three or four years, as we have run the last three or four or five years, actually retiring twice as much debt as our program calls for, some of that surplus should be devoted to tax reduction. That gets too much. It is all very well to say that we have a surplus of $25,000,000 or $30,000,000 a year beyond the desirable and necessary bank balance which a great institution like the Government ought to maintain, and that that little surplus should be automatically devoted to retirement. Every man here would say yes; but if the difficulties of the situation are so great that these anticipated surpluses actually double, unconsciously, your program of debt retirement is going too far. That is my personal opinion about it.

The CHAIRMAN. Under the estimates of the department, if you think they are right or approximately right, the coming year we could not apply to the reduction of our foreign debt more than $500,000,000.

Mr. ADAMS. Mr. Chairman, let us get back to that a moment. We have for this fiscal year an expected surplus of $400,000,000, in round figures, for the fiscal year ending June 30, 1928. There is $400,000,000 more than our statutory program of debt retirement calls for—this program carefully and prudently and wisely and skillfuuly adopted. Now, then, I say we have $400,000,000 more than our deliberately planned program called for, and if somebody proposes to carry $200,000,000 over into next year to make a program of tax

reduction possible that would otherwise be impossible, I say that is justified from every standpoint. It is justified from the standpoint of business common sense. It is justified from the standpoint of business practice, and it is justified from the standpoint of financial science. If we "carry over" $200,000,000 of that, we are not necessarily running at a deficit next year. We are using $200,000,000 which turned up in excess of our requirements for this year, to stabilize and smooth out our financial operations.

I am in exactly the same position as the Federal Government. Practically ever year of my life for the last 10 years I have earned or collected considerably more money in the first six months of the year than I spent; and regularly, the last six months of the year I have spent more than I earned. Do you mean to tell me that I have to stop every June 30 and devote the artificial surplus I have at that time to debt retirement, and starve the rest of the year?

The fiscal year is nothing sacrosanct. It is particularly otherwise in view of the fact that our natural business year is a calendar year rather than a year ending June 30, because our major revenues come from the income taxes, which in the main are based upon a calendar-year basis, so that that does not get me. The bookkeeping fact is in this connection the real fact.

We do not have a cash surplus at any time. No individual has it. In these six months of the first half of my own year, where I have an excess of receipts over expenditures, I do not have it stacked up in the bank. I reduce my indebtedness by that amount, and in the subsequent half of the year, the last six months of the year, I increase my indebtedness a little, and in no year in my life have I ever spent more than I earned. I consider that I am prudent and practical and that no other course of affairs would be wise.

It all comes down to this: Do the necessities of financing the Federal Government make possible and probable enormous and disproportionate surpluses? If they do, then some provision should be made to take care of that fact, and it is within the wisdom and ingenuity of you gentlemen to take steps to that end.

I want to make another point. This is a point which has gotten entirely out of this discussion, and to me it is far and away the most important point in the whole situation. The time is fast approaching, in my opinion, where Federal tax reduction will be impossible. The normal expenditures of the Federal Government are going to catch up in the very near future with our tax receipts, in the general sense. Tax reduction in the future is going to be very difficult. That is my judgment about it. Just when it is coming I do not know, but the time is close at hand.

The CHAIRMAN. More than likely next year.

Mr. ADAMS. I think you have to take that into account, Mr. Chairman. I want to go a step further. Meanwhile we are going into that situation with a tax system whose structure is, in one respect, exceedingly bad. We ought to have corrected that. We ought to have gotten the thing symmetrical before we came into the period of possible tax increases, and if we had done that, I should regard the question of a tax increase with far more equanimity than I now regard it.

The CHAIRMAN. Doctor, many of us agree exactly with the statement you made, but we have a legislative situation.

Mr. ADAMS. I want to meet that, Mr. Chairman. May I develop my thought, and then see if it answers your question?

Here is the thing that I think is seriously wrong in the tax system. We have a normal tax applicable to corporations of 13½ per cent. We have a normal tax applicable to individuals of 5 per cent. It is not a normal tax of 5 per cent, because it is graduated—1½, 3, and 5.

I shall not stop to elaborate that, but you have to bring it into the discussion because it is, to my mind, right at the foundation of the discussion.

Here is a 5 per cent normal tax applicable to certain classes of business enterprises and individuals, and 13½ per cent applicable to corporations.

Let me illustrate the absurdity, in one sense, of the whole situation, as brought out to me very keenly the other day when an important corporation with a foreign bondholder asked me what to do. Some sort of an association was getting some bond interest from this corporation. It was not clear whether it was a corporation or not. They said, "What shall we do about it?" It is a German association of some kind. If it is such an association that under our laws it should be interpreted to be a corporation, we will hold 13½ per cent, but if it is a partnership or one of those associations that does not get technically into the class of corporations, we withhold 5 per cent. What difference does it make? There is an absolutely artificial and very excessive disproportion between the tax applicable to a corporation and that applicable to the individual. It is so bad that we are beginning to introduce devices with which we all are sentimentally in agreement, I take it. We want to relieve the small corporations, and we are increasing the exemptions to the corporations and providing for graduated rates to the corporations with smaller incomes.

If you gentlemen will look into that you will see that in its practical application it is even worse than illogical. A small corporation may be owned by powerful and wealthy individuals, and thousands of them are. That is another illustration of it.

I do not want to go into this any more. As a student of taxation—and I have no interest in it apart from that—this discrepancy between the individual rate and the corporation rate is a major fundamental defect in our system. It has been one of the grave mistakes or misfortunes—I do not know that it was a mistake of the past—that we have not gotten those two things together. If we had, I think we could do this. If we had the corporation rate somewhere near where it ought to be, we could handle the situation very easily. It could probably be evened up by a 7½ per cent rate, in my opinion. I think 9 per cent is the very outside anybody could possibly suggest as a fair rate on corporations in view of a 5 per cent normal tax on individuals.

If we had that evened up you gentlemen would be in a position where you could make the income tax fulfill its proper function. You could simply put on automatic increases on the individual and corporation rate alone. If we threatened to have a small deficit, or had a small deficit, you could make a surtax on the actual tax bills turned in. You could get an automatic adjustment, and I can not conceive of anything more wholesome than that, in a general way.

That is what I would like to see done. I would like to see you get that corporation rate nearer to the point where it should be, and then introduce a policy of getting the additional revenues that you needed by a proportionate increase, and if you ran into surpluses in the future you could make a proportionate decrease. I think that that is statesmanlike and I think it would be wholesome in every way.

The CHAIRMAN. The tax on individuals has its effect on everybody. You are opposed to any graduated tax for corporations?

Mr. ADAMS. I am most certainly opposed to that. The point I want to make, Mr. Chairman, is that every time we have any tax increases we have an awful struggle down here as to who shall pay the increase, and we have almost as difficult and intense a struggle as to who shall get the benefits of decreases. If we had that thing on a stable relationship of rates the natural thing would be the wholesome thing—boost them both up a little. Let the taxpayer know, as he should know, that increased expenditures are increasing his tax bill. Let the taxpayer know that prudent and economical management of the Government will reduce his tax bill. If we had such a provision as that, if we only had that custom or policy, I would regard going into the next fiscal year, the fiscal year 1929, that year alone, with entire equanimity—not only with equanimity, but, I think, it would be wise. I can not quite honestly say that I would advocate personally a 10 per cent rate, but I should go into it with an 11 per cent rate on corporations, or 10½ per cent.

Just one more point: I have made more in the nature of a speech than I wanted to, or had any justification for.

The CHAIRMAN. You do not mean to say that we could possibly make that 10½ per cent?

Mr. ADAMS. I think you could; carrying over the surplus in the way I spoke of.

The CHAIRMAN. That would be $246,000,000. It is not the next year. That is not where we are bothered. It is the year following. How on earth would we ever meet our obligations? The appropriations are going to increase.

Mr. ADAMS. You say the appropriations are going to increase, Mr. Chairman. That has been said in the past. You need some obstacle to that increase. That is precisely why I want the tax rate down, and precisely the viciousness of having a tax rate that produces a surplus. You have the most difficult task in the world. Nobody knows it as well as you know it. It is the most difficult task in the world to stop appropriations and stop expenditures. I do not think all of it, personally, is as unwise as some people think, but we need the resistance that would come from decreasing the general income-tax rate to stop it. That is personally why I am in favor of cutting the tax rate to the bone at the present time, in order that everybody who champions an increased expenditure will have to provide the additional rate to produce it.

Senator SHORTRIDGE. If that proposition had been submitted along with the others through the referendum proceedings, what do you think would have been the reply?

Mr. ADAMS. Senator, I do not know about that. I am coming down here to try to help arrive at the truth.

Senator SHORTRIDGE. I understand.

Mr. ADAMS. I have worked a great deal for this committee. I never do anything else than that. I do not care what you say. If you convict me of making mistakes or of inconsistencies, I am not interested in that.

The CHAIRMAN. I agree absolutely with you that the partnership and corporation taxes need attention. Here is the corporation tax: That has not had any kind of a reduction, from the very first of the war period, with the exception of the excess-profit tax, of course, that went off on everybody. But 4 per cent is $82,000,000.

Mr. ADAMS. Senator, may I talk a little about figures? You may want to correct it, but here is the way I figure that: Suppose we cut the rate to 10 per cent, which I think is perhaps a little extreme.

The CHAIRMAN. That would be $287,000,000.

Mr. ADAMS. That is for one year, Senator.

Senator SHORTRIDGE. That is a fact, though, is it not?

Mr. ADAMS. That is a fact. I accept that as a fair estimate.

The CHAIRMAN. It is low enough.

Mr. ADAMS. That is about right. It would amount to about $287,000,000 for a year.

In the fiscal year 1929, only one-half of that would affect the revenues for the fiscal year, because that tax, on that basis, would be paid in the four quarters of 1929, and two of them would come in the fiscal year 1930, so that only one-half of that would affect the finances for the year 1929. Now, half of that $287,000,000 is about $140,000,000 and odd.

The CHAIRMAN. $143,000,000.

Mr. ADAMS. Personally, in view of our excess surplus for the year 1928, I am not at all affrighted by a tax reduction of $143,000,000. I think a tax reduction is more than important. Will you gentlemen remember this, please——

The CHAIRMAN. That is only one. What are you going to do about all the other taxes you are going to have, on the intermediate brackets, on automobiles, admission tickets, etc.?

Mr. ADAMS. Take those into account.

The CHAIRMAN. Doctor, you can not carry that through Congress to-day. I would not care if it amounted to half a billion dollars. They are going off, and I know it.

Mr. ADAMS. Senator, I shall have to say what I think is right, whether it goes through Congress or not. I think it should.

The CHAIRMAN. That is what we have to consider.

Mr. ADAMS. But you have the resources there. You can carry over safely $250,000,000.

The CHAIRMAN. What about the following year?

Mr. ADAMS. Senator, there is where, if you will excuse me, I think Congress is abandoning its principal duty. You are here to vote increased taxes, and that is the reason I suggested getting the corporation rate and the individual rate on a sound basis. Then you can simply come in and say that that ought to be increased by one-tenth, or three-tenths.

What has caused the trouble in the past? Why have we had surpluses in the last five or six years exceeding our provision for debt retirement? It has been excessive caution. I am a cautious man myself. I admire caution and due prudence, but there is such a thing

as excessive prudence. We have to take some slight risk, and if you figure that our borrowing power is unlimited, and that in the ordinary course of events we are going to retire debt to the extent of $541,000,000 in the next fiscal year, the horrible bogey of a possible deficit does not afflict me. We have had it before. We have it here for five or six years, and I have about concluded that I have been unduly frightened.

One other point about the desirability of tax reduction. Mr. McCoy suggested that we would have a deficit in current revenue. What is our program of debt retirement to be? There is a little thing that I think you gentlemen ought to clear up in your minds. Is it to be a fixed sum, or is it to be a fixed sum plus the realizations on capital assets, a thing which is frequently suggested, or is it to be a fixed sum plus the realization of capital assets plus the surpluses? What is it to be?

Nobody sitting in this room, probably, is more in favor of generous debt retirement than I am. If Congress wants to say, "We will retire in accordance with the schedule, which brings us $541,000,000—as I recall—for 1929, plus all the realizations from the sales of capital assets," I personally am willing; but that is not what you have said. That is not your program. That is not the basis of your estimates. That is not the financing and figuring on which the President and the Secretary of the Treasury have made their estimates. They have included in their estimates these realizations of capital assets when tax reduction was under discussion; and later, when that plan and that forecast yielded an unexpected surplus, they have said, "Well, it is all right. We got a lot of that from capital assets." I do not agree, but that is an aspect of the reasoning which you have to consider.

I pass on to one other thing. Secretary Mills said that this year we have a surplus of $400,000,000—but it is not a surplus, because $170,000,000 comes from payment of railroad obligations. It is realization of capital assets. That, of course, is true; and, of course, it is true in general that we ought to devote the sums realized from payment of capital obligations to debt retirement. But he also said that we had a surplus of some $220,000,000, as I recall, of current receipts.

The CHAIRMAN. That is the collection of——

Mr. ADAMS. Suppose we use $200,000,000 next year, the so-called carry over. Suppose we carry over $200,000,000. Have we carried over the surplus of current receipts, or have we carried over the realization of dead assets? That means nothing to me.

I go back to the older language—in which I can discuss all this—that we had a careful, adequate plan of debt retirement. We said, "We are going to stick as closely as we can to that plan"; and in the year 1928, through the fault of nobody—because I know the temper and intellectual honesty of the people who made those estimates—we ran $400,000,000 ahead of our plan.

Now, if tax reduction is what the college professors call a great desideratum, if we really want it, if it is worth while, I think it is playing the baby act to say that we can not use some of that $400,000,000 in achieving tax reduction.

The CHAIRMAN. The only way to answer that is that if next year we did not have those capital assets, then we would have to raise

the rates to meet the obligations of the Government, and that is almost an impossibility.

Mr. ADAMS. Senator, what do we mean by carrying over a surplus? Mr. Mills told you—and it is true and skillful and wise—that we never have anything but a working balance in the Treasury. We extinguish our current debt by the full amount of whatever the momentary surplus is, and that is wise. That is what we would all do.

The CHAIRMAN. Of course.

Mr. ADAMS. But you finish the year, and if you have run ahead of generous plans made in advance, of $400,000,000, the difference is a true surplus. It is a bookkeeping proposition.

If in the following fiscal year—and here is where I differ with Mr. Mills—you issue, we will say, $200,000,000 of short time certificates to make up for that, to equalize and stabilize, it seems to me not only thoroughly legitimate, but the sensible and sane thing to do. I have to do it. Every business concern has to do it.

The CHAIRMAN. And, so far as I am concerned, I would not want to be the chairman of a committee that would be compelled to do it.

Senator SHORTRIDGE. You would have to pay interest on those certificates, would you not?

Mr. ADAMS. May I speak about the interest? They also have to pay interest on them, but let us stop to think about this. The Government, according to Mr. Mills's statement, is paying 3.88 per cent interest rate on its indebtedness. Nearly every business taxpayer who pays taxes to the Government is indebted, and he is paying more than 3.88 per cent interest every year. I believe in generous debt retirement, but you have to come to a balance of judgment here. There are two sides to this. I am borrowing money, and most people are. I am paying a great deal more than 3.88 per cent. I am paying close to 6 per cent. I borrowed money to pay my taxes this year. I think I did so wisely. The interest side of the situation, put forth from the standpoint of the Government alone, is not controlling. It is important. It is weighty; it ought to have solemn consideration, but there is something on the other side.

The CHAIRMAN. We are saving 3½ per cent interest on the amount we have already paid, $250,000,000, that would have been paid here out of interest.

Mr. ADAMS. You are getting it from taxpayers who are paying 5 per cent on their money.

The CHAIRMAN. They do not have to pay anything on that. That is finished.

Mr. ADAMS. I thank you, gentlemen, very much.

STATEMENT OF D. D. TENNEY, REPRESENTING THE TENNEY CO., OF MINNEAPOLIS, AND OTHERS

Mr. TENNEY. My name is D. D. Tenney. I am president of the Tenney Co., of Minneapolis, a grain commission house, and I represent 12 grain exchanges in this country, as follows: The Minneapolis Chamber of Commerce, the Kansas City Board of Trade, the Milwaukee Chamber of Commerce, the Duluth Board of Trade, the

Omaha Grain Exchange, the Chicago Board of Trade, the St. Louis Merchants Exchange, the Toledo Produce Exchange, the Buffalo Corn Exchange, the Boston Grain and Flour Exchange, the Baltimore Chamber of Commerce, and the New York Produce Exchange.

In reporting the 1928 revenue measure to the House of Representatives, Chairman Green said in regard to this tax:

> The stamp tax on sales of produce on exchanges which has always operated as a tax on agricultural products, has been repealed.

The commodities affected are wheat, cotton, corn, sugar, oats, flax, lard and other hog products, rice, rye, barley, butter, and eggs, which are dealt in for future delivery on organized markets. It will be noted that all of these commodities are agricultural commodities which are necessities of life.

This tax has been in effect for 12 years—5 years at the present rate and 7 years at a higher rate.

Revenues which the Government obtains from this have never been large.

Under the act of 1924, this tax has been a decreasing source of revenue to the Federal Government, collections for the last three fiscal years being for 1925, $5,400,000; for 1926, about $4,000,000; and for 1927, $2,844,000.

Of the taxes collected, as nearly as we can determine, cotton and rice for the fiscal year 1927 bore $1,000,000, grains contributed $1,750,000, and the other commodities affected by the bill contributed the small additional revenue.

In addition to taxes imposed by the terms of the bill, the manner of collection imposes a further burdensome tax on commission houses through whom and by whom the tax is collected for the Government. The tax itself, however, is passed on to those dealers and traders who use the organized exchanges for protection against market fluctuations in the handling of these commodities.

The CHAIRMAN. The greater amount of the tax collected, however, comes from the transactions on these exchanges where there is no transfer of the property itself. In other words, it is sold one day to one commission man and the next day to another.

Mr. TENNEY. May I inlarge on that just a moment?

The CHAIRMAN. He in turn the next day will sell it to somebody else, and every turn is taxed.

Mr. TENNEY. Very true. I think the original framers of the bill did not realize that. They thought that there would be one tax on one bushel of wheat, for instance, and instead of that, because of the necessity of transfering from market to market in order to equalize the markets and keep them in equal situations so that there would be no stoppage in the flow of grain——

The CHAIRMAN. Just qualify that by adding "and gamblers."

Mr. TENNEY. No; we do not want to do that. May I emphasize that point, Mr. Chairman? This stamp tax would not stop for one moment the public entrance into the grain exchange for the purpose of what you and I call gambling. That is very detrimental to the grain exchanges, because it means unnatural fluctuations, which are often detrimental to the producer. If we could by this stamp tax stop that, we would not ask for its withdrawal, but there is another side which it does stop, if I may mention it, and that is the scalpers,

people who are not familiar with the grain trade also think of as grain gamblers.

The scalpers are a very necessary part of the marketing machinery. The country dealer buys in varying quantities, at various points, and sends in various messages to sell.

The CHAIRMAN. What I had reference to in connection with gambling was this: You go down to the stock exchange and you see one man buy 5,000,000,000 bushels of wheat. He will either sell it at a loss or sell it at a gain.

Mr. TENNEY. May I finish this? This stamp tax does deter the scalper, and in that respect it is a disadvantage to the producer, because the scalper, before this stamp tax, was very willing to assume the risk of insurance on a decline of one-sixteenth. To-day he hesitates between one-sixteenth and one-eighth, because often his stamp tax for the year is from two to ten times his earning for the year. We do not want to carry on a tax that would deter the character of insurance that is good for the farmer, because of the erroneous thought that it might deter the character of speculation which neither you nor I, nor any thinking grain man wants to see in the market.

The stamp tax would not deter investment buying, which is a good thing, but what you refer to as gambling we do not encourage. We do not want it. We are under Government control to-day, and we have our business relations committee of each exchange at work with the Government to prevent that character of trading.

The tax itself, however, is passed on to those dealers and traders who use the organized exchanges for protection against market fluctuations in the handling of these commodities. The necessity of an active, unhampered market for agricultural commodities is admitted and the imposition of this tax, applied only on transactions on exchanges, naturally reduces the volume of business on exchanges with undoubted serious loss to the producer.

As this tax applies only to sales on organized exchanges, which are the farmers' best markets, and does not apply to similar transactions conducted elsewhere, and without the protection which the rules of these exchanges afford buyers and sellers, we consider it a discriminatory tax which should not be longer continued, since the emergency which was the occasion for the imposition of the tax has largely disappeared.

The last two revenue acts have shown some disposition to return to peace-time sources of revenue, among which the Government has never included such sales taxes as those referred to.

Under these conditions, should there be a disposition to continue this discriminatory tax, we could not consider it as other than a punitive measure designed to punish those who engage in the business of distributing these necessities of life on the theory either that the business is disreputable or that the merchants are so prosperous as to fully justify the imposition of the tax. We call attention to the fact that Congress has designated this business as essential to the public welfare. (See grain futures act.)

It will also be found on investigation that the tax is in part paid by thousands of small country dealers who find it necessary to use the facilities of these exchanges in the marketing of these agricultural products.

It will be kept in mind that our domestic commodity exchanges are in some instances in direct competition with Canadian and Enblish markets of a similar character, in which countries no such tax is imposed.

There should be no confusion between this tax, which applies to transactions in necessities of life, and the tax on transactions in securities, dealt in for the investment of surplus funds of members of the public.

The House of Representatives concurred in the recommendation by its Ways and Means Committee and provided for the repeal of this tax. (H. R. 1, in the Senate of the United States, December 17, 1927, p. 191, lines 7–11, inclusive, sec. 441.)

We respectfully petition the Finance Committee of the United States Senate to concur with the action of the House of Representatives and to recommend to the Senate the same action as taken by the House with respect to this sales tax.

STATEMENT OF WALTER A. STAUB, REPRESENTING AMERICAN SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. STAUB. I just wanted to touch very briefly on a few of the items brought to your attention. I shall make it exceedingly brief.

The CHAIRMAN. When we begin consideration of the bill we will take the briefs generally. If you have any special points you want to bring out, you may cover those.

Mr. STAUB. I will just touch on one or two of those. I probably will not be over 5 or 10 minutes in all.

The American Society of Certified Public Accountants, as its name indicates, consists of practitioners in all parts of the country who have to do with the financial affairs of their clients and are in very close touch with them on matters of taxation, and in a good many instances naturally represent them before the Treasury and also before the Board of Tax Appeals, sometimes alone and sometimes in conjunction with counsel, depending upon whether or not there are matters of law involved as well as matters of fact.

As an organization we are not interested in presenting the matter of rates. We do not feel as accountants that that is primarily a matter we should deal with, although, naturally, as individuals we would be interested in that subject.

We have, however, been very much interested all through the years in the various provisions of the act, particularly the administrative provisions, and have felt that at times we might be of assistance in directing attention to sections of the act which, from our observation, might either result in injustice or might unduly complicate the administration of the income tax act.

We have summarized in this memorandum those particular sections of the bill as it passed the House to which we wanted to direct your attention, under a few general headings, and I am just going to touch on the outstanding items that come under those headings.

First, we have grouped under the heading of double taxation three items: First, installment sales; second, the disposition of installment obligations; and, third, the matter of reserve for bad debts.

I might say that on both the installment sales and the reserve for bad debts the situation that has developed has arisen not out of the

interpretation of the earlier laws by the Treasury Department, but rather out of the decisions in certain cases by the Board of Tax Appeals.

The Treasury, under its regulations for a period of at least five years, had interpreted the law and its application to the matter of installment sales in a way that the Treasury seemed to regard as fair, and which was satisfactory to the installment houses. But in a decision of the Board of Tax Appeals, or following a decision of the board, the Treasury has revised its regulations, and the effect of the present act, probably, would be to continue those regulations.

There seems to be a feeling that the provisions of the regulations as revised pursuant to this decision of the board do not result in double taxation, but simply result in imposing a tax on what might be called a normal amount of income in each year, regardless of whether a taxpayer, an installment house, is on the accrual basis, so called, or on the installment basis of realization from sales.

As a matter of fact, there is bound to be duplication of tax if a concern was first on the accrual basis, as practically all were, prior to about 1918 or 1919, because up to that time the Treasury regarded only the same basis for installment houses as for any other business concern. It is first on an accrual basis and pays a tax on the profits in sales when made, regardless of whether collected or not, and then, due, one might say, to the invitation of the regulations as they were enacted in 1920 and one or two years before—if on that invitation the taxpayer had changed to the cash basis, and under those regulations of 1920, the taxpayer was required to pay only on the profit as realized in cash collections, there would be perfect justice. But under the new attitude toward the matter the taxpayer is expected again to pay on the profit in collections made after the change to the new basis, from sales which he had already reported, and on the profit from which he had already paid a tax on the accrual basis.

If he has to double up in that way, the only answer I have heard made to the criticism of duplicate taxation there is that in any event he is paying only a tax on a normal amount of income for each year. But the difference is this, that as the business rises or falls in volume, and particularly if for any reason it liquidates, then a tax is again bound to be paid on the collections right up to the final time of liquidation, and the income that is thought to have escaped tax under the old Treasury regulations will, as a matter of fact, be bound to pay a tax at that time.

If the new regulations continue in force the effect is that there is a duplicate taxation there because of the fact that sales which have once been reported on the accrual basis must again be reported later when the collections are made. That seems to us an obvious injustice, and especially now that the tax rates have become more or less stabilized as to corporations, particularly, it does not seem that there ought to be a scheme of duplicate taxation as the result of a feeling, perhaps, that some particular taxpayers may have had an advantage during years of high tax in making the switch from one basis to the other.

One other very practical consideration in that connection, I think, is this. I doubt very much whether there are as many as 10 per cent—that is my own guess, and of course, it is purely a guess, because there are no official figures extant that I know of—probably

not over 5 per cent of the installment cases that go back to the time when the regulations were changed, are still unsettled. The consequence is that that 5 per cent will now be dealt with in the settlement of their cases on an entirely different basis from those whose cases were closed on the basis of the regulations as the Treasury quite voluntarily had promulgated in 1920 and thereabouts. It does seem, not merely a hardship, but rather an injustice, to have a given class of taxpayers, 90 or 95 per cent of whom have their cases adjusted on one basis, and the other 5 or 10 per cent on the other.

The CHAIRMAN. Does your brief suggest the amendment that you desire made to the bill?

Mr. STAUB. Yes, sir; it does, Mr. Chairman. It suggests that the regulations that were in force at the time be permitted to control.

On the matter of bad debts, a somewhat similar situation developed, to which I shall not refer.

The CHAIRMAN. We had that discussed here at length.

Mr. STAUB. On the matter of consolidated returns, I would like to just call that matter to your attention, because I think that is very important.

On the matter of retroactivity, I should like to close by just quoting from Mr. Gregg, who was formerly general counsel, and who, in the hearings of the Finance Committee, I think in connection with the 1926 act, said:

> It is very bad precedent to set, for Congress eight years after the enactment of an act, to construe it retroactively. * * * It seems to me that the matter of construing a statute enacted by Congress is up, in the first place, to the department and then to the courts.

The CHAIRMAN. We have had that matter discussed.

(The brief submitted by Mr. Staub is as follows:)

COMMENTS ON SOME OF THE OBJECTIONABLE FEATURES OF THE PROPOSED "REVENUE ACT OF 1928" AS PASSED BY THE HOUSE OF REPRESENTATIVES ON DECEMBER 15, 1927

[Submitted by the American Society of Certified Public Accountants, National Press Building, Washington, D. C.]

The American Society of Certified Public Accountants, in presenting this statement and comments on the proposed revenue act, as passed by the House of Representatives on December 15, 1927, which is now being considered by the Senate, desires to preface its specific comments by a general statement as to its position on this subject.

As an organization, the American society is not interested in the question of tax rates. The tax rate is a matter in which the clients of members of the organization are interested, but the organization as such does not propose to express an opinion on this phase of the general subject. On matters of phraseology in the proposed act and administrative procedure provided therein, certified public accountants are interested because they, as well as attorneys, represent the taxpaying public in controversies that arise with the United States Treasury Department in the administration of the tax law and in cases before the United States Board of Tax Appeals.

It was generally reported to be the intention of Congress to enact at this time a simplified internal revenue law. But it is respectfully submitted that such intention has not been carried out in the proposed act now under consideration. It is true that many admirable changes have been made in form and arrangement, but the work has not yet been completed, as is evidenced by the proposal to continue the joint congressional committee, which had the matter of simplification in charge, with the expectation that its work may be finished by the time it will be necessary to enact another internal revenue law.

The effect of this plan will be to disturb administrative procedure twice instead of once. A complete renumbering and rearranging of the law is offered,

which, however, is not in its final form. This will make necessary a double study of all the provisions instead of a single study. It is respectfully suggested, therefore, in the interest of the public, that it would be much better were the Senate to amend the revenue act of 1926 by inserting such changed rates as may be agreed upon and let the other matters rest until they can be presented in complete form.

An added difficulty is found in the fact that, different from any other internal-retvenue revision, it is proposed to not repeal the act of 1926, but to retain it in force except for minor repeals and also pass the act of 1928. This will make necessary the checking of one act against another, in addition to the checking of one section in an act against another section in the same act in order to find the applicable law and its exceptions.

Real simplification of the tax law must be substantive and not merely formal. The proposed act has all the disadvantages attached to any rearranging and rewording of the law, but does not have the advantage of the substantive improvements which the public has been led to expect would be the result of the study of the joint congressional committee. To attack the matter twice is both confusing and an invitation to make a third attack. If this method be continued, business interests of the country will be subjected to a much more complex situation from now on than they have had to face in the past. This complexity applies equally to the Treasury Department's staff called upon to administer the law.

If, in the future, the same practice is followed of retaining the prior laws when enacting a new tax law, it will be possible to have four laws on the statute books governing procedure before the time arrives when a claim or deficiency as to a particular year becomes outlawed. This overlapping of laws will be extremely injurious to the taxpaying public because it will open the door for a diversity of administrative regulations and decisions.

The provision of the proposed act that makes it optional with the Board of Tax Appeals to present a statement of fact with its opinions opens the way for one-man decisions, except in so far as the business of the board slows down. As an administrative matter, a compulsory statement of fact facilitates consideration of the case by members of a division of the board.

The act now pending contains many provisions which will invite and encourage litigation in the courts of the United States and appeals to the Supreme Court of the United States for the purpose of determining the meaning of its several provisions. Retroactive legislation is one of the most fruitful sources of controversy. The proposed act is replete with retroactive provisions. To attempt by retroactive legislation to vitiate a Supreme Court decision is furnishing an argument against our present systems of government. The taxpaying public will have just complaint of Congress if it gives, instead of simplification, an act that will cause more litigation than all prior income-tax laws combined.

As illustrating the failings of the proposed act under consideration, several comments on specific provisions follows.

WALTER A. STAUB, *Chairman*,
HOWARD C. BECK,
EDWARD S. ELLIOTT,
H. IVOR THOMAS,
PATRICK F. CROWLEY,
Committee on Federal Legislation.

1. DOUBLE TAXATION

A. *On installment sales.*—Section 44 (c) of the proposed revenue act continues in positive terms the unfair interpretation that has been placed on section 212 (d) of the revenue act of 1926. This treatment of installment sales is the most flagrant instance of double taxation of income to be found in the revenue laws. The injustice results when a taxpayer changes to be installment method of reporting profit on installment sales. Under the existing interpretation by the Board of Tax Appeals and the Treasury Department and under the proposed revenue provisions, a taxpayer who had paid all taxes on income on sales up to the end of a period and then proposed to change to the installment method of accounting for such sales would find himself taxed in the succeeding years on all payments received on account of sales made prior to the change in method.

The Ways and Means Committee went on record, as did the joint congressional committee, that it would be improper to afford relief where there is such a change in basis. The claim is made that for several years after the time of change in method income would not be fairly reflected. This contention is not well founded, inasmuch as no income from such business finally escapes taxation. All income actually realized, whether in regular course of business or at taxpayer's liquidation of business, will be subject to tax at the time of realization. The failure to recognize this very evident fact prompts the present proposal which automatically results in double taxation. Double taxation of a taxpayer's income, while in his hands, is basically unsound.

The further claim is sometimes made that taxpayers changing from the straight method of reporting to the installment basis in high tax years of the war period realized an undue benefit when the tax rates were reduced. The answer to this contention, particularly from a practical standpoint, is that (a) as to future changes, this is immaterial since Federal income tax rates are now relatively stabilized, and (b) as to past changes, at least 90 per cent of the taxpayers who changed to the installment basis during the war years have already had their tax liability finally determined and settled under the Treasury regulations then in force (which at that time eliminated the injustice of double taxation), and it now seems highly inequitable to apply a different method of computing income in the settlement of the relatively few cases still remaining in the hands of the commissioner for consideration.

It is passingly strange, when it is observed that this proposed act is saturated with retroactive provisions, many of which are calculated to circumvent court decisions, that the Ways and Means Committee in its report on the measure should have been so considerate of judicial determination when it advances the following excuse for continuing a rank injustice; "the committee does not deem it desirable retroactively to validate or invalidate such construction but leaves the matter to judicial determination."

It is submitted that under these circumstances the ends of justice would best be served if a provision were written into the proposed bill to the effect that income from installment sales would be held to have been computed correctly for the years 1916 to 1924 if computed in accordance with the Treasury regulations in force at the time the return of such income was made, and that, in the change to the installment method after this period, the receipts on account of sales made prior to the change shall be excluded in the computation of the taxable profit for years after the change has been made. No net income would finally escape taxation under this procedure, and what is more in point, all installment dealers would have received the same equitable treatment regardless of when their tax matters happened to be finally settled by the Treasury Department.

B. *On disposition of installment obligation.*—Section 44 (d) of the proposed bill provides that "if an installment obligation is satisfied at other than its face value or distributed, transferred, sold, or otherwise disposed of, gain or loss shall result. * * *" The evident intention of this provision is to prevent a taxpayer from disposing of an installment obligation without reporting the deferred and unrealized profit thereon.

There is no objection to this provision in its relation to the disposal of installment obligations by sale (except its retroactivity(, but there is considerable doubt as to the validity of imputing a gain or loss to other means of disposition where actually none has occurred. Take the case of a corporation reporting on the installment basis which proceeds to liquidate by distributing its assets in kind to its stockholders. This provision would require the corporation to report as income the unrealized profit in its installment accounts so distributed. There is no reason why this unrealized profit should not be taxed to the corporation any more than the unrealized appreciation which may be present in any other assets distributed. Certainly a corporation realizes no income on the distribution of its assets to its stockholders. Even if this provision does not violate the sixteenth amendment it is certain to be fruitful of litigation.

Another objection to this provision would be its peculiar effect in a case where a taxpayer made a gift of installment obligations. In the first place, the part of the gift representing unrealized installment profit would be called "income" for the sake of subjecting it to an income tax. In the second place, the donee would also have to report the installment profits when realized, because under section 113 he would be required to take the donor's basis,

which under section 44 (d) is defined as clearly excluding the unrealized profits at the time of the gift. Thus we have not only double taxation but also the taxation of a gift as income.

It is probable that the provision would apply similarly in the case of the transmittal of installment obligations upon the death of a taxpayer, except that there would be no double tax, because the beneficiary would not be required to take the decedent's basis. Here, again, a gift would be taxed as "income" unless it could be held that the act of dying is such an act as is capable of realizing income to the decedent.

C. *On reserve for bad debts.*—Section 23 (j) of the proposed revenue act makes no change in sections 214 (a) (7) and 234 (a) (5) of the act of 1926. These provisions cover the subject of deductions on account of bad debts and deductions from income for the purpose of creating a reserve for bad debts. The practical effect of this section is to double tax income in case of a change in the method of accounting; that is, a change from the method of charging off bad accounts when they actually become bad to the method of creating a reserve for bad debts. The section of the present law is innocent enough, but the double taxation results from the commissioner's adherence to the decision of the Board of Tax Appeals in the Trans-Atlantic Clock & Watch Co. case (3 B. T. A. 1064). As the Treasury regulation now stands, the taxpayer loses the benefit of a deduction on account of amount of back debts originating prior to the change in method of accounting. The situation that has arisen in the administration of this section is particularly hard upon taxpayers who acted in good faith upon the regulations made and promulgated by the Commissioner of Internal Revenue pursuant to the revenue act of 1921, and which original provisions are still believed to be equitable to both taxpayer and Government.

2. TAXATION OF CAPITAL

A. *On distribution by corporation of surplus accumulated prior to March 1 1913.*—Section 201 (2) of the revenue act of 1926, and similar provisions in prior acts provided that a corporate distribution to its shareholders, whether in money or other property out of its earnings or profits, accumulated prior to March 1, 1913, would be nontaxable as income to the shareholder. Section 115 (2) of the proposed revenue act proposes to tax such distribution as income. This change is retroactive to January 1, 1927, which makes the change objectionable on account of being retroactive if for no other reason. That such distributions are distributions of capital under the revenue law is a principle laid down by the Supreme Court of the United States and followed by both Congress and the Treasury Department for many years.

There are no sound reasons for departing from the principle that what was earned prior to March 1, 1913, was capital at that date and is not to be treated as taxable income thereafter. The fact that distributions of corporate profits earned prior to March 1, 1913, are not now as frequent as formerly is no reason for the taxation of such distributions as are made in the future when all such prior distributions have been nontaxable. The reasons advanced by the Ways and Means Committee in its report on the proposed revenue bill are: (a) The exemption should not be continued indefinitely; (b) the exemption has been on the statute books 14 years; (c) most corporations have distributed the surplus accumulated by them prior to March 1, 1913; and (4) the elimination would result in simplification.

There is a principle involved here which is just as sound as it was 14 years ago. The Ways and Means Committee is evidently laboring under a misconception of the facts, because there still remain a great many corporations with large surpluses accumulated prior to March 1, 1913. By law corporations must distribute their latest earnings, and it is fallacious to assume that those prior to 1913 have been distributed. The elimination not only will not result in simplification but will bring about complications arising where dividends are paid out of the depletion reserves of natural resource companies in cases where such reserves are based on March 1, 1913, values and represent the difference between the cost and March 1, 1913, fair market valuation. (See secs. 115 and 111 of the proposed revenue act.) It involves a serious question of equity in the case of natural resource concerns.

A like complication will be involved where dividends are paid out of the depletion reserves of mining companies. Where such reserves are based on March 1, 1913, values, that part of the distribution which represents the difference between cost and 1913 value will be taxable. (See secs. 115 and 111.)

The injustice of this proposed change is such as to demand that it be not made if there be left one corporation with an undistributed surplus accumulated prior to March 1, 1913, that would have such surplus taxed by this proposal.

B. *On taxpayers' change to accrual basis of accounting.*—No change is proposed in respect of section 202 and 212 (b) of the revenue act of 1926. (See sec. 22 (c) and 41 of proposed revenue act.) Under the present law and prior laws, as they relate to change of method of accounting for taxable income, Treasury regulations have been promulgated to justify taxation of capital under the guise of calling it "income." The practice of the commissioner, under his own regulations, has been to require in many cases that inventories be taken in order to more clearly reflect income of the taxpayer, and in such cases at the same time refuse to adjust the income of the year in which the inventory was first employed by the amount of the inventory at the beginning of the year. This is of vital interest to ranchers, farmers, and all livestock, cattle, and sheep raisers who, according to custom, prior to the war tax years, did not use in the accepted sense an inventory in computing their annual net income. Many injustices have been done taxpayers by taxation of capital (in many cases owned for many years prior to the advent of income taxes) as "income" under arbitrary regulations made under authority of these provisions of law.

3. CONSOLIDATED RETURNS

A. *On elimination of consolidated returns of affiliated corporations for the year 1929 and thereafter.*—Section 141 of the proposed revenue bill continues the option which affiliated corporations have of filing consolidated returns under section 240 of the revenue act of 1926. This privilege is continued only for the years 1927 and 1928 and specifically denied for subsequent years. The proposed revenue bill as introduced made provisions in old section 118 for continuing to extend to affiliated corporations the privileges of filing consolidated returns for year subsequent to 1928, but this section was eliminated in the House.

The consolidated return provision of the revenue laws was born out of experience and without its application great hardship and injustice would have been effected during the high-tax years. The corporation rates are still so high that unless the consolidated return is retained, hardships will fall on some units of a group. For the years 1917 to 1921, inclusive, the revenue acts made it mandatory upon affiliated corporations to file consolidated returns, and following the year 1921, Treasury Department officials encouraged the continuation of the filing of consolidated returns. During the time that the returns were required to be filed and up to the present time the whole structure of large corporate activities has been built around the idea of consolidation. It has come to be recognized as a sound principle that separate corporate entities should be disregarded in ascertaining true net income where there is a single ownership, a substantial common ownership, or the separate legal entities are virtually departments of an economic unit. It is generally recognized that measures of taxation should just as far as possible be adapted to existing practices and conditions.

The consolidation of corporations for tax purposes follows this principle. Separate corporations are frequently needed to permit of doing business in a number of different States, to protect the interests of bondholders in specific assets, or for other considerations equally as cogent. The elimination of consolidated returns would force numerous business units to modify their present corporate structure and corporate relationships. This would entail unnecessary inconvenience and expense without resulting in any ultimate benefit to the Government.

Consolidations have been effected on two entirely different bases and consolidated returns have naturally followed the consolidations. One theory, generally spoken of as the "community of interests" theory, is based on the question of legal ownership by the same group of the stock of several corporations, regardless of the character of the businesses in which they were engaged. The other basis for consolidation is dependent on whether the several corporations are operated as an economic unit. Historically, the economic unit idea was the more important in the early days of consolidations and the community of interests idea has become the more important basis in later years. Each theory can be defended and criticized but the Government, having not only consented thereto but made it a specific requirement through many years, ought not to change its policy in a matter which would require readjustment on the part of the citizens affected when it is not demonstrable

that by this change the Government would be benefited to as great an extent as it can be demonstrated that the citizen members thereof would be inconvenienced and, in many cases, injured. Section 240 of the present act should be retained as it now stands.

4. TAXATION OF UNDISTRIBUTED SURPLUS

A. *On accumulated corporate surplus.*—Sections 104 and 105 of the proposed revenue act in substance are intended to take the place of section 220 of the revenue act of 1926. It is claimed by the Government that there is a class of corporations which are formed and operated for the purpose of avoiding the surtaxes on the income of the individual stockholders and that the United States Government is losing a considerable amount of tax by reason of this practice. The attempt in section 220 of the Revenue Act of 1926 to remedy this situation could have been effected through its enforcement by the Treasury Department, had the penalties imposed by that section been reasonable.

The provisions of the proposed revenue act which are designed to reach this class of corporation are much too drastic, and in the so-called personal holding company cases, too inflexible. The provisions which attempt in the proposed revenue bill to reach the personal holding company class of corporations are so broad that they would seemingly include any operating corporations which should be so unfortunate as to have less than 10 stockholders. The stock of a very large number of the smaller corporations in this country is very closely held.

American businesses have been built up by the reinvestment of the corporate surplus in the business. The history of industry in this country shows a very large number of successful enterprises which in their early history were organized and the stock held by a very few men. In the more or less experimental days of such businesses no wide market could be found for their stock. No outside money could be procured to carry on the enterprise and its growth was insured by retaining and reinvesting its earnings in the business.

There are a great many corporations to-day which would be severely injured by a compulsory distribution of surplus or by the imposition of a heavy penalty for failing to distribute, or by the requirement to disclose the details of present plans for future developments to governmental representatives who might at an early date leave the Government employ and carry the information to competitors.

It will be observed from the provisions of the proposed revenue bill that in this class of personal holding corporation no discretion is given to the commissioner as to what is a reasonable accumulation of surplus, but on the other hand, it is arbitrarily set down in the act what amount of surplus may be accumulated free of tax.

To illustrate: A corporation puts out a bond issue and by the terms thereof is required to redeem a certain amount of the bonds each year. If it should be a "personal-holding corporation," that is, a corporation with income arising from rents, royalties, interest, etc., and with not more than 10 stockholders, it must distribute 70 per cent of its net income to avoid the additional 25 per cen tax. This leaves 30 per cent of the income with which to redeem the bonds, and if in any year this 30 per cent should be insufficient for the purpose the 25 per cent tax would apply on the insufficiency. If there should happen to be 11 stockholders then, of course, "unreasonable accumulation" would be a matter for the discretion of the commissioner. Hardships from the application of this section are evidently anticipated because "banking" and "insurance" corporations are specifically excluded.

5. DENIAL OF EQUAL RIGHTS AND REMEDIES

A. *On increase of jurisdiction and powers of United States district courts.*—The pending revenue act, in section 617 (b), grants in addition to the existing powers of district courts and remedies of the United States in such courts at the instance of the United States very broad jurisdiction and powers to such courts. This section would reenact section 1122 (b) of the revenue act of 1926. If there be justification for granting such additional and extraordinary jurisdiction and powers to United States district courts in matters of internal-revenue taxes, the grant of enlarged jurisdiction and powers should also extend at the instance of the taxpayer the same rights and remedies to the taxpayer as is proposed for the United States at its own instance.

6. RETROACTIVITY

A. *On basis for determining gain and loss in certain reorganizations.*—Section 113 (a) (7) and (8) of the proposed revenue act of 1926 requires that securities of a party to reorganization shall take the transferer's basis for valuation. The provisions of the 1926 revenue act specifically exempt such securities from the general rule as to profit realized in an exchange. The main objection to the provisions of the proposed revenue act is found in its retroactive features, as it will affect all sales of such securities made after January 1, 1927, provided they were acquired after December 31, 1917, in some cases and in others after December 31, 1920. This retroactive feature of the provision is of doubtful constitutionality. That the Ways and Means Committee had a similar doubt is evidenced in their report, when they describe the change as merely a clarifying one. Since the prior laws on this point are not ambiguous, it is not likely that the courts will be impressed with such a declaration of retroactive intention merely for "clarity."

Whatever view the courts may take of the matter, it is certain that a very large number of reorganizations have been effected since 1920 which will be adversely affected by the proposed law. The proposed provision will result in great hardship upon reorganizations already effected, because if the provisions of the proposed law had been in the law at the time of the reorganization undoubtedly the reorganization would have been accomplished in a different manner.

Still greater hardship will be experienced by those taxpayers who sold such reorganization securities since January 1, 1927, because they would now have no opportunity of retroactively rearranging the form of the transaction in the light of the retroactive effect of the law. This retroactive feature will in effect impose an unfair penalty on past transactions which could and would have been consummated in a manner not subject to the penalty if the proposed provisions had been in effect at the time the transaction was consummated.

B. *On basis for determining gain and loss in sale of property of estates and beneficiaries in certain cases.*—Section 704 of the proposed revenue bill recognizes and adopts the principle laid down in the McKinney decision (2 B. T. A. 1340) and in the W. L. Mattheissen, jr., decision (2 B. T. A. 921), which requires an estate to take a basis of valuation of the decedent's property the value at the date of death. It is provided, however, that claim for refund or credit for the benefits of this provision be filed prior to the enactment of this revenue act.

In section 113 (a) (5) of the proposed revenue act a similar situation arises in cases affected by the Mattheissen decision, which requires beneficiaries to take the value of the property received at the time the property vests rather than at the date of the decedent's death.

This retroactive discrimination should be eliminated because there would appear to be no sound reason for deeming a principle such as that involved in these cases to fluctuate according to the accident of whether or not a claim happened to be filed prior to or subsequent to the more or less accidental passage date of a pending taxing measure.

C. *On collection stayed by claim in abatement.*—Section 611 of the proposed revenue bill will give the United States one year after the passage of the act in which to collect taxes on rejected claims in abatement, whether or not the statute of limitations, as provided in prior acts, has already run against such collection. This provision would nullify the effect of the United States Supreme Court decision in the case of Bowers *v.* New York & Albany Lighterage Co. Any attempt upon the part of Congress to nullify a decision of the Supreme Court by retroactive legislation can not be too strongly condemned.

It is a very unfair situation whereby the Government, through an act of Congress, can revive a statute of limitation or nullify a decision of the Supreme Court, in the event the decision is detrimental to the Government's interests, where at the same time a taxpayer of that Government has no recourse when the statute has run against him or a case before the Supreme Court has been decided against him. That a statute of limitation may be amended at will prior to its expiration is well settled. This proposal is intended to cure the negligence of the Commissioner of Internal Revenue. It seems that the Government ought to abide by the consequences of its negligence just as a taxpayer is compelled to do in like cases, or all statutes of limitation and periods within which claims for refund may be filed and made should be repealed.

D. *On waivers after expiration of period of limitation.*—Section 506 of the proposed revenue act proposes to validate waivers which were filed under prior

revenue acts waiving the statute of limitation after it had run. It is not believed that Congress has the authority to validate or invalidate these waivers in view of the statute in force, because rights have vested and the courts should be allowed to decide this matter.

E. *On repeal retroactively of section 1106 (a) of act of 1926.*—Section 612 of the proposed revenue act proposes to repeal section 1106 (a) of the revenue act of 1926 and to make the repeal effective as of the date the act of 1926 became effective, viz, February 26, 1926.

Since February 26, 1926, rights have vested both in the Government and the taxpayer and this proposed act attempts to disturb such rights. If its repeal should be deemed by Congress to be wise, it should not be retroactively, for such action can only produce litigation over vested rights.

7. DENIAL OF RIGHT TO CARRY FORWARD "NET LOSS" IN A CORPORATE REORGANIZATION

A. *On no provisions for successor corporation to absorb "net loss" of predecessor.*—There is no provision made in the pending revenue act which would permit the "net loss" of one company to be carried forward and applied against the profits of its successor in the succeeding year. Where one taxpayer has to take the "basis" of its predecessor it would seem to be self-evident that the successor should also have the privilege of bringing forward the "net loss" of its predecessor. This is a vital question in many reorganizations, and justice would demand that where the successor takes the same "basis" of valuation of assets taken over of the predecessor, the benefit of the "net loss" of the predecessor should also be granted to the successor.

8. BROAD POWERS IN DECLARING THAT A "JEOPARDY" EXISTS

A. *On commissioner making "jeopardy assessment" to protect the United States Government from the effect of his delay.*—Section 273 (a) of the proposed revenue act makes no change in section 279 of the revenue act of 1926, which grants broad discretionary powers to the commissioner in determining when the collection of a deficiency in taxes is in jeopardy. The practice of the commissioner under the 1926 and prior acts has been to hold the collection of tax to be in jeopardy if the expiration of the statutory period for collection should be about to expire through his delay. It clearly never was the intention of Congress to place in the commissioner's hands this strong weapon for defeating the effect of his delay, but rather it was the intention of Congress that a jeopardy could only exist where circumstances were arising or about to arise that affect the ability of the taxpayer to meet and discharge his liability for taxes demanded in due course by the collector of internal revenue.

The proposed revenue act, if one is passed, should make the intention of Congress plain by including in this section a definition of what shall constitute jeopardy of collection such as that contained in section 146 (a) of the proposed act. It should state that the commissioner should make a prima facie showing that delay will jeopardize the collectibility of his claim and that the imminence of the bar of the statute of limitation shall be deemed to have no effect on the jeopardy of the Government's claim for taxes.

A further point is that the commissioner was in no sense surprised by the New York & Albany Lighterage Co. decision. In article 1032 of regulations 45 and 62, it is distinctly stated that "the filing of a claim for abatement does not necessarily operate as a suspension of the collection of the tax or make it any less the duty of the collector to exercise due diligence to prevent the collection of the tax being jeopardized. He should, if he considers it necessary, collect the tax and leave the taxpayer to his remedy by a claim for refund." Moreover as early as 1923, a number of cases were pending in which the Government's construction of the collection period was in question.

The injustice of the provision in question will be most marked in cases where taxpayers have already obtained a decision from the board or the courts that collection is barred, and have made their financial arrangements accordingly. They would now be compelled to pay the tax without even the solace of having their costs of litigation reimbursed. And it must be remembered that these taxes were barred at the time of the passage of the 1924 act, viz, June 2, 1924. Hence they have already been barred for more than three and one-half years. Uncertainty as to tax liability, which is the most disturbing element in business, can not be removed except as it is possible to know for a certainty that Congress will not reopen closed cases. If statutes of limitation are meaningless, they should all be abolished.

STATEMENT OF HERBERT S. WOOD, WASHINGTON, D. C., REPRESENTING NEW YORK STATE CHAMBER OF COMMERCE

Mr. WOOD. I have some resolutions of the New York State Chamber of Commerce to present, and I shall make a few brief remarks in support of one of these resolutions.

As I say, I have three resolutions, one of them opposing the Federal estate or inheritance taxation; one favoring the principle of consolidated returns of corporations; and one opposing the retroactive provisions of sections 611 and 612, affecting the limitation on collections under the revenue act of 1921.

The CHAIRMAN. We have had all three of those matters pretty well covered in our hearings already.

Mr. WOOD. On that last point it is possible that what I have to say has already been covered, but I may be able to suggest a few detailed considerations that have not been mentioned.

I presume you know the character of the New York State Chamber of Commerce, consisting of 2,000 substantial business men of New York, with a large waiting list, I believe. These resolutions were presented to the members five days before action time, and were acted on at the meeting by all the membership.

I might add that they have also passed resolutions favoring tax reduction, and particularly the reduction of corporation taxes, but they did not undertake to fix the amount by which the taxes should be reduced.

On the question of sections 611 and 612 the chamber has had a special interest, and wished me to say a few words in further explanation of the resolution. I shall not deal with the constitutionality of the provision. I presume that has been adequately dealt with already. Neither shall I deal with the general unwisdom of retroactive legislation.

Perhaps the third point has been adequately dealt with also.

In any system of taxation, it is necessary and desirable to win and keep the confidence of taxpayers. The two objections they have felt, chiefly, to income taxation, have been, first, the difficulty about getting their cases closed; and, second, the fact that they are subjected to the ex parte decision of the commissioner.

Congress has provided for a time limit on assessments and collections, and for appeal to the courts, but those remedies do not amount to much, if Congress shall, after a limitation has taken effect, undertake to pass legislation practically nullifying the decision of a court.

The House, in its report on these provisions, has urged that they provide for the collection only of taxes properly due. Of course, the same argument may be urged in favor of any repeal of a limitations provision, and, if it has effect here, that will not tend to strengthen the confidence of the taxpayer in the effectiveness of the limitation provision.

The Treasury Department, in support of these provisions, has urged that they affect only those taxpayers who file claims in abatement, and not those who filed no claims; and they have endeavored to draw the line between those who filed claims in abatement and those who did not, and to urge that those who filed claims in abatement have thereby surrendered their claims to the benefit of the limitations.

These are the points to which I want to call attention, to find out what is the distinction between taxpayers who filed claims in abatement and those who did not.

Under section 250–D of the revenue act of 1921, claims in abatement might not be accepted from any taxpayer who had had a hearing and who had had his case decided after hearing. The law forbade the acceptance of such claims. Therefore, taxpayers who filed claims should have been only those against whom assessments were made at the last possible moment, so that they had no opportunity for hearing. Instead of being in a class that should have no consideration, they are in a class which should have the most consideration. Those who did not file claims, those who, under the law, could not file claims, and who, nevertheless, did not pay their taxes within the time limit, are protected by the decision of the Supreme Court in the New York and Albany Lighterage case, and will not be affected by this legislation; but those who were reached so late by the Treasury Department that there was no opportunity to have a hearing are affected by this legislation.

As a further point, the Treasury Department has urged that the filing of a claim in abatement was, in effect, a waiver. I want to point out that the regulations in effect at the time these claims were filed did not so point out.

Article 1006 of the regulations practically invited taxpayers to file claims in abatement if they had not had hearings, and said nothing about the possibility that these claims would be treated as waivers.

Article 1032 provided that claims in abatement should not necessarily be regarded as a stay of collection, but that the Treasury Department reserved responsibility for protecting the revenues to itself. It imposed on its collectors all these provisions tending to relieve the taxpayer of any responsibility for filing a claim in abatement. Now, it attempts to pass that responsibility on to the taxpayer.

Inasmuch as most of these taxpayers who filed claims in abatement were those who had refused to sign waivers—because, if they signed waivers, the jeopardy assessments were not made—it seems as though the Treasury Department had tricked those taxpayers into signing what are considered as waivers, by offering them the opportunity to file claims in abatement, which were not then, at least, claimed to be waivers.

Senator SHORTRIDGE. Is that the ruling now?

Mr. ALVORD. Claims in abatement are not accepted at all.

Mr. WOOD. Claims in abatement are not now accepted.

Senator SHORTRIDGE. Is his statement of the ruling questioned?

Mr. ALVORD. No. He did not quote exactly the regulation, but substantially so.

Mr. WOOD. The Treasury Department in this matter has laid a good deal of stress on the cases of those taxpayers who have, by their own request, pstponed consideration of their cases from week to week and from month to month until the limitation had run. If there are many of such cases the responsibility for them is certainly on the Treasury. After having granted a hearing, it had the right to make a final decision and refuse to accept a claim in abatement under the law.

The Treasury Department has not called attention to the many taxpayers who received for the first time notices of assessment so late that it was not legally possible to collect the tax before the limitation had run. The law gives 10 days after the receipt of notice and demand from the collector, within which to pay the tax. There are many taxpayers who will be affected by these regulations, sections 611 and 612, if they are passed, who received their notices and demands for tax within 10 days of the expiration of the time limit, so that by no possibility could they have been required to pay within the period allowed.

There are others. I have several cases with which I am personally familiar, in which the claim was not filed until after the limitation had run, so that the proposal is, in effect, with respect to them, to reinstate a tax liability that has become extinguished merebly because, after it became extinguished, they endeavored to protect themselves from illegal collection by filing a claim.

I thank you.

STATEMENT OF TAYLOR VINSON, HUNTINGTON, W. VA., REPRESENTING TAXPAYERS LEAGUE OF HUNTINGTON, W. VA.

Mr. VINSON. Mr. Chairman and gentlemen of the committee, I want to say a word in behalf of all the taxpayers who have business before the Internal Revenue Bureau at Washington. I believe that comprises a great number of taxpayers in the country. I am impressed with the statement that was made by Judge Green on November 15:

> The principal duties of the joint committee are to investigate the operation and effects of the Federal system of internal-revenue taxes; to investigate the administration of such taxes by the Bureau of Internal Revenue or any executive department, establishment, or any agency charged with their administration; and to make such other investigations in respect to such system of taxes as the committee may deem necessary; and to investigate measures and methods for the simplification of internal taxes, particularly the income tax.

It is to that particular idea that I want to address myself. I will state that in the memorandum that was issued by the Treasury Department to the joint committee, of which Judge Green was chairman, the present personnel of the bureau for the administration of income taxes is wholly inefficient——

The CHAIRMAN. Are you going to submit certain amendments to this bill?

Mr. VINSON. I am going to suggest them; yes, sir.

The CHAIRMAN. That is what we want. That is all we can deal with. We can not bring about the appointment of a new Commissioner of Internal Revenue, and while he is commissioner he is responsible for those under his employ. If there is anything wrong with the bill, we would like to hear about it.

Mr. VINSON. That is what I want to suggest to your committee.

Unquestionably the Treasury officials who made this report contained in the published report that was sent out by that committee were inefficient, and they give facts to show the inefficiency. One was that of all the cases that had been taken to the Board of Tax Appeals practically one-half the decisions of the Board of Tax Appeals were against the finding of the bureau, so that the bureau has been right only in every other case that it has taken up and heard.

The CHAIRMAN. I do not know, Judge, whether you know the reason for a great deal of that. Many of those cases were put on as jeopardy assessments, and that is the only way the department could have protected itself at the time because of the laches of time. I am a member of the joint commission. I am only tellingg you that we understand that situation thoroughly. What I would like to know is, what is the matter with this bill? What improvements do do you want to make in this bill?

Mr. VINSON. I might make this suggestion. We will assume the inefficiency of those employees to whom I referred. I think we are all familiar with it to a certain extent. The principal thing that I want to suggest to this committee, in connection with any amendments which you may be in a position to make as a result of the investigation that you have undertaken, is with reference to section 57 of the bill as it comes from the House.

In order to do that it is necessary to state to the committee that the taxpayer after he makes his return is then visited by a field agent. The field agent goes over the books and accounts and the records, and hears statements from the taxpayer sustaining the return that he has made.

After the agent has made such investigation as he feels he ought to he makes a report to the local office, or what I call the local agency. I think there are 34 of them in the United States. We have one at home, at Huntington, W. Va. I refer to the field agents who stay in their offices and hear objections to the report of the field agents from the taxpayers.

We go, then, to that agency, and they have quite an organization of clerks, assistants, and experts in that office.

When the tax agent who makes the preliminary report makes his finding, and he finds that there is a very considerable deficiency, then it is up to the taxpayer, if that finding is not correct to present his case to this local collector. He is not a collector, but he is a local agent. I want to come to the collector in just a minute.

He then goes before that tribunal, and he must present evidence to show that the field agent's report is erroneous. That means that the same books, papers, and records that were subjected to inspection by the field agent must be again produced and explained by accountants.

It does not end there, because, wherever there are questions of depreciation and depletion, and value, then it takes a lot of experts, some of whom may come from quite a distance, and all of whom come there at a very large compensation to give their evidence before that tribunal in behalf of the taxpayer so as to sustain his contention.

There is a complete trial, from beginning to end, of the taxpayers' contention.

After that is heard, then that agency makes a finding and sends a report of its finding to the bureau at Washington. The bureau goes over it. Whether it acquiesces in it or not, it sends a letter, either increasing the deficiency or decreasing it, as the case may be, to the taxpayer.

Then the taxpayer has to hurry to Washington and arrange for a hearing before a unit in the department here. and that means that he must bring the same witnesses who have been heard, and perhaps

additional witnesses to go before the unit, together with his books, accounts, and records, and his accountants; and in addition, it usually becomes necessary to employ here in Washington a resident accountant who is familiar with the procedure, as well as an attorney before the unit.

These witnesses are produced and they testify. It may be that they have had to travel a thousand miles or two thousand miles. They may have to come from California. They testify and are heard.

The taxpayer, then, after he presents his case, goes home, and in a short time he gets notice that the unit has failed to accept his evidence or accept his statement, or correct the report that came in.

He then goes back, and in many instances gets a rehearing. not always before the same unit; sometimes before another unit. The same thing is gone over again with witnesses and experts, all of whose expenses, traveling and hotel expenses and compensation, must be paid by the taxpayer.

Finally, he gets no relief from the unit, and he has to take his appeal to the Board of Tax Appeals, which he does.

You know the Board of Tax Appeals hears and tries this case de novo. They pay no attention at all to any evidence that was taken theretofore in two trials, but the whole thing must be gone over again from the very beginning, with books and papers and records, and witnesses, before the Board of Tax Appeals, before there can be a final disposition of the case.

Of course, that is not final, because there is resort to the courts. Up to the time that the Board of Tax Appeals makes its decision, the taxpayer has had practically four trials, three of them with witnesses and records, at a tremendous cost and expense, as you gentlemen may know if you have had any experience in going through one of these hearings.

Let me say that that involves such a burden upon the taxpayer that many of them figure it out this way: That by the time they pay the expense of going through three separate and distinct trials, in addition to the field agent's aid, that it is going to cost them more than to pay the illegal finding. They figure that it will cost them more to successfully defend the suit than to go ahead and pay it, at least in many cases, and they are doing that very thing.

Now, Mr. Chairman and gentlemen of the committee, that is admittedly wrong. The Government ought not to impose upon its taxpayers any unreasonable or unnecessary burdens. I think we will all agree on that proposition.

The CHAIRMAN. Oh, of course, that is fundamental, although we may disagree on the best method of bringing that about.

Mr. VINSON. Now, what is the remedy for all this machinery? The remedy is simple, and it is this: That when the return is made to the local collector that he may appoint a field agent—or it says here one may be appointed by the Commissioner of Internal Revenue—to go and examine these returns, and on his examination the field agent makes a report to the collector.

If the taxpayer is not satisfied with the finding of the field agent, he then enters his protest or objections to the finding. If he finds that there is a large deficiency, he makes that protest, not here in Washington, not before a local field agent, but before the collector

of internal revenue. Then a time is fixed by the collector and the taxpayer when the case can be tried.

Well, when that time comes the collector, who lives in the district where the taxpayer lives, which means that the taxpayer will not have to travel a great many miles to reach the place of trial, the taxpayer presents his witnesses and they are examined and his books and records are introduced in evidence. In other words, it becomes just like a plain, everyday, ordinary trial at law, pro and con. The Government will be represented before the collector by whatever counsel it may select, with the right, of course, to introduce rebuttal evidence to sustain the contention of the Government's field agent.

The CHAIRMAN. Do you think that the decision there ought to be final?

Mr. VINSON. No; I do not.

The CHAIRMAN. What is the difference?

Mr. VINSON. I will just explain that. Now then, in all the proceedings that are taken before the collector the evidence will be taken down in shorthand and typewritten, and that will become, together with the collector's decision, a part of the record; and, of course, the Commissioner of Internal Revenue may be called on by the collector for such aid in the matter as he may see fit to give.

Now then, as I say, there is a complete record made, a record of all the evidence and of all the proceedings, with the finding of the collector. And if the Government is not satisfied with the collector's finding it simply notes an appeal to the Board of Tax Appeals, and if the taxpayer is not satisfied he similarly notes an appeal to the Board of Tax Appeals. Then that original record is sent to the Board of Tax Appeals, and is docketed, and the parties go there and argue the case from the record made. The Board of Tax Appeals will not hear any oral evidence. They will sit as an appellate court. And, for that matter, they have no business to be drawing people here to Washington from all over the United States, at tremendous cost and at cost that the taxpayer can never get back.

The CHAIRMAN. How many members of the Board of Tax Appeals would it take for this work, do you think?

Mr. VINSON. It would take probably about half as many as there are.

The CHAIRMAN. Oh, you could not get enough to hear the matters on appeal.

Senator SHORTRIDGE. As I understand you, your position would be that the final trial should be before the collector of the district.

Mr. VINSON. Yes, sir; all evidence would be taken before him.

Senator SHORTRIDGE. And then that the Board of Tax Appeals would take the record certified up to it and dispose of the case as the Supreme Court of the United States disposes of cases on appeal.

Mr. VINSON. Absolutely. The Board of Tax Appeals will have precisely the same facts before it that the collector heard and passed on.

Senator SHORTRIDGE. And that change of procedure is suggested by you in order to do away with the great expense of people coming from far-distant points to try out their cases here in Washington.

Mr. VINSON. Yes, sir.

Senator SHORTRIDGE. I appreciate the suggestion that you make.

The CHAIRMAN. I understand that we have only about 21,000 cases now before the Board of Tax Appeals. And not only that, on the question of expense, I do not know how many collectors there are, but the collectors would have to be attorneys.

Mr. VINSON. Not necessarily.

The CHAIRMAN. Well, I mean that if you are going to have any final decision that would be satisfactory to either the one side or the other, that would necessarily be so. I can not see any saving whatsoever in this proposition.

Mr. VINSON. But I can show you, Mr. Chairman.

The CHAIRMAN. We would never get our taxes in until about 10 years after they were imposed if the parties wanted to appeal cases.

Mr. VINSON. Let us see how much shorter what I suggest is than what is done now.

The CHAIRMAN. You are not taking into consideration the hundreds of thousands of cases that are settled here without appealing from one man to another, in the department here below.

Mr. VINSON. Let that be done before the collector. It can be done better out in the collector's districts and at very much less expense. I think I can tell you why, or at least I want to call your attention to the reason why the Board of Tax Appeals is so far behind in its work. It is simply because it has to be practically a jury trial. Of course there is not a jury, but they have to go on and hear evidence. It will take sometimes two or three days or longer to hear the evidence in a case that has come up to it from the bureau. If they did not have to hear that evidence, if they did not have to spend three of four days in listening to testimony, they would simply read over the testimony in an hour or two, and would dispose of four or five times as much business, or each unit of the Board of Tax Appeals acting as an appellant court could dispose of four or five times as many cases as they could when sitting down and trying them in the ordinary course of what you have as a jury trial.

The CHAIRMAN. Do you think that the taxpayer would be satisfied with that?

Mr. VINSON. He would be infinitely better satisfied than what he is now.

Senator SHORTRIDGE. The law permits one or more members of the Board of Tax Appeals to proceed, for instance, to Utah or to California, and there hear cases.

The CHAIRMAN. And that is why they are appointed. Some of them are out in the field all the time.

Senator SHORTRIDGE. The taxpayers do not have to go long distances to Washington every time they have a case heard before the Board of Tax Appeals.

Mr. VINSON. But in the meantime you have gone through a long trial and at great expense.

The CHAIRMAN. Only a small percentage of the cases reach the Board of Tax Appeals.

Mr. VINSON. And that same percentage of cases could be settled just as well before the local collector of internal revenue as is done here before the bureau. The collector would be furnished help, and the aid of counsel to advise him, and he would understand the situa-

tion better than it is possible to have it understood here in Washington by the department.

I want to say to you gentlemen of the committee that I have had 10 or 12 years' experience in the department, and I know how very difficult it is to get a department unit to really understand the claim of the taxpayer when he feels that he has been unjustly treated, that he has had an unjust demand made against him.

I do say this, Mr. Chairman, and I want to insist on this, and I think it will commend itself to your judgment: In our system of courts and our system of trials, and of the Federal courts I am speaking now, it was the purpose of the act and a very wise purpose as we all must necessarily concede, that we should have our trial courts in the district where the people live, so that the expense of litigation might be reduced to a minimum, and that we might bring every trial in which the citizen is interested as near to his home as possible, so as to save him traveling all over the United States, into some foreign jurisdiction. And therefore that is the way it is that we have our district courts that try these cases.

And therein the record is made just precisely as it would be made under my suggestion for a trial before the collector, and that would be the only trial, that would be the only time witnesses would be examined. And an appeal is taken then either to the circuit court of appeals or to the Supreme Court as the case may be.

Now, that is precisely the same idea that I feel ought to prevail in our system of internal revenue. I think all questions primarily should be tried in the district where the taxpayer lives, so as to save him the enormous amount of expense and time that he never can get back.

If our judicial system is correct, or if it is the best that the Congress has been able to devise, and it certainly pleases everybody, then the trials—and they are trials with the Government on one side and the taxpayer on the other, and we may call it whatever we please, but it is a trial—in which witnesses are introduced and evidence taken, and in which judgments are rendered, and in which the law is cited——

Senator SHORTRIDGE (interposing). If the law does not give the collector that authority now you suggestion is that it ought to do it?

Mr. VINSON. Yes; that it ought to give it to him.

Senator SHORTRIDGE. That it ought to give the power to the collector to hear and determine a given case, you mean?

Mr. VINSON. Yes, sir.

Senator SHORTRIDGE. And from which decision an appeal would lie directly where?

Mr. VINSON. To the Board of Tax Appeals.

Senator SHORTRIDGE. And that appeal might be heard by one of the units or one of the members of the Board of Tax Appeals?

Mr. VINSON. Yes; by one of the members, for instance.

Senator SHORTRIDGE. Traveling throughout the country, the purpose being to avoid the bringing of witnesses here to Washington.

Mr. VINSON. Yes; and if the record is sent to Washington there is no necessity of bringing witnesses here. Counsel can come here and argue the case on the record as made before the Collector of Internal Revenue.

The CHAIRMAN. I think we understand the idea you have presented.

Senator SHORTRIDGE. I think I understand it now, and I am very sympathetic with the idea of saving the taxpayer from the necessity of traveling far in order to present his case, with, of course, the consequent expense incident thereto.

Mr. VINSON. There is no way of knowing how many people, how many taxpayers, have paid what they were advised by their counsel and their accountants and tax experts were unjust taxes, just because it was cheaper to do it, Senator Shortridge, than to expend the money necessary to make a successful defense. Now then, of course, that means not only a very great saving of expense, of money to the taxpayer, but it means an enormous saving to the Government itself. And then you get results in one-half the time that these people can get it in any other way.

I have here a memorandum that I suggest as amendments. It is very crude no doubt, but the idea is contained in it.

The CHAIRMAN. That may be made a part of your remarks.

Mr. VINSON. I thank you, Mr. Chairman and gentlemen of the committee.

(The memorandum referred to is here made a part of the record, as follows:)

[Section 57, p. 46, of H. R. 1]

EXAMINATION OF RETURN AND DETERMINATION OF TAX

As soon as practicable after the return is filed, the collector shall determine the correct amount of the tax.

A. When the collector deems it expedient, he shall send a field agent to any taxpayer in his district for the purpose of checking over the return and ascertaining the correctness thereof. The field agent shall have access to the books and records of the taxpayer, and examine the taxpayer or any other person, under oath, respecting the matters contained in the report, or any omission therefrom, which should have been included in taxpayer's report.

B. After concluding his examination, the field agent shall make and file a report of his findings with the collector, and furnish to the taxpayer a copy. The field agent shall include in such report a statement of facts found by him upon which he bases any conclusion not in accord with taxpayer's report to the collector.

C. The commissioner shall furnish to the collector such field agents as may be required to do the work expeditiously, who shall be under the direction of the collector to whom he is assigned.

D. Unless within thirty days after receiving a copy of the field agent's report the taxpayer shall file his protest with the collector setting out his objections thereto, the collector shall proceed to ascertain the amount of deficiency due from the taxpayer and collect the same as provided in this act. Such determination of the collector shall be final.

E. Upon receiving any such protest from the taxpayer, the collector shall, as soon as practicable, hear the taxpayer, who may be represented by agent, attorney, or in person, upon the objections set forth in his protest, and receive all pertinent evidence, either oral or written, offered in support of his contention. At any such hearing the Commissioner of Internal Revenue shall be represented by counsel who may introduce any pertinent evidence, either written or oral, to support the field agent's report and in rebuttal of the evidence introduced by the taxpayer. At such hearing witnesses may be cross-examined as in trials of actions at law in the trial courts of the district, and the rules of evidence prevailing in such trial courts shall govern in the admissibility of evidence before the collector. Upon the evidence so received and argument of counsel, when counsel shall request it, the collector shall determine and fix the just amount of taxes owing by the taxpayer, and file statement thereof with

the record of the hearing. The finding of the collector in such cases shall be final unless an appeal be taken from his decision.

F. All the evidence introduced shall be taken down in shorthand and transcribed. The original copy shall be filed with the collector as part of the record of the hearing, and a carbon copy thereof shall be given to counsel for taxpayer and counsel for the Commissioner of Internal Revenue. From the judgment and finding of the collector an appeal may be taken to the Board of Tax Appeals by either the taxpayer or Commissioner of Internal Revenue.

G. When an appeal is desired, the collector shall be so notified within 30 days after he renders his decision, and he shall send the original record made before him, including the transcript of the evidence, to the Board of Tax Appeals, which shall cause the same to be docketed, and hear argument of counsel and decide the matters in controversy according to law. No other evidence shall be received by the Board of Tax Appeals than was given or offered before the collector, but the case shall be heard exclusively upon the record made before the collector.

H. The Commissioner of Internal Revenue shall furnish to the collector such accountants, engineers, and experts as the collector shall request to aid him in the discharge of his duties hereunder.

I. The collector is hereby empowered to require the attendance of witnesses and the production of books, papers, and records in any hearing before him, to the same extent as the United States district courts may do.

J. Upon request of the Commissioner of Internal Revenue the collector shall furnish him a copy of any return, paper, record, or decision in his office.

The CHAIRMAN. Is Mr. Fesler here?

Mr. FESLER. Yes, sir.

The CHAIRMAN. You may come to the table and make your statement.

STATEMENT OF MAYO FESLER, DIRECTOR OF THE CITIZENS' LEAGUE OF CLEVELAND, CLEVELAND, OHIO

Mr. FESLER. Mr. Chairman and gentlemen of the committee, I am speaking not only for the Citizens' League of Cleveland but also for similar organizations in a number of the larger cities, such as the Citizens' Union of New York, the Citizens' Association of Chicago, the Citizens' League of Detroit, and others.

The revenue act since 1921 has contained provisions permitting income-tax payers, in computing their net income, to deduct voluntary contributions to certain welfare agencies and associations or foundations organized exclusively for religious, charitable, scientific, literary, or educational purposes—those agencies and organizations to which taxpayers contribute for the promotion of the general welfare, no part of whose income inures to the benefit of any private shareholder or individual.

It is our belief that Congress meant the language to be rather inclusive and to include associations organized solely for the improvement of local government and for civic betterment generally. When it came to an interpretation of that law by the internal-revenue service in the Treasury Department a considerable number of city clubs, municipal associations, and citizens' leagues were not exempted. For example, in 1924 we took up with the collector of internal revenue two questions:

(*a*) Are contributions made to the Citizens' League of Cleveland, an association of citizens supported by membership dues and established solely for the promotion of better government in Cleveland and Cuyahoga County, deductible in computing net income for tax purposes?

(*b*) Is the citizens' league required to file returns of its annual income under section 231 of the revenue act?

The matter was referred to Washington, and on December 31, 1924, the collector wrote us in answer to our first question:

Evidence discloses that you are an unincorporated association of citizens interested in the government of Cleveland and Cuyahoga County and generally in the welfare of the city of Cleveland. This is not an educational or charitable activity, but is exclusively for the civic betterment of the community. It is held that contributions made to you by individuals are not deductible for income-tax purposes by the donors.

In answer to our second question he wrote:

Since you are actively engaged in activities of an exclusive civic nature for the civic betterment of the community, you are relieved of the duty of filing returns of annual income.

The same general ruling was made regarding a number of city clubs and militant civic organizations. The ruling it seems hinged not on the broad question whether or not these contributions were made for general welfare movement, but on the technical question whether the organization or agency was strictly educational or charitable in its purposes.

We have had the feeling that Congress never intended a hair-splitting distinction of that nature, but intended rather to say that voluntary contributions made to these community organizations whose only object is to promote the community welfare, whether charitable, scientific, civic, or educational, should be exempt from the income tax.

Several of our organizations have since then sought relief, some of them have obtained a favorable ruling, especially some of the city clubs, but the other organizations have not.

For that reason I come before you representing these organizations, to request the Senate Finance Committee to so amend section 23 of the pending "revenue act of 1928" as to make clear that such contributions to the associations, no part of whose income inures as profit to anyone but is devoted wholly to the public service, may be deducted in computing net income for taxation purposes.

Some weeks ago the attorney for the Citizens' League of Cleveland, at the request of my executive board, prepared amendments to the pending revenue act, sent copies to our distinguished Senator (Hon. Simeon D. Fess) who is a member of the Finance Committee. We also sent copies to the associations in the larger cities of the country asking their opinion and cooperation. The suggested amendments met with unanimous approval except in the case of one national association to which I will refer in considering the text of the amendment.

The amendments which we propose call for only slight modifications in sections 23 and 213. We had mimeograph copies made so that the members of the committee can see the text of the suggested change. The italicized words are the amendments submitted for your consideration.

The only difference of opinion, and that was with the National Civil Service League, was regarding the wisdom of including "or political purposes." The objection of the league was that large contributions by presidents of public utility or oil companies to political campaigns to elect United States Senators should not be deductible. While such a provision might be abused once in a great while, we felt that since the actual saving in taxes would amount to so little as to be negligible it could not be construed as an encouragement

for such wrong contributions. Moreover, we feel that a legitimate contribution to a political party by interested citizens is just as much in the public interest as a contribution to a civic association or welfare agency. While we constitute a strictly nonpartisan association we believe in political parties and realize that it is only under our two-party system that government can be administered in this country. We believe further that contributions to political parties can be, and that a majority of them are, just as public-spirited as those which are made to our civic bodies.

However, we are not pressing that particular clause "for political purposes," because we believe our nonpartisan associations would be covered by the clause "or for purposes of civic betterment." It might be omitted entirely, or the word "nonpartisan" written in before the word "political" which would make it read "nonpartisan political purposes." Personally I should like to see it included as it appears in the copy for the reasons above stated. But we shall be satisfied if it is not.

We are concerned, however, with the effect of the present ruling of the Treasury Department on our contributors. We get repeated inquiries from those men who contribute $25 to $100 to our work annually asking, "Why are not these contributions deductible the same as are our contributions to the chamber of commerce and the welfare federation?" We can make only one reply, i. e., because the Treasury Department has ruled otherwise. All of our associations suffer each year in their financial support because of this ruling. The income derived by the Government from these contributions is, of course, infinitesimal in comparison to the good which the contribution of the men can do in the direction of improving government in our cities and counties.

If the Senate committee can see its way to include in the revenue act these amendments, we feel that you will not only have carried out the original intentions of Congress, but that it will make deductible voluntary contributions for strictly community service which should not be subject to income taxes any more than are compulsory contributions in the form of State and local taxes or than are membership dues in chambers of commerce. They are all contributions for civic betterment and should be treated alike in the revenue laws of the Federal Government.

AMENDMENTS TO PENDING REVENUE ACT (H. R. 1)

(1) Amendment to section 23 (N) (2); lines 23–25, page 22; lines 1–4, page 23:

"(2) Any corporation, or trust, or community chest, fund, or foundation, *league, club, or association of citizens*, organized and operated exclusively for religious, charitable, scientific, literary, (or) educational, *or political* purposes, *or for purposes of civic betterment*, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual. * * *"

(2) Amendment to section 23 (N) (5), lines 14–18, page 23:

"(5) A fraternal society, order, or association operated under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, (or) educational, *or political* purposes, *or for purposes of civic betterment*, or for the prevention of cruelty to animals."

(3) Amendment to section 213 (c), lines 7–13, page 143:

"(c) *Charitable, etc., contributions.*—The so-called 'charitable-contribution' deduction allowed by section 23 (n) shall be allowed whether or not connected with income from sources within the United States, but only as to contributions or gifts made to domestic corporations, or to community chests, funds, (or)

foundations, *leagues, clubs, or associations of citizens* created in the United States, or to the vocational rehabilitation fund."

The CHAIRMAN. These proposed amendments provide:

Any corporation, or trust, or community chest, fund, or foundation, league, club, or association of citizens organized and operated exclusively for religious, charitable, scientific, literary, (or) educational, or political purposes.

The Ku-Klux Klan would come under that, would it not?

Mr. FESLER. Well, they come under the law now.

The CHAIRMAN. No; they are not exempted under the law now You speak also of chambers of commerce. They are not exempt under the law now.

Mr. FESLER. It is my understanding that they are.

The CHAIRMAN. No, sir; they are not exempt at all.

Mr. FESLER. I thought they were.

Mr. ALVORD. Contributions made to chambers of commerce are not deductible. But a chamber of commerce itself is nontaxable. At the same time your gift to the chamber of commerce is not deductible.

Mr. FESLER. I understand that gifts to chambers of commerce are deductible.

Mr. ALVORD. No, sir.

Mr. FESLER. Mr. Redpath told me they were.

The CHAIRMAN. Well, Mr. Redpath is mistaken.

Mr. ALVORD. I have not recently examined into the practices followed by the various collectors, but under the law the contributions are not deductible.

The CHAIRMAN. As to a chamber of commerce as a body, after sums are given to it, if it should make anything or lose anything in any activity, of course that is not taxable.

Mr. FESLER. Then I was misinformed on that point. The point we wish to make is that associations organized purely for civic betterment and that have no profits of any kind——

The CHAIRMAN (interposing). That is, chambers of commerce.

Mr. FESLER. Yes, sir; and citizens' leagues. We want to see them treated the same as welfare federations and scientific clubs and religious organizations. We are not particular about the language, just so we get these items exempted.

The CHAIRMAN. Very well. The committee understands your viewpoint.

(And the witness was excused.)

The CHAIRMAN. Mr. Gresner.

STATEMENT OF ARNOLD R. GRESNER, OF MINNEAPOLIS, MINN., REPRESENTING THE INLAND DAILY PRESS ASSOCIATION

Mr. GRESNER. Mr. Chairman and gentlemen of the committee, I am speaking for the Inland Daily Press Association, an association of daily newspaper publishers located chiefly in the Middle West, and chiefly in the smaller cities there, although the newspapers of Minneapolis and the Chicago Tribune and the Chicago Daily News are members of our association. It was organized about 1888, and meets three or four times a year, and discusses matters of general interest. And it has various committees, including a tax committee of which I am a member.

The CHAIRMAN. This is the same subject on which you submitted a brief to Senator George, is it not?

Mr. GRESNER. Well. I will say this: We have submitted to the chairman—and the chairman has a copy as have also the various other members of the committee—a document containing about nine suggested amendments to the 1926 act, ministerial amendments. We have set forth the amendments, and the old law as it is, and with strikeouts, and with italics to indicate the new bill, and then with comment on each one, so as to make our contention clear for the benefit of the members of the committee.

Now, after so much discussion the problem of your committee seems to be to accomplish a reduction of the burdens upon the taxpayer without reducing the revenues. The proposals that we make have the effect at one and the same time of bringing about a saving to the taxpayer and yet without injury to the Treasury. That is to say, bringing about a saving every time litigation is avoided, and every time it is simplified it means a saving to both the Treasury and to the taxpayer.

I think there is an opportunity in the statutes as they are now to make certain changes that will clarify and simplify the procedural provisions, so that the taxpayer will save an immense amount of money as a result, and so will the Government.

I am not going to mention each one of these, but I think this will set forth the situation——

The CHAIRMAN. I believe we have your brief, and each member will have the benefit of it.

Mr. GRESNER. I will mention one in order to give you an example of these proposals: Under the 1926 act, and also under the 1928 bill as it passed the House, we have this kind of a situation: The taxpayer appealed his case to the Board of Tax Appeals prior to January 1, 1926, and tried it there prior to that time, and made a full record just as he would in court. If the board decides his case after January 1, 1926, and he would then like to appeal the questions of law to the court of appeals, he can not because section 283 (j) expressly forbids it. He may take his claim for refund into court, but that is his only remedy.

Now, then, the gentlemen of the committee will observe that we have made a full record, and the evidence has been taken down stenographically, just as would be done in a court, and the board has made a finding on all of the facts and issues, and nothing remains in dispute except questions of law.

Then they have a record, and the decision can go to the appellate court, and all that appellate court would have to do is to pass upon the law. But we can not appeal there. We have to sue and try the case all over again, making a new record and duplicating the work and expense for ourselves and the Government.

Now, it is perfectly proper that in some cases the trip should be made into court, and a trial had de novo. Sometimes cases are tried by accountants before the board, and they do not make a full record, and the record made would not inform an appellate court of the full facts in the case. But where there is a full record that necessity should be obviated.

Our amendment proposes to add to section 283 (j) a provision saying that—

If the taxpayer shall within 30 days after the enactment of this new revenue act, or within 30 days after a decision of the board, file with the board a

notice that he intends to take his case up by appeal instead of to sue, then either the commissioner or the taxpayer will have the right within 90 days to take it up to the appellate court by appeal and there have it heard on the record already made in the Board of Tax Appeals.

That can not possibly hurt the Government. On the contrary, it will provide a protection for the taxpayer. It seems to us that this amendment should be adopted.

And there is lurking in the law as it is now this trap—or I might call it a trap—into which the taxpayer might fall: Government attorneys have taken the position that if you appealed for one or two years from the Government claim on a deficiency, and that you as to this one or two years' claim you have already paid you are seeking a refund, that you can not sue on your refund claim in court until after the case has been disposed of before the board. And if you do so sue, they will make a motion to dismiss your case on the ground that the court does not have jurisdiction to entertain a suit brought while there is a case pending before the board. I think that is legally unsound, and yet they take that position: and we are going to have to go clear to the Supreme Court of the United States on it, perhaps. I have a concrete case in mind where that position is taken——

Senator SHORTRIDGE (interposing). That is a case that I heard a well-known chancellor describe as "justice smothered in her own robes."

Mr. GRESNER. Yes: that is the difficulty there. And if you do not bring your suit for refund while the case is pending before the board on deficiency, then the statute of limitations runs against you, because you have only a limited time to bring your suit. So you may just take your choice. You can go before the board and sue before the board, but if you do, you run the risk of getting your case dismissed on the ground that the board does not have jurisdiction. And if you go to court first and then attempt to go to the board, your case may be thrown out, because your are too late. And no matter which way it goes the taxpayer loses. And in that kind of a situation he does not get his case heard in court at all. Now, that is an example of the kind of things that are in the statutes as they are now.

That is just one example. The others are not perhaps as harsh as that, but they are equally obvious, and equally easy of remedy, and equally harmless to the Government, and on the contrary beneficial.

Take the counterpart of the case I have been talking about: Some one has a case handled before the board by an accountant. He has a perfectly good case, and the accountant comes up with little or nothing. The case is decided against him because not proven. Then the taxpayer hires a lawyer. The record has been made before the board, but the lawyer will say there is no use appealing because the taxpayer has no record on which to go up. In such a case the taxpayer better sue in court and make a record there. But if he happened to take an appeal after January 1, 1926, he can not go into court; and, therefore, he never gets his case before a court.

If things of that kind could be remedied, it would save a lot of money to the Government and to the taxpayer at one and the same time, and if you gentlemen of this committee can give some relief it will certainly be helpful.

The CHAIRMAN. Did you file a brief?

Mr. GRESNER. You were furnished with a copy, Mr. Chairman. And I will undertake to present one to each and every member of the committee in order that he may have it.

The CHAIRMAN. I wish you would just put it in the record. Hand it to the shorthand reporter there so that everybody may have it.

Mr. GRESNER. All right.

(The brief referred to is here made a part of the record, as follows:)

I. Amend section 1113 (a) so as to read as follows:

"SEC. 1113. (a) Section 3226 of the Revised Statutes, as amended, is reenacted as follows:

"SEC. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regards, and the regulations of the Secretary of the Treasury established in pursuance thereof; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim, unless the commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum, unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The commissioner shall within 90 days after any such disallowance notify the taxpayer thereof by mail. *The benefit of said two-year period shall not be defeated nor curtailed by abstention from actual disallowance. The collector shall, upon written request of the taxpayer, state to him in writing the date of the disallowance and upon what list or record the same appears.*"

COMMENT

The only amendment suggested is the addition of the italicized language above.

Representatives of the Government have suggested that the two-year period can be nullified by the simple process of abstaining from making any disallowance. While it seems impossible that any court would sustain that view, it is advisable to make impossible such a subterfuge. The saving of expense of litigating that assertion is alone sufficient to justify the amendment.

There are many cases wherein the above-mentioned five-year period has gone by, but in which no actual rejection has yet been made, or wherein the rejection has been made within the last two years. Some of these are pending before the board. As long as there was a possibility that the claims might be allowed, or that the board decision might induce an allowance, the taxpayer naturally did not bring suit, but relied on his right to sue within the two years after rejection. His right to sue within that two years should be left without question, and not subject to defeat by the clever trick above suggested.

This is particularly important in view of the fact that the bureau is said to be now taking the stand it will not allow a refund, even though claim was filed in time, if the time to sue thereon has gone by. This will mean that there may be some grabbing at straws to show that the time to sue has gone by.

The Bureau may not ultimately stand on the highly technical policy above mentioned; but it is well enough to have the statute so clear that it can not do so, and can not put some taxpayer to the expense of litigating this technical point.

When the taxpayer asks the commissioner for the date of disallowance, if any, or refund claims, the commissioner refers him to the collector. The record of the disallowance seems to be in the collector's hands. The taxpayer never sees the record whereby the actual disallowance is made, which is an inside record. While the collector might give the information, without the statutory provision above suggested, it is proper that the taxpayer should have the statutory right, expressly give, to get that information, which is vital to proving that a suit was brought in time. Also he needs this information to obviate the chance of letting the time go by. He naturally does not want to sue until it is apparent that he can not get his rights without doing that. In the meantime he needs to know how soon he must sue.

Obviously there can be no valid objection to the suggested amendment, from the Government's standpoint.

II. Add, at end of section 284 (d), the following:

"(4) If within thirty days after the board's decision has been rendered, the taxpayer files with it a waiver of his right to have the decision reviewed by the circuit court of appeals, he may, after paying the deficiency determined by the decision, make and enforce claim for refund thereof, within the time and in the manner provided by statute.

"In case of such waiver, the taxpayer may, within one year after the board's decision has been rendered, sue on any other refund claim for any year for which deficiency was asserted before the board, if filed within the time and in the manner provided by statute, and if the time to sue thereon had expired when the petition for redetermination was filed with the board.

"The court shall include in its judgment interest upon the amount thereof in the same cases, at the same rate, and for the same period, as if such amount were collected otherwise than by suit.

"If the taxpayer brings such suit for refund, the commissioner shall have the right to counterclaim therein, and such counterclaim shall be substituted for such suit by him, to the end that the controversy may be determined by one and the same litigation."

COMMENT

(*a*) Since the board allows accountants to practice before it, and since experience has shown that many cases are not fully presented to it, so there is no proper record for appeal, the taxpayer should have the right to pay up, file refund claim, and sue to enforce it, instead of going to the court of appeals, a futile step on an insufficient record. In practice he has no alternative, as the statute now is, in cases of an insufficient record, except to quit and forego entirely meritorious claims and pay an unwarranted tax. It is no effective answer to say that that may be his own fault, due to his failure to employ some one who would put in the full record. The law should meet the exigencies of what actually happens. This is particularly true about a complicated thing, not well understood by laymen, who are entitled to all practical protection within reason.

(*b*) Also in some instances the Government will claim a deficiency for one or two excess-profits tax years, and the taxpayer will claim refund claims for those years and for the other three profits-tax years. Only the years for which deficiencies are asserted are before the board. After the board has passed on those deficiencies the taxpayer may want to place his claims before a court. The claims may all turn on some point about capital investment common to all five years, so that one litigation will dispose of all five years at one and the same time and one and the same expense. In these circumstances the taxpayer should not be obliged to go to the court of appeals on the claims for the two years, and to sue in court on the claims for the other three years, thus duplicating the litigation, entailing unnecessary work and expense on the taxpayer, the bureau, and the courts. He should have the right in a case of that kind to pay up as to the two years before the board, and then to put those two years into court with the other three. While it is not necessary to go so far as to require that in all cases, the way should be left open to do it in those cases in which that, under the particular circumstances therein existing, is the best practical and most economical course.

In some instances the two years above supposed could be taken to the court of appeals under an arrangement that the result as to those two years should govern the other three; but that can not always be done.

Whenever the two litigations are necessary, in the court of appeals as to the two years and by suit in court as to the other three, of course that method will have to be followed; but it is well to put a provision into the law which will permit the taxpayer to obviate it in those instances wherein the facts make it practicable.

III. Proposed amendment of section 823 (j), 1926, revenue act. Amend section 283 (*j*) to read as follows:

"(j) ~~In cases within the scope of subdivision (b) or (f) of this section,~~ where any hearing before the board has been held before the enactment of this act, and the decision is rendered after the enactment of this act, such decision shall, for the purposes of this title, be considered to have become final upon the date when it is rendered and neither party shall have any right to petition for a review of the decision. The commissioner may, within one year

from the time the decision is rendered, begin a proceeding in court for the collection of any part of the amount disallowed by the board, unless the statutory period of limitations properly applicable thereto has expired before the appeal was taken to the board. The court shall include in its judgment interest upon the amount thereof in the same cases, at the same rate, and for the same period, as if such amount were collected otherwise than by proceeding in court. In any such proceeding by the commissioner or in any suit by the taxpayer for a refund, the findings of the board shall be prima facie evidence of the facts therein stated.

"*However, if the taxpayer, within thirty days after the enactment of this amendment, or within thirty days after the board's decision is rendered, files with the board a statement that he intends to petition for a review of the decision, either party shall have the right to petition for the review thereof, within three months thereafter and in the manner by statute provided. In such case the board's decision shall become final according to the provisions applicable to decisions subject to review. In such event no such suit shall be brought or prosecuted as to any taxable year for which any deficiency was asserted before the board and as to which the board had jurisdiction to determine an overpayment.*

EXPLANATION

This sets forth section 283 (j) and makes no changes except the words stricken out and the words underscored.

1. The words stricken out appear unnecessary because the provision should apply to any case tried before the 1926 act and decided afterward.

2. In cases wherein the record was fully presented to the board, the taxpayer ought to have the right to avoid bringing a separate action and to go to the appellate court on the record made before the board and on its findings of the facts. There should be saved the expense and bother of starting a new proceeding and having another trial. Also the taxpayer would not then have to pay up the deficiency in a case in which the board has found all the facts in his favor but has decided against him on some law point, as to which the court is the final deciding authority.

3. Government attorneys are taking the position that if the taxpayer appealed his case to the Board under the 1924 act, and tried it there before the 1926 act came, he can not bring a suit until after the board's decision has been made, and the deficiency awarded paid.

They claim that the law as it now stands puts the taxpayer in the following trap: If he brings his suit to enforce his claims, before the board has made a decision, and before the deficiency awarded by it has been paid, that suit can not be maintained; if he does not bring that suit, before the Board decides, then the statute of limitations may, before the board has decided, have run against the right to bring it. Thus, since he has no right, in this kind of a case, to appeal from the board's decision, the doors of all the courts are closed to him, and he never can get his case before any court at any time in any manner.

They cite Suhr v. United States, 18 Fed. 2. 81, in support of that claim, and are seeking to use this beautiful trap in which they say there has been caught the taxpayer who appealed to the board and tried his case there before the 1926 act was passed, not suspecting, of course, that any such trap would be set for him.

While the courts may not ultimately uphold this extremely astute defense, designed to keep cases from being decided on their merits, the statute should be amended to save both the taxpayer and the Government the expense of litigating such a point, which would at least delay the determination of the merits and perhaps thwart ever reaching them.

IV. Amend section 277 as follows:

1. In subdivision (a), strike out the words "in court" in paragraphs (1) (2) (3) (4).

2. Make subdivision (b) read as follows:

"(b) The statute of limitations provided in this section or in section 278 on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall (after the mailing of a notice under subdivision (a) of section 274) be ~~suspended~~ *extended (unless it has previously expired)* during the period in which the commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court, and for sixty days thereafter."

COMMENT

The changes suggested are shown by line type and italic, the latter being new.

1. It will be noted that in the section as it now stands there is a time limit only on proceedings in court, but not on proceedings by distraint or otherwise. The limit should be on all kinds of proceedings.

It will be recalled that in a case wherein the right to proceed in court had admittedly expired, the bureau proceeded by distraint, claiming that the statutory provision involved in that case placed a limit only on proceedings in court. However, the court held that the statute, in the case before it, was sufficiently broad to reach also other proceedings, and hence barred distraint. Very evidently the words "in court," appearing in section 277, were put in by the bureau, in drawing the 1926 act, to change the law so as to avoid any future similar experience in respect to distraint.

As sections 277 and 278 now stand, there is no time limit on distraint without assessment, but only on "proceeding in court without assessment."

2. In respect to subdivision (b) of section 277, it is to be noted that if, at the time of mailing the deficiency letter, let us say in the fall of 1926, the Government still had two years, for instance, to make assessments, and if the appeal from the deficiency letter should be in litigation for, say, two years, the Government could claim that it may make an assessment at any time within two years and sixty days after that litigation terminates in final judgment. It could say that because the statute says that the limitation statute is "suspended," it quits running on the day when the deficiency letter is mailed, and does not begin to run again until sixty days after final judgment, and then runs for the two years that were left at the time when the deficiency letter was mailed.

Since the litigation may last more than two years, it is easy to see what an extraordinary extension of time to make assessment is made by the statutory provision as it now stands. It must not be overlooked that long before that time there has expired the taxpayer's right to assert claims for refunds.

It ought to be sufficient to have the statute preclude the expiration of the statute of limitations after the sixty-day letter has been sent, during one hundred twenty days after sending that letter, in cases of no appeal, and during the litigation of the appeal and sixty days thereafter, in cases wherein appeal is made from the sixty-day letter. In other words, after the appeal has been fully litigated and has terminated in final judgment, the Government should have sixty days thereafter to make an assessment, even if the statutory time so to do would, in the absence of the litigation, have run out before that.

Some people contend that that is the effect of 277 (b) now; but that position is subject to serious question. The law on this point should be rendered clear and free from doubt. The change above suggested accomplishes that purpose.

V. Amend section 283 (i) to read as follows:

"(1) In the case of any income, war-profits, or excess-profits tax imposed by prior act of Congress, in computing the period of limitations provided in section 277 or 278 of this act on the making of assessments and the beginning of distraint or a proceeding in court, ~~the running of the~~ statute of limitations shall be considered to have been ~~suspended~~ *extended* (in addition to the period of ~~suspension~~ *extension* provided for in subdivision (b) of section 277) for any period prior to the enactment of this act during which the commissioner was prohibited from making the assessment or beginning distraint or proceeding in court, *unless it had expired before the inception of such prohibition.*"

COMMENT

The only changes are the cross-outs and the italics, the latter being new.

What has been said under IV above is applicable here.

VI. Add at the end of section 907 (a), as set forth in section 1000, 1926 act, the following:

"Within sixty days after the commissioner has filed with the board his answer, or within such further time as the board may grant, the taxpayer may file with the board five legible typewritten copies of balance sheets, income, profit and loss statements, depreciation schedules, and/or other statements of accounting data, fairly, properly, and intelligibly reflective of the taxpayer's books and records, whenever and to the extent that such data are material and relevant to the issues in the case. The board shall thereupon supply the commissioner with two of said copies. The commissioner may, within sixty days

after such filing of said copies or within such further time as the board may grant, check such statements against the taxpayer's books and records, and file with the board five copies of a typewritten statement intelligibly specifying in what respects, if any, he claims that any such statement does not fairly, properly, and intelligibly reflect the taxpayer's books and records which it purports to cover, on any material or relevant point. The board shall furnish the taxpayer with two copies of any such statement filed by the commissioner. If no such statement be filed by the commissioner within the time above provided, said statements filed by the taxpayer shall be deemed to be fairly, properly, and intelligibly reflective of the taxpayer's books and records which they purport to cover. Said statements so filed by the taxpayer may be received in evidence, without putting in evidence the books and records from which they are made. As to relevant and material points on which the commissioner has so claimed that such statements are not fairly and properly reflective of the taxpayer's books and records which they purport to cover, the board may require the taxpayer to furnish proof tending to show that they are properly and fairly reflective of the books and records which they purport to cover. The board may, however, require the taxpayer to produce any original book or record of the taxpayer which it may think necessary and shall give the taxpayer reasonable opportunity so to do."

COMMENT

1. Accounting data are, of course, an important factor in almost every tax case. They are usually found scattered through a large volume of books and records, put in evidence, and piled up in front of a board member. They mean nothing to him, unless he is an expert accountant and can take the several days or weeks or months to search out the information which they contain, which to anyone except an expert accountant is hidden away in them.

In the conduct of the important business transactions of the country the practice is to rely on statements made by accountants from the books and records. One party to the transaction furnishes the statements and the other party has them checked against the books and records. A means of getting at the essential facts and accounting data which has been found to work successfully, when knowledge of such data is essential to paying out or loaning large sums of money, can safely be deemed sufficient to ascertain the similar facts when the data are necessary for taxation purposes. If it were practicable to find any safer method, it would be applied in the business world, wherein men on opposite sides of transactions are most anxious to get their data in the most reliable manner. They are as interested as the Government is in guarding against being fooled about the capital or income of a corporation for a year or period of years.

As a matter of fact, if the wagonload of original records is placed before the board members, they still have to reply on the statements and testimony of accountants as to what those records show, because the board members, even if accountants themselves, could not take time to go through those records and ascertain, first hand, what is there. That is a job which takes an expert accountant weeks and months.

2. The board is overloaded with work and its time should be conserved. By the process suggested by this amendment the time-consuming work would be done out of court. Board members would not have to sit through protracted sessions while books and records are being introduced according to the rules of evidence.

Also, instead of having piled up before them a mass of books and records, they would have clean-cut, intelligible statements such as a busy business man always gets and acts on. He could not afford to put in his time going through the books and records. The board members are in much the same position.

3. It will be observed that the amendment does not make it impossible to get in the books and records. It merely gives the board the power to thwart unduly prolonging the trial and keeping out essential facts on technical objections. Whenever it thinks the original books and records are unnecessary, it can dispense with them; whenever it thinks them necessary, it can call for them.

All the board members want is the facts and, as in the case of experienced business men, they can tell whether or not they are getting them.

The taxpayer, knowing that the books and records can be called for, would naturally be careful in making his statements; the commissioner has a chance to check the statements and the board has the power to call for the original records whenever it appears that both the taxpayer and the commissioner may have overlooked something not convincingly covered by the statements. These

three safeguards appear as ample as it is usually possible to get in working out complicated problems. As in the case of all litigation, we can not escape the necessity for placing reliance on individuals, and can not go beyond the practical safeguard of various men approaching the problem from different angles, and working in an atmosphere of watchfulness, wherein there is some one present looking out for each interest concerned.

VII. 1. Strike out section 1001 (b) of the 1926 act and substitute therefor the following:

"(b) Such petition for review shall be filed with the clerk of the board and shall merely state that the taxpayer or commissioner, as the case may be, petitions for a review by the specified proper court of the board's decision of a specified date, and shall be signed by the party so applying for review or by the attorney of such party in the party's behalf. The clerk of the board shall, with reasonable promptness, notify the opposite party of the filing of such petition."

As soon as practicable after such filing the clerk of the board shall transmit to the clerk of the court specified in the petition the original pleadings, exhibits, depositions, and certified transcript of the oral evidence, and certified copy of the board's findings, decision, and opinion. The clerk of said court shall give the clerk of the board a receipt therefor. When the case has been disposed of by the courts said papers shall be returned by the clerk of the court to the clerk of the board and the latter shall give the former a receipt therefor.

Before said documents are so sent to the clerk of the court, the board shall give the parties an opportunity to inspect the transcript of the testimony, and the board may correct any errors therein which the parties may point out.

Upon receipt by the clerk of the court of said papers, such court shall be vested with jurisdiction of the case and shall hear and determine the same thereafter, in proper course.

The courts are authorized to prescribe rules for the printing of the record, the printing and filing of briefs, and the hearing of the case by the court.

The board is authorized to fix a fee, not in excess of the fee fixed by law to be charged and collected therefor by the clerks of the district courts, for so preparing and transmitting the papers to the court.

2. Strike out section 1004 (b) of the 1926 act, which is superseded by the last paragraph above set forth.

COMMENT

1. It is of outstanding importance to make the procedure simple and inexpensive. All unnecessary drawing of documents, applying for writs, making voluminous copies, and making a cumbersome job of getting the case from one tribunal to another can and should be obviated.

All the parties, the board, and the appellate court want to know is that the case is appealed, and the simple, short notice will tell them that. An extended petition for review, a writ of error, and getting a writ of error allowed are all idle formalities, which do not help but hamper getting to the determination of the merits. The appellate court gets no help from these, but concerns itself with the pleadings, evidence, and the decision of the lower tribunal.

2. When the papers are sent to the court as above provided, it has before it everything the board had, everything it needs.

There is no use making copies of all these. That time-consuming, irksome, and expensive detail is pure waste of effort and money by officials and everybody else concerned. The board will have no use for the originals while the appellate court is dealing with the case. No one would look at them if they were lying around in the board's files while the case is up on appeal. When the case comes back to the board, the documents will come with it. The less the volume of documents the less the expense and the greater the facility for everybody concerned.

3. Even if this were without precedent, it ought not to alarm anyone. However, this very system was provided by statute in Minnesota several years ago, at the suggestion of a committee of judges appointed by the governor, and it has worked perfectly in getting cases from the trial courts to the Supreme Court, and the consequent saving in money to the citizens of Minnesota has run into many thousands of dollars. The judges do not have their time taken up with petitions and writs and formalities, but can be at work at something that cuts some figure.

VIII. 1. Strike out section 1001 (c) of the 1926 act, and substitute therefor the following:

"(c) Despite the provisions of sections 274 and 308, such review shall not operate as a stay of assessment or collection of any portion of the amount of the deficiency determined by the board unless a petition for review in respect of such portion is filed by the taxpayer. If the court be satisfied that a bond should be filed by the taxpayer, the court may, upon application of the commissioner, require the taxpayer to file such a bond as it may deem proper, to secure the payment of the deficiency as finally determined, together with interest and other lawful additions thereto. If such bond be so required, the taxpayer may pay the deficiency determined by the board, instead of furnishing a bond. If, upon the making of such an order, the taxpayer fails to do either, such review proceeding shall not operate as a stay of assessment or collection of the deficiency determined by the board."

2. Strike out section 1001 (e) of the 1926 act, and substitute therefor the following:

"(e) Except as above provided, no bond shall be required as a condition of or in connection with the review."

COMMENT

It must be remembered that the taxpayer has already paid a tax, and that the asserted deficiency is a proposed additional exaction honestly disputed. Until it has been made certain that the taxpayer owes the asserted deficiency, he should not have to pay it, or do the equivalent of paying it, and filing a bond of this kind is as a rule as great a hardship as payment, because bonding companies will not write such a bond except upon deposit of the practical equivalent of cash, and exact heavy premiums for this class of bonds.

Care must be taken that these alleged deficiencies do not harass and ruin the taxpayer during the course of the Government's assertion thereof, when they are being legitimately contested.

Only in extraordinary cases should the taxpayer be subject to bond or payment in advance of final determination.

Since the case is before the court, it ought to be left to the court to say whether or not the appeal is evidently for delay or the situation is so extraordinary as to justify a bond. The only practical course is to leave it to the court to pass sensible judgment, under the particular circumstances in each case, after there has been opportunity to show the circumstances. The court will have no difficulty in recognizing the few crooks who may be trying to dodge taxes. It is neither necessary nor proper, for the sake of shackling one crook, to ensnare and embarrass dozens of decent citizens suffering under the difficulty of getting at the correct amount of their tax liability under laws giving rise to complicated problems, when they are in good faith endeavoring to get a correct solution of those problems.

The escape from liability by one crook is not nearly so great an evil, even from the Government's standpoint, as is the ruin of a good citizen by an exaction ultimately held by the courts to have been unwarranted.

In the case of one, not a crook, the Government does not need the bond protection. It went without such protection for several years before the deficiency was asserted, and can equally well go without such protection while it is being, in good faith, litigated. If the tax is going to make the taxpayer insolvent, the Government's tax claim will have a preference in the liquidation proceedings. Such insolvency should not be precipitated before the asserted deficiency has by the court been determined to be owing by the taxpayer. It is of importance that the Government collect its legitimate taxes; however, it is even more important that in endeavoring to do so it proceed with proper regard for the interests of the taxpayer, who, with others, has set it up with the idea that it will be regardful of his interests.

IX. Add to section 1105, 1926 act, the following paragraph:

"An item properly deductible in an earlier year for which examination has previously been made, but not used as a deductible in that year, shall not, without the taxpayer's consent, be cast out of deductions in a later year wherein it has been used by the taxpayer."

COMMENT

Revenue agents make a practice of casting out of the deductions made by the taxpayer in the year under examination items which they concede to be proper deductions but which they claim should be allocated to some earlier year. They throw them out of the deductions for the later year, but make

no correction for the earlier year. In such a case, the revenue agent should either have added the item to the taxpayer's deductibles in the earlier year, when examination was being made for that year, or he should let it be used in the later year, since it was not used in the earlier year. This process of throwing it out of the later year, upon examination for that year, and claiming that it should have been deducted in some earlier year, is a bad one. It makes it necessary for the taxpayer to file an amended return for that earlier year, and puts the bureau to the bother of going over that amended return, entailing extra work and expense on both the taxpayer and the Government. What is worse, in many cases, the statute of limitations has run against the taxpayer, so that he never can get the benefit of that deductible. If the item is properly deductible, the taxpayer should have the benefit of it. The mere fact that the taxpayer thought it properly belonged in a later year, and the revenue agent thinks it belongs in an earlier year, should not deprive the taxpayer entirely of the benefit of that item. The revenue agent should have made the correction in the earlier year when he examined for that year. Not having done that, he ought to be obliged to leave it in the year wherein the taxpayer deducted it.

In this connection it is to be noted that since the rates have been going downward year by year, it was to the taxpayer's advantage to use it in the earlier year when the rates were higher, and is to the Government's advantage to have him use it in the later year when the rates are lower.

It will be noted that by this process a mistake made by the taxpayer in an earlier year against himself and then allowed to stand by the revenue agent, is used against the taxpayer a second time by the revenue agent in the later year.

This situation ought to be remedied by an amendment along the lines above suggested.

The CHAIRMAN. We will now hear Delegate Houston.

STATEMENT OF HON. VICTOR S. K. HOUSTON, A DELEGATE IN CONGRESS FROM THE TERRITORY OF HAWAII

Delegate HOUSTON. Mr. Chairman and members of the committee, House bill No. 1 has in it section 116 (b), as follows:

Teachers in Alaska and Hawaii, in the case of an individual employed by Alaska or Hawaii or any political subdivision thereof as a teacher in any educational institution, the compensation received as such. This subsection shall not exempt compensation paid directly or indirectly by the Government of the United States.

Prior to 1918——

The CHAIRMAN (interposing). All that has already been passed upon, Mr. Houston.

Delegate HOUSTON. All right, Mr. Chairman. I will leave with you a copy of the joint resolution and the amendment offered.

The CHAIRMAN. I do not think that is necessary. That has already been passed upon.

Delegate HOUSTON. Very well.

The CHAIRMAN. Now we will hear Mr. Gandy.

STATEMENT OF HARRY L. GANDY, EXECUTIVE SECRETARY OF THE NATIONAL COAL ASSOCIATION, WASHINGTON, D. C.

Mr. GANDY. Mr. Chairman and gentlemen of the committee, I am executive secretary of the National Coal Association, a nation-wide association of bituminous coal operators.

The suggestion has been made, in which the National Coal Association heartily concurs, that it may be the part of wisdom by this committee to confine this bill to the matter of rates and noncontroversial questions.

But I wish to direct your attention to the amendment introduced by Senator Watson, and which I think falls into the noncontroversial class. We made quite an extensive effort to find out what was causing all the litigation over the Maine tax returns of bituminous coal companies. In that study which was made some two or three months ago, we found that one out of every thirty-eight cases that had ever gone to the Board of Tax Appeals was a case of a coal company. It was evident right on the face of things that something had provoked litigation that was far out of line with the revenue to be received.

Then we made a study of those cases, and we found that as to approximately 75 per cent of them the questions of depletion or depreciation showed up from one angle or another.

Going back to the revenue bill we found that section 204 (c) (2), being the provision for oil and gas depletion, provided an optional standard rate for depletion that has worked very satisfactorily.

Senator Watson's amendment offered to this bill would simply take the wording of section 204 (c) (2), being the oil and gas optional standard rate for depletion, and strike out the words "oil and gas" and insert the words "coal mines" and change the rate from 27½ per cent of gross return to 6 per cent. It is barely possible that in the discussion of that amendment in the committee you may want to change it some.

The CHAIRMAN. There has already been suggested by the American Mining Congress an amendment to bring about the same result. But it was not 6 per cent, but 15 per cent.

Mr. GANDY. That applies to metal mines, and this is the same proposition applying to coal mines.

The CHAIRMAN. You may just put in your amendment at this time. We will take them all up at once.

Mr. GANDY. It is as follows:

In the case of coal mines the allowance for depletion shall be 6 per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

That is all, Mr. Chairman.

(Mr. Chester H. Gray, Washington representative American Farm Bureau Federation, appeared before the committee and offered the following statement:)

The attention of the members of the Senate Committee on Finance is called to statements made in behalf of the American Farm Bureau Federation before the House Committee on Ways and Means earlier in this session of Congress. It is not necessary to repeat at full length the position on Federal taxation outlined in those statements, but a short summary is herewith supplied the committee for its information.

The American Farm Bureau Federation does not subscribe to the idea that severe tax reduction at this time is either necessary or expedient. The Federal tax structure as it was devised in the revenue act of the Sixty-ninth Congress is not throttling industry. It is unnecessary to submit figures to justify the above statement. The general course of business affairs is now flowing so smoothly and profitably that it is untenable to advance the thought that Federal taxation is a severe burden on industry and commerce.

The big task in taxation matters which should be kept constantly in mind is not tax reduction, although there are some items in which reductions might

advantageously be made, but is debt reduction. We have now an approximate $18,000,000,000 debt unpaid. If our revenue bills are devised in such way that this Federal debt can be liquidated at a rather rapid rate, more funds will come to industry, to commerce, and to the citizenship generally than by any other method whatsoever.

It has been advocated by the American Farm Bureau Federation that the Federal debt should be eliminated at the rate of $1,000,000,000 per year. If severe tax reductions are put into effect, it will be impossible to approach this amount of annual reduction or even to accomplish any reduction whatsoever.

In Secretary Mellon's statement recently presented to the Senate Committee on Finance, the estimates are so clearly drawn that one is justified in concluding a slight change in income or unforseen expense on the part of the Federal Government would wipe out any possibility of applying surplus revenues to the liquidation of the Federal debt. If the Federal debt can be made a dominant factor in revenue measures, rather than tax reduction, eventually a great burden of taxation will have been removed not only from corporations but from our citizens at large, who directly and indirectly contribute to the support of the central Government. At the rate of $1,000,000,000 per year, with interest at 4 per cent there will be a total aggregate interest payment of only $6,840,000,000 on the Federal debt. This amount added to the approximate total of our present Federal debt, $18,000,000,000, makes a grand total of $24,840,000,000, all of which must be provided from some sort of Federal taxes and paid by citizens in all walks of life.

Going now to the other extreme, which is not an impossible development as closely as Secretary Mellon has figures expenditures against receipts, and presuming that we have no reduction on our debt at all, we shall have paid in a generation, 25 years, at 4 per cent, $18,000,000,000 interest and still have the original debt hanging over us. If, however, we should adopt a more moderate rate of payment on the Federal debt and liquidate it at the rate of $500,000,000 per year, we shall find at the end of a generation we have paid at the 4 per cent interest rate $10,600,000,000 in interest, which is almost $4,000,000,000 more in interest than by liquidating the debt twice as fast. Furthermore, at the $500,000,000 per year rate of liquidation we have not finished payment of interest or principal at the end of a generation, but such payments run on 11 more years, or a total of 36 payments. At the final installment our taxpayers will have paid $10,940,000,000 interest, which added to the original Federal debt, $18,000,000,000, makes a grand total of $28,940,000,000 to be paid when the debt is amortized only at the rate of $500,000,000 per year.

Presuming, however, that the payment of the Federal debt at the $1,000,000,000 annual rate, or the $500,000,000 annual rate, is not to be followed, let us see the results if we should be more modest and liquidate the debt at the rate of $250,000,000 per year. At the end of a generation, with interest at 4 per cent, our present Federal debt will have aggregated interest payments of $15,000,000,000, which is $4,400,000,000 more than if the debt should be liquidated at the $500,000,000 annual rate. But at this slow rate of payment on the Federal debt a generation does not wipe out the debt. Payments run on for almost a half century so that the aggregate interest on the national debt when it is liquidated only at the rate of $250,000,000 per year will be in excess of $26,000,000,000. This vast amount added to the present debt makes a grand total in excess of $44,000,000,000, all to have been raised by Federal taxation. The above gigantic total of $44,000,000,000, the result of slow liquidation of the Federal debt, is to be compared to the amount above designated, $24,840,000,000 when the debt is liquidated at the more rapid rate of $1,000,000,000 per year.

Few taxpayers see the wisdom of carrying into future generations the cumulative burden which is incident to a great Federal debt when it is liquidated too slowly. The continuing burden of such a Federal debt with interest accruing constantly leads those who are most adroit in taxation matters constantly to agitate for reduced rates of taxation, for shiftings of the taxation burden, and for various incidentals which will ease their burden. Those who are less adroit as a consequence are burdened with this great load of Federal debt, plus interest, and pay it in indirect and sometimes hidden ways, even though doing so complainingly.

One of the methods which often has been used, and now sometimes is advocated to shift the burden of Federal taxation to the great mass of our consumers, is the sales tax. Although, as above stated, the American Farm Bureau Federation does not now advocate any substantial reduction in the revenue structure, it does seem advisable to remove the last vestige of the sales

taxes which were imposed in the war period. Sales taxes are paid ordinarily by those least able to pay, or by those who are under the necessity to consume. We have still with us a few of such taxes, which, with one exception, do not bring into the Federal Government much revenue.

The tax on admission and dues is inconsequential in its return to the Federal Government and may be properly classed as a sales tax. It is recommended for elimination in the revenue act of the Seventieth Congress. The excise tax on automobiles is another direct sales tax adding to the cost which the consumer must pay for the product. It is not easily proven that the repeal of this excise tax is only sought by the manufacturers of automobiles. For several years the American Farm Bureau Federation has consistently repeated its declarations in favor of the elimination of this tax, which position is a correlary to our fundamental advocacy of the repeal of all sales taxes and against their reinstitution except in direst national need. It is said from some quarters that the repeal of this excise tax on automobiles will not be reflected to the ultimate consumer. That might have been true under certain trade conditions of former years, but with the fierce competition which is now in evidence in the automobile trade, and on account of the constant effort of that trade to increase volume and decrease price rather than to decrease volume and increase price, one is wholly justified in concluding that immediately upon the elimination of this tax the purchaser of an automobile will be benefited to the amount of the tax on the automobile purchased. This statement is more significantly true now that the representatives of the automobile trade have appeared before the Finance Committee and given their promise that such reduction will be made in the price of automobiles to consumers. However, without such personal and official promises the competition within the automobile trade as above described would have secured the benefits of the elimination of this tax to the consumer.

The Federal estate tax should be retained, not so much on account of the revenue which it secures for the Federal Treasury, but that it makes possible the collection of estate taxes from decedents by authority of our State governments. Without a Federal estate tax the structure of the State statues upon his subject would be eventually, if not immediately, broken down. It is nothing more than right that an estate should contribute to the support of society when it is transferred from one generation to the next succeeding one, inasmuch as society, which means government, has made it possible to accumulate the estate. The principle of Federal Government staying in the estate-tax field is the thing most to be retained, more than the revenue accruing from the continuance of this principle. The revenues which accrue will most likely be incident to State statutes.

It will be seen from the above summary that the American Farm Bureau Federation does not support the elaborate estimates which are advanced from some quarters relative to tax reduction. If we are to receive with any seriousness the desire of the average citizen to reduce the Federal debt, it is, to state it mildly, ridiculous to contemplate reducing tax payments to the extent of $400,000,000 or $500,000,000, as is being advocated from some quarters. To eliminate the last vestige of sales taxes, the automobile excise tax should be discontinued. This reduces the Federal income approximately $66,000,000 a year. Add to this amount the exemption on admissions and dues incorporated in the House measure, $8,000,000, and we have approximately $75,000,000 total reduction in regard to the general classification of eliminating sales taxes.

There may be some justification in reducing the corporation income-tax rate, since there was added to the 12 per cent rate the original 1½ per cent capital tax. No one can advocate a tax on capital except as a last resort, and accordingly this tax in part or in whole might be eliminated. But whatever is done in regard to the corporation income-tax rate need not bring the entire total of tax reduction beyond the amount of $150,000,000.

Industry and commerce do not need more reductions than this, and the average citizen is more in favor of applying our income on the Federal debt than granting tax gratuities to those who have ability to pay taxes and are not suffering from the present rates.

The CHAIRMAN. Very well. The hearings are closed and the committee will now stand adjourned for the day, to meet to-morrow morning at 10 o'clock to take up the consideration of the bill.

(Whereupon, at 4.10 p. m., Friday, April 13, 1928, the committee adjourned.)

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