

[CONFIDENTIAL]

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# REVENUE ACT OF 1938

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## HEARINGS

BEFORE THE

### COMMITTEE ON FINANCE UNITED STATES SENATE

SEVENTY-FIFTH CONGRESS

THIRD SESSION

ON

## H. R. 9682

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

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PART 1

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MARCH 17, 1938

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# REVENUE ACT OF 1938

THURSDAY, MARCH 17, 1938

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

## EXECUTIVE SESSION

The committee met in executive session, pursuant to call, at 10:30 o'clock a. m., in the Senate Finance Committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

The CHAIRMAN. Mr. Magill, the other day I asked for certain estimates, and I think other members have asked for some estimates, on certain provisions of this bill and on some suggested changes. Have you those estimates that were requested?

Mr. MAGILL (Mr. Roswell Magill, Under Secretary of the Treasury). I think I have; yes, sir.

The CHAIRMAN. Give those to the committee and they will be taken down by the stenographer.

Mr. MAGILL. As you probably know, there have been a considerable number of requests from various members of the committee for different figures.

The CHAIRMAN. Yes.

Mr. MAGILL. I do not know precisely what you may wish this morning.

The CHAIRMAN. I would like to get all the estimates.

Mr. MAGILL. I will give you what I have in mind, and then if there are other things that you wish, I can probably get them out of the figures that we have here.

The CHAIRMAN. I am anxious to get them as soon as possible, so that later on, in the consideration of the bill in executive session, we will not be delayed because of lack of estimates.

Mr. MAGILL. There are one or two minor things that I might give you first before we get on to the main issues. I was asked yesterday to give you the Department's views with respect to the elimination of the tax on brewers' wort and malt sirup, and so forth. I have a letter here from the Commissioner on the subject, the substance of which is that the Bureau does not find that the tax on malt sirup, and so forth, is of any value in enforcing the tax on fermented malt liquors, and, consequently, that the Bureau would not be opposed to the repeal of the tax imposed thereon. The amount involved is \$825,000, in the last fiscal year.

The CHAIRMAN. Well, is it not a fact that that controversy grows out of the fact that there are some brewers that are selling malt sirup and others that are not?

Mr. MAGILL. I do not know, but I suspect something of that kind may be true. The subcommittee originally recommended that this

tax be repealed. In the full committee Congressman Dingell of Michigan was very anxious that it should be retained. On the floor I think Congressman Dirksen of Illinois strongly supported the idea of repeal. As the bill comes to you the tax on brewers' wort is not repealed.

The CHAIRMAN. The subcommittee did recommend its repeal?

Mr. MAGILL. That is right.

The CHAIRMAN. And the House did repeal it?

Mr. MAGILL. No, the House has retained the tax, as things stand now.

The CHAIRMAN. How much is involved?

Mr. MAGILL. \$825,000 for the last fiscal year.

The CHAIRMAN. Now that is only on brewers wort?

Mr. MAGILL. Brewers wort and malt sirup, it is called.

The CHAIRMAN. Will you tell us the difference between brewers wort and malt sirup?

Mr. MAGILL. No, I cannot tell you that.

The CHAIRMAN. Do any of the experts know enough about this matter to explain it to us?

Mr. WALLACE (Mr. W. L. Wallace, of the staff of the Joint Committee on Internal Revenue Taxation). Senator, I can tell you the difference in the use, I cannot tell you the difference in the constituent parts of it. The malt sirup, with certain other things, hop flavor for instance, is said to be more easily used for brewing beer than the wort, and the position taken against the elimination of the tax was that the use of that permitted the home brewing of beer. I cannot recall the figures, but my mind carries about five or six million gallons that was being brewed from that malt sirup. It was easier to brew from that.

The CHAIRMAN. Easier to brew from the sirup than the wort?

Mr. WALLACE. The sirup was used more easily and more frequently. That was the testimony. As I stated, I have no personal knowledge of it, you understand.

The CHAIRMAN. But the results are practically the same, whether it is brewed from brewers wort or malt sirup?

Mr. WALLACE. Yes; they can use both of them.

Senator KING. The use of the sirup was more general in the days of prohibition when people brewed their own beer, but now with the good beer—that is, it is alleged to be good, they say it is—made by so many licensed manufacturers throughout the United States, they are not using that, they are not resorting to the home-made beer.

Mr. MAGILL. That is my understanding. It is the understanding on the part of the Treasury that the tax was originally imposed primarily as a prohibitive device to prevent the brewing of home brew, and so forth, and that now they do not have any particular enforcement difficulties and this tax, as far as they can see, does not help them.

The CHAIRMAN. As I understand this controversy, there are certain brewers, limited in number, that sell this wort or malt sirup, and it is used in the dry States in the home to make the beer. There are other brewers that do not make it, and they are opposed to it. So it is a fight within the brewing interests, as I understand it. One group would like the tax to be higher and another group wants it off. Is that right?

Mr. WALLACE. I cannot say as to that. I do know that part of your statement is correct, as far as I have learned from the information that I received from the outside. As to whether it is a fight really between the brewers I do not know. There is a difference, however.

Mr. PARKER (Mr. L. H. Parker, Chief of Staff, Joint Committee on Internal Revenue Taxation). I think the brewers are against taking it off; they are opposed to taking off the tax.

The CHAIRMAN. There were certain brewers that opposed taking it off?

Mr. PARKER. Yes, they opposed taking off the tax. They were afraid of bootlegging. There was certain testimony, I think from Ohio, that there was a certain amount of beer manufactured in some of the small places there.

Mr. WALLACE. That is what I had reference to.

The CHAIRMAN. And there were other brewers that wanted it taken off?

Mr. PARKER. There were no brewers that wanted it taken off, they wanted it kept on.

Senator KING. There is unanimity then among the brewers on that point.

The CHAIRMAN. I understand that there was no unanimity at the time they were in the committee.

Mr. WALLACE. The impression attempted to be created was that it permitted more of the tax-free beer to be made. That is the whole thing.

The CHAIRMAN. Senator Clark, we have had up the question, trying to find out something about brewers wort and malt sirup, and it has been rumored to the committee that some of the brewers want the tax retained and some of them want it taken off.

Senator CLARK. I never heard any intimation of that fact out there, Mr. Chairman. All the brewers I ever heard of wanted the tax taken off and not to have the taxes paid by the manufacturers any more, that it is a tax that is an extra nuisance on the whole industry. In other words, as I understand it, a great bulk of the malt sirup goes into uses which are exempt from the tax, but in order to catch the small proportion which is subject to the tax it is necessary to go through a tremendous number of forms, certificates, and one thing and another. It makes it a very great burden on the whole trade, the whole industry. A great user of malt sirup is the bakery industry.

Now, I understand that there is a charge in the House that if this malt sirup tax was taken off it would be conducive to an increase in the manufacture of illegal beer. I think the experience of the Alcohol Control Administration and the Treasury Department both bear out the assertion that the illegal manufacture of beer at the present time is practically negligible.

Mr. MAGILL. That is our understanding.

Senator CLARK. I never heard any dispute about that. As far as the taxes raised, it is very little revenue and it imposes a tremendous burden on the Treasury Department in the matter of administration, and it also imposes a great burden on the industry in the collection of the tax, which applies only to a very moderate part of the product. It seems to me there is no justification to keep the tax on the books.

The CHAIRMAN. The counsel for the American Brewers Association appeared before the House Ways and Means Committee. He stated (p. 981, Ways and Means Committee hearings):

I am appearing today, gentlemen, protesting against the repeal of the tax. I am not asking that a tax be reduced, but that a tax be continued.

Another gentleman, Mr. John Lewis Smith, general counsel, United States Brewers Association, an organization of approximately 190 of the leading brewers of the country, stated before the Ways and Means Committee (p. 984, Ways and Means Committee hearings):

By unanimous vote of our board of directors I was directed to appear and protest the dropping of the tax on malt sirup. \* \* \*

We feel that not only should this tax be continued but that if any change should be made in it, it should be increased, in order to compensate for the loss of revenue which the Government will suffer from the beer which is not properly taxed, the home-brew beer. We agree with the American Association of Brewers in every detail.

I think I was told—I do not remember all these things—that some of the brewers sold this wort or malt sirup in these dry States, and so on, and that of course, if the tax was increased, it would have a bad effect on them, and that they wanted it taken off, while the other brewers, who did not sell it but only sold the straight beer, felt that it might be increased in order to stop the sale of the other product.

Well, we will hear further about it. Perhaps some of these gentlemen will appear before the committee.

Mr. MAGILL. Then there were, secondly, some inquiries about income-tax collections this year. I presume you have seen the stories in the paper. I am informed by Mr. Bell, Acting Director of the Budget, who makes these up for the Treasury, that accurate figures will be available Monday that will enable us to tell pretty well where we are.

The present situation is this: The collectors have actually deposited \$439,000,000 in the first 15 days of March, as compared to \$381,000,000 which they had deposited from the income tax in the same period last year, \$381,512,000. Now our experience is that those figures are about all that you can depend on with any high degree of accuracy. The collectors estimate how much there remains in the mail bags and in checks, which they have not yet looked at, and they estimate they have \$176,000,000 in those mail sacks, whereas last year they had only \$139,000,000 in the mail sacks. Whether that estimate will be borne out we will know in a couple of days.

The CHAIRMAN. Last year at this time I remember a good deal of controversy came over the estimate. Has this year shown an increase over the estimate, or have you got that?

Mr. MAGILL. Well now, let me see. The big collection, the big day last year was the 16th of March, and apparently the time at which the Treasury was able to see that we were falling short was shortly after that, that is around the 20th of March, from the schedule that I have here.

The CHAIRMAN. Well, is the 16th of March in the figures that you have?

Mr. MAGILL. No, all I have is up to the 15th.

The CHAIRMAN. That is up to about the 15th of March?

Mr. MAGILL. That is right. As I say, Mr. Bell stated by Monday morning it would be possible to give you a statement, if you wish it, which would be pretty accurate.

The CHAIRMAN. So far it looks pretty good?

Mr. MAGILL. So far it looks all right. It would seem that the income-tax collections will exceed the Budget estimates, but how much I do not think we can yet tell.

Senator VANDENBERG. Are there figures in the record on what happened last year, I mean the fact that you fell below the estimate last year, and how much, are those figures in the record?

Mr. MAGILL. I think not.

The CHAIRMAN. Were they put in the House hearing? I got the idea somewhere that it was about \$200,000,000 below the estimate, on undistributed-profits taxes.

Senator VANDENBERG. The brief statement that you made informally when we started a few days ago I think would be helpful in the record.

Mr. MAGILL. I can give you that now.

Senator VANDENBERG. That is what I mean.

Mr. MAGILL. That is not the revenues as a whole, it is the undistributed-profits tax.

Senator VANDENBERG. That is what I was particularly interested in.

Senator KING. Would the first report that we got the other day be a fair basis upon which to judge the entire amount that will be received for the year?

Mr. MAGILL. Well, yes. There has been, as I understand it, some falling off in some of the excise taxes as against the Budget estimates, but taking the Budget picture as a whole I think there is no reason to believe now that the Budget estimate of receipts will not be equalled. The income-tax collections have been running slightly ahead and the excise taxes slightly under. It looks as if the two would just about balance off. We give just what we estimated in receipts for the current year in the January Budget estimate.

Senator VANDENBERG. There is one other set of figures that I would like to get, if they are available. I would like to know whether the Treasury's revenues are increased or decreased, and if so how much, from tariff income on the items affected by the reciprocal trade treaties.

Mr. MAGILL. We will get that up for you. We will get after the Customs people.

Senator VANDENBERG. If possible, I would like to have that exhibit.

Mr. MAGILL. We can give you the gross receipts from Customs as shown in the Budget figures.

Senator VANDENBERG. That would not do.

Mr. MAGILL. I do not know how much they broke it down.

Senator VANDENBERG. I want to know, as a revenue proposition, what the reciprocal trade treaties do to us.

Mr. MAGILL. I will see what I can get on that.

Senator KING. However, there will be no figures to show to what extent those reciprocal trade treaties stimulate exports, and to that extent benefit the United States.

The CHAIRMAN. Mr. Magill, have you got anything else preliminary to giving us those estimates?

Mr. MAGILL. I think now, as I get it, the main things you want are the estimates of the revenues from the House bill as compared to existing law, the estimates with respect to the reduction in surtax rates from 75 percent to 60 percent, the estimates on various proposals on capital gains and losses which you suggested, and the esti-

mate on the various changes in the corporation tax which you suggested.

The CHAIRMAN. Have you got those?

Mr. MAGILL. As to the estimates on the House bill, I want to say this:

As you are all aware, the fiscal year on which the Government does business, commencing the 1st of July, of course reflects the receipts for two different calendar years each time. In other words, the fiscal year commencing the 1st of July will contain one-half of the receipts, roughly, from the income tax levied with respect to 1937 income, so that, to put it another way, whatever changes are made in this revenue act, if they are only effective as of January 1, 1938, or later, will not have their full effect during the fiscal year 1938-39, but will have substantially one-half their effect, so far as the income tax is concerned.

Now at the present time, as you are aware, between 50 and 60 percent of the total Federal revenue receipts, are from various forms of excise taxes and the balance from income taxes. Now, so far as those excise taxes are concerned, those, for the most part, are left unchanged by this bill. So this difficulty in estimating, which I am leading up to, has primarily to do with the income taxes.

Senator KING. Of course that means corporate as well as individual?

Mr. MAGILL. Corporate and individual, both. As to that, bear in mind then that what figures I give you for the fiscal year 1939 will, in general, reflect about one-half of the effect of what changes have been made. For that reason it seems more or less essential that you should also have another set of figures, that is what the effect of these provisions would be with respect to the full year. Supposing they were all in effect and you get all of the revenue, and all of the relief provisions took effect, how would you come out?

Senator KING. When you say "full year" you mean the fiscal year or the calendar year?

Mr. MAGILL. We have done it on a calendar year basis, because I think it is really simpler for that purpose.

Senator KING. From January 1 to December 31?

Mr. MAGILL. That is right. That is assuming a particular level of business activity, and assuming all of these provisions were in effect, how would you come out as compared with existing law?

The CHAIRMAN. This is from the 1st day of January this year?

Mr. MAGILL. That is right, so far as the income-tax provisions are concerned. The excise taxes and estate tax provisions can only take effect some time after the passage of the bill, but the income tax can take effect as of the first of the year, and that is when we think it should.

Now as to what this other year shall be, on the whole we have taken this view in preparing these estimates: We have used the 1936 calendar year because we now have the statistics as to what the levels of income and business activity were in that year, and, consequently, we can tell with a fair degree of accuracy how the provisions would work with respect to that kind of a year. So I will give you figures, in general, for the fiscal year 1938-39, that is the next fiscal year, and then also what the effect would be for a full calendar year with the level of business activity which we had in 1936 or 1937. I will tell you which I am using if I use one rather than the other.

Now those years, as you recall, were comparatively good business years. They were not as good as some of the years in the middle twenties; on the other hand, they were of course much better years than the present year appears to be, and I think, for these purposes, since they are recent and comparatively normal, that they are satisfactory for estimating purposes.

Well now, with those provisos, the House bill, as we figure, taking the actual fiscal year 1938-39, would yield about \$21,000,000 less than the existing law would yield for that period. Now not all of the provisions of the House bill, either relief or additional revenue, take effect during 1938-39. The estate tax amendments, for instance, would have practically no effect in 1938-39.

The CHAIRMAN. And that figure is estimated at how much?

Mr. MAGILL. \$21,000,000—a little over \$21,000,000 loss of revenue for 1938-39. Now, as I told you earlier, that is \$21,000,000 as against the total internal revenue figure of \$5,330,000,000. That is what we have in the Budget. So that your loss there is comparatively slight as contrasted with the total volume of revenue.

Senator CLARK. With a naval expenditure of two or three billion dollars, \$21,000,000 is just small change, is it not?

Mr. MAGILL. Yes; it certainly is a fraction as compared to \$5,300,000,000.

Senator VANDENBERG. Let me understand again at what level of business for the fiscal year you are contemplating that these revenues will be produced.

Mr. MAGILL. I may have to call on Mr. O'Donnell to tell you that. As to 1938-39, we used the same level of business activity, as I understand it, that was used in making up the Budget figures which the President transmitted on the 1st of January. That is, we thought you ought to use the same assumptions in order to get an appropriate comparison. Taking that assumption you get \$5,330,000,000 under existing law, and you get \$5,309,000,000 under the House bill.

Senator VANDENBERG. In other words, if there was a greater recession you would get less?

Mr. MAGILL. You would get less.

Senator VANDENBERG. And in that proportion the revenue would further sink?

Mr. MAGILL. That is right. Now taking such a year as 1937 was—

Senator KING. Calendar year?

Mr. MAGILL. Calendar year—which was a comparatively good calendar year, the loss of revenue from the House bill, as we estimated, would be greater, and would run somewhere around \$127,000,000 loss of revenue as against existing law. The principal reason for that is that under the so-called 20-16 plan, whereby you have only a 4 percent undistributed-profits tax, our estimators calculate that there would be comparatively little forcing out of dividends. Corporations will do pretty much as they please with their earnings, and consequently the increase in individual surtaxes which can be anticipated as the result of the law will be very much less than what they are under the 1936 law, the present law, which quite strongly forced the distribution of dividends, as you know.

Senator KING. Did not you take into account, or did you, the certainty of an expansion in business by the change in the undistributed-profits law and the benefit that would result from that expansion?

**Mr. MAGILL.** No. In figuring all these things, and that is true of capital gains as well as undistributed profits, we have calculated on the basis of an existing level of business activity for whatever year I am giving you. In other words, we made no assumptions as to whether business activity would be increased or decreased as the result of the tax bill.

Now why have we done that? Well, because when you get into the question of what the effect on business is going to be, I think you gentlemen can probably answer it about as well as we can. We can tell you what would happen if you had such and such a percentage of increase in business activity, but our attitude generally is that we ought to be highly conservative with respect to revenue estimates. That is what we tried to be. We have to do the financing on the basis of the yields, as to how much money we are going to get in and that being true, we operate on the basis of a particular level which we estimate will exist irrespective of what the tax bill might do or how other similar things might separate.

**Senator KING.** You have not taken into account then the effect of plowing back into the business the undistributed profits, the expansion which would result, the increase in wages, and, obviously, the increase in the taxes imposed upon individuals because of increased profits which they might derive, corporations and individuals?

**Mr. MAGILL.** That is my understanding. You stated it correctly.

**The CHAIRMAN.** You leave that to the judgment of individuals passing upon the law.

**Mr. MAGILL.** That is right. In other words, if the 20-16 plan, or if the flat corporation tax rate which has been suggested here should have a stimulating effect on business, in one sense, that is velvet as compared to the figures that you have here. These figures are based on what we have already estimated the business activity to be for 1938-39, or what the business activity actually was for the calendar years 1936 and 1937, where I have used those figures.

**Senator KING.** Understand, I was making no criticism of your predicate.

**Mr. MAGILL.** I am very glad to have you ask it. I should have mentioned it myself, because I want you to understand exactly on what basis these figures are presented, so you can make your own conclusions as to what you want to do.

**Senator LONERGAN.** Has the Treasury Department any objection to the repeal of the surplus tax?

**Mr. MAGILL.** You mean the undistributed profits?

**Senator LONERGAN.** Yes.

**Mr. MAGILL.** We have taken the position straight along, in line with what the President has said, that the undistributed-profits tax is equitable and should be retained.

**Senator BULKLEY.** Mr. Secretary, will you go back there a minute and tell us what that \$127,000,000 figure was? I do not think I understood it.

**Mr. MAGILL.** I will be glad to do so. For the coming fiscal year, 1938-39, the next fiscal year, we estimated that the House bill would not yield quite as much revenue as existing law; the difference being around \$21,000,000 or \$22,000,000. On the other hand, if you had a business year of the activity which we had in the calendar year 1937, our estimate is that the loss of revenue from the House bill as against existing law would be somewhere in the neighborhood of \$127,000,000.

Senator BULKLEY. That is because 1937 was a better business year than you are anticipating for the fiscal year 1938-39?

Mr. MAGILL. Exactly.

The CHAIRMAN. He is not anticipating on the present situation, as I understood.

Senator BULKLEY. It does not involve any prediction at all, it is just taking a certain assumption.

Mr. MAGILL. For 1938-39 we take the same assumptions which were used in making the Budget estimate that was transmitted in January, and that shows internal revenues \$5,330,000,000. Now, using the same assumption as to business activity, and so forth, we figure that the present bill would yield almost the same amount, that is, about \$21,000,000 or \$22,000,000 less.

Senator BULKLEY. When you arrive at that \$127,000,000 do you take into consideration the changes in the estate tax?

Mr. MAGILL. Yes. Now, those figures are plus figures. On the other hand, there are a good many relief provisions of one sort and another that do not take full effect in 1938-39, particularly these provisions for carry-over of past losses, and those will cost you revenue in the future.

Senator VANDENBERG. The \$21,000,000 losses that you referred to will be more than covered by the repeal of half a dozen so-called nuisance taxes, will they not?

Mr. MAGILL. Yes; there are several of those nuisance taxes, as you know, that run several million dollars apiece, and if you take three at \$7,000,000 each you have it.

Senator GERRY. Do not the nuisance taxes come to about \$34,000,000? Was not that the estimate the other day?

Mr. MAGILL. I think not. The figure I have here on the repeal of these taxes amounts to a little more than \$27,000,000 for the fiscal year 1939, and on the basis of a calendar year like 1937 it would be a little more, something like \$29,500,000. I think, for your purposes, you may consider about \$30,000,000 as being what the repeal on the excises amounts to. That is exclusive of this distilled-spirits amendments, for instance, which is a plus.

Senator GERRY. And that distilled-spirits amendment comes to \$25,000,000?

Mr. MAGILL. We estimated \$19,000,000 for the next fiscal year, and \$22,000,000 for a year like 1937.

Senator KING. Whereas you lose by these excise nuisance taxes estimated, you gain by the increase in taxes upon recovery?

Mr. MAGILL. That is right. Now, the next one that I have here—I will give you these in any order that you wish—is what would be the effect of decreasing the top surtax bracket to 60 percent from 75 percent? I think a better way to state that—Mr. O'Donnell will correct me if I am wrong on this—I believe Senator Bailey asked this question, and I think the way he asked it and I believe what it means is: How much revenue is produced by the surtax rates between 60 percent and 75 percent? Now, of course if you did reduce the top surtax to 60 percent you probably would make some other changes down the line, but I think the figures I am giving you here represent that block of receipts which is produced by rates between 60 percent and 75 percent.

Senator KING. May I say right there, you might increase the humps between there and zero, and thus make it considerable.

Mr. MAGILL. Yes. Of course, if you did a combination of things, if you took, for instance, Senator La Follette's suggestion for an increase in surtax rates in the middle brackets and then in addition adopted Senator Bailey's suggestion, which is contrary to Senator La Follette's suggestion, I believe, limit the top rate to 60 percent, you might in the end come out without any losses in revenue at all, or indeed get a gain, depending on what you did down the line. My figure, which is for such a calendar year as 1937, is \$20,000,000.

The CHAIRMAN. How much?

Mr. MAGILL. \$20,000,000. Now, I do not know that it does much good to give you that for the fiscal year 1939.

Senator BULKLEY. That means we are to get that much less, if we made 60 percent the maximum, instead of what it is, is that right?

Mr. MAGILL. That is practically true. It is just about what you said, but not quite. Assume you just cut off the surtax rates between 60 percent and 75 percent, so that 60 percent was your last rate, you made no other changes in the surtax schedule, the loss of revenue in 1937 would have been about \$20,000,000.

Senator GERRY. What is the State tax rate?

Mr. MAGILL. It varies. Have you the California and New York figures, Mr. O'Donnell? What does the New York run to?

Mr. O'DONNELL of the Treasury Department. New York runs to 8 percent.

Mr. MAGILL. And California runs to what?

Mr. O'DONNELL. Fifteen, but only on very, very high incomes.

Mr. MAGILL. It runs to a top of 8 percent in New York, but it gets there fairly quickly.

Mr. PARKER. It gets to 8 percent very quickly.

The CHAIRMAN. Now, I will ask Mr. Parker in this connection, do the experts agree that reducing it from 75 percent to 60 percent would be a loss probably of \$20,000,000?

Mr. PARKER. I agree with it on paper, but I do not think it would work out that way. I think it would not be that much, taking into account that it would free certain capital, so that it could go into business instead of going into tax-exempt income when income bears such a high tax. I think it is pretty obvious that the profit motive of those individuals in that group has very much diminished. Of course I am not talking about the social problem, or the distribution of wealth, I am talking about how many dollars we will get in the Treasury. I think in the long run you will probably increase revenues instead of losing the \$20,000,000.

Senator KING. That is what Great Britain found, is it not?

Mr. PARKER. Yes; Senator, and they have lower rates than our.

The CHAIRMAN. Of course, as Mr. Magill stated, he had not taken into consideration the increased business, and all that.

Mr. MAGILL. Not at all. I think that is the best figure we can give you, because it represents an actual figure with as little speculation in it as possible.

Well now, on capital gains and losses, I have a pretty complicated problem to handle, because of the number of different options that there may be. Perhaps the best way to give it to you is like this—I have a whole lot of figures here, but I do not believe you want all of them.

Under the present law you recall capital gains are taxable and capital losses deducted according to a series of percentages which are

applied whether you have a gain or whether you have a loss, and the percentages decline according to the length of time that the property sold has been held. The reason for that is that it is thought inequitable to tax a man on a profit in one year which has accumulated over several years, and the purpose of the percentages was to try to get the tax at something like the point at which it would be if this gain had been realized equally over the period and taxed at the rate applicable each year. In fact, the tax is considerably less under the present law than it would be if the gain were taxed in that way.

Now for the purposes of this estimate the important fact to notice I think is this: The provisions of the present law do not differentiate between sizes of incomes. In other words, all the taxpayers who have capital gains, no matter what their income class may be, are entitled to precisely the same set of percentages. Well, as contrasted with that, you had in the twenties, commencing from 1921 and running to 1933, a scheme whereby an individual might put his capital gains and losses into his ordinary income; or on the other hand, he might apply to his capital gains a tax of 12½ percent, and his losses would be deductible to an extent which would not reduce his tax with respect to them by more than 12½ percent. That is, he could not get a greater tax credit than 12½ percent on the losses.

Now you notice that the effect of that situation is that a taxpayer in the lower brackets, and how low varied with the different years, a taxpayer in the lower brackets got no benefit because of the 12½ percent rate, because his ordinary tax rate was less than that. Hence it did not mean anything to him. That breaking point occurred at various figures which ran down to \$30,000, between \$30,000 and \$45,000, higher in some years and lower in others. Most of the taxpayers got no benefit of the 12½-percent provision but their gains were taxable as ordinary income and their losses were deductible as ordinary losses. Consequently, in giving you estimates with respect to what a flat tax will yield, one important question that has to be asked is: What treatment is going to be given to the individual who is in the lower brackets and who does not get any benefit from the 15 percent, or whatever the flat rate may be; and then, a second important question for our purposes is whether this flat tax is to start on assets sold after 1 year or assets sold after 2 years, in other words, what is the period with which you are concerned.

Under the 1921 law, and the successors up to 1934, the period within which the gains were treated substantially like ordinary income was always 2 years. In other words, the capital gains treatment started on assets which had been held longer than 2 years and were thereafter sold.

Well now, the suggestion which was made to us the other day was: What would happen to the revenues if a flat 15-percent tax were imposed with respect to capital gains on sales of property held over 1 year, not 2 years, but 1 year, and that makes quite a difference in the calculation.

We have calculated this both ways. That is, first, what would happen if there were simply an option whereby a taxpayer might take the 15-percent rate if he wanted it, but if he did not take that, his gains would be taxed as ordinary income, in other words, the kind of scheme that you had in the law which was in effect in the twenties; and, secondly, what would happen if you gave him the option of either using that method or a method like the one in the House bill, which steps

down the amounts of gain which would be taken into account in the taxpayer's ordinary income.

The CHAIRMAN. You have got the estimate not only on 1, but you have got it on 2 years too?

Mr. MAGILL. I think we have it for both. On the present basis, that is the basis now in the law, the yield of the tax on capital gains, reduced by whatever losses would be deducted for such a year as 1936, that is the last year for which we have complete figures, we estimate that what we got in 1936 was \$187,000,000. I might say that there was a table showing what the yield from the tax on capital gains has been in the other years in the hearings before the House.

Now in 1937 we figure that will be way down, on account of the deductions of losses toward the end of the year, and we will only get \$28,700,000 from the present tax, and for the calendar year 1938, the year that we are in now, we have estimated that we will get \$74,500,000.

Senator KING. For which year was that?

Mr. MAGILL. The present calendar year. Each of these three figures I have given you are for calendar years.

Senator GERRY. Would you mind giving those again?

Mr. MAGILL. For the calendar year 1936, \$187,000,000.

The CHAIRMAN. That is on the present basis?

Mr. MAGILL. On the present basis. The calendar year 1937, \$28,700,000; the calendar year 1938, \$74,500,000.

Senator CONNALLY. What is it for 1936?

Mr. MAGILL. \$187,000,000.

Senator CONNALLY. How do you account for that shift in there?

Mr. MAGILL. We figure that 85 percent of the revenue which we get from capital gains comes from stock-market transactions, and only 15 percent from other kinds of sales. In 1936 you had, on the whole, a rising market. In 1937 you had these very severe declines at the end of the year, consequently we anticipate that a great many taxpayers will have taken heavy capital losses at the end of 1937, and hence the net yield of the taxes for these gains, less losses, will only be the approximate amount of \$28,700,000.

Senator VANDENBERG. The stock value sank \$25,000,000,000 in 5 months, and naturally that is going to show up in the losses to the owner of the stock.

Mr. MAGILL. Very much so. Under the bill as it comes to you from the House—suppose I give you the comparative figures for each of those 3 years, is not that as good a way as any?

The CHAIRMAN. Yes.

Mr. MAGILL. As against the \$187,000,000 for the calendar year 1936 we figure the House bill would have given us \$154,000,000; for 1937 it would have given us \$11,700,000, and for 1938 it would give us \$42,200,000. Let me say again, those assume the levels of transactions which actually existed, or which we expect to exist for this year, and assume no stimulation or diminishing of these transactions on account of the tax bill. For the fiscal year 1938-39 we figure, the House bill would yield a little more than the present law, about \$1,500,000 more. It is virtually the same.

The CHAIRMAN. 1938-39?

Mr. MAGILL. Yes.

The CHAIRMAN. Will you give that to us on the present basis?

Mr. MAGILL. I will give you both, if you like. 1938-39, on the present basis, \$56,200,000, and under the House bill, \$57,800,000.

Now, I presume, that one reason why it is that way is that the capital loss carry-over which was embodied in the House bill, and which will cost a good deal of money, which will take effect, in fact, for the fiscal year 1938-39, is not reflected.

Now, the next set of figures, I believe, that you would like would be what would be yielded for these various years from a flat 15-percent tax, and the assumption, as I understand it, is that there is no other treatment to be given to capital gains. In other words, the taxpayer may calculate his tax on his capital gains at 15 percent, but if his rate of tax on his ordinary income is less than that no preferential treatment is given to him, he returns his capital gains as ordinary income.

The CHAIRMAN. That is the way you figured it?

Mr. MAGILL. That is the way we figured it.

The CHAIRMAN. And you did not figure it on the other basis, too?

Mr. MAGILL. Yes, I have got the other basis too, but I gave this one first.

The CHAIRMAN. All right.

Mr. MAGILL. In other words, this scheme is the same as what existed throughout the twenties, except you get a 15-percent rate instead of a 12½-percent rate.

Senator VANDENBERG. Is it on a 2-year or a 1-year basis?

Mr. MAGILL. One year, on transactions, sales of assets held more than 1 year.

Senator CONNALLY. Held more than 1 year?

Mr. MAGILL. Yes. In other words, sales of assets which had been held less than a year would be taxed as ordinary income. If an asset had been held more than a year before it was sold the taxpayer, at his option, could take the 15 percent rate on the gain. For 1936, if we figure on that basis, you would have received \$137,400,000. For 1937, the calendar year, we would have had a net loss of \$8,400,000. For 1938 we would get \$45,600,000.

The CHAIRMAN. That is taking into consideration no upturn in business by virtue of the new policy?

Mr. MAGILL. That is right.

Senator VANDENBERG. Is there a figure for 1938-39?

Mr. MAGILL. Yes. For the fiscal year 1938-39, the next fiscal year we would receive \$38,900,000.

Senator BULKLEY. Have you got those comparisons in the form of a table that you can give to the stenographer so it will be easy to look at the figures in following the text?

Mr. MAGILL. Yes, I think we can do that. What I would like to do, if it is agreeable to you, would be this: I think I have more figures here, probably, than you have any use for. If you would advise me as to what alternatives you really want to consider I can have these things mimeographed in some sort of shape so you can each have a copy, if you want it.

The CHAIRMAN. You can have that prepared for us by Monday.

Mr. MAGILL. My understanding was that you wanted this material from me on Monday, that this was a sort of a preliminary session. For instance, I take it one thing you want Monday is what would happen on this 15-percent rate if it applied to sales of assets held 2 years or more.

The CHAIRMAN. You haven't got that?

Mr. O'DONNELL. We have the 12½ percent but not the 15 percent yet.

Senator KING. Let us have the 12½ percent.

Mr. MAGILL. You want the 12½-percent figures?

Senator KING. Yes; to show what variation there would be.

The CHAIRMAN. That is on 2-year holdings.

Mr. MAGILL. I will have to give you that 12½-percent figure later. I have got the 12½-percent figure here if it were applied to sales of assets held over 1 year; I do not have it on 2 years. That would be comparable to the flat 15 percent that I just gave you.

The CHAIRMAN. Does the committee want to hear that now?

Senator BULKLEY. No.

The CHAIRMAN. All right; give us the other figure.

Mr. MAGILL. What you would like to have would be the flat 15 percent as applied to sales of assets held 2 years or more.

Senator CONNALLY. Can they deduct all the losses?

Mr. MAGILL. The scheme in the 1924 act is a little difficult to explain. You could not get more of a tax benefit from the deduction of your losses than 12½ percent of the losses that would be affected. That is, you might have a taxpayer in the upper bracket whose effective rate of tax is, say, 30 percent; if you let him deduct the capital losses in full he, in effect, reduces his tax by 30 percent of the losses, you see. The 1924 act was so framed as to restrict the reduction of his tax by a deduction of the capital losses to 12½ percent of the losses.

Mr. PARKER. I would like to add one thing, to make sure that you get the figures that you want, Senator. Of course you can go back to the system that was inaugurated by the 1921 act, in which case a certain portion of these long-term losses, or a percentage was deducted from ordinary income. Now, of course it would not be necessary to do that. You could still restrict the proposition so that if there was any excess of losses over gains that they would not come off of ordinary income. I wondered what you had in mind, whether you wanted to allow the losses against ordinary income or not.

The CHAIRMAN. I think they ought to be applied, but not more than the capital gains.

Mr. PARKER. You think it ought to come off of ordinary income?

The CHAIRMAN. I did not say ordinary income, I said up to the capital gains.

Mr. PARKER. Well, that would make a difference in the estimate then.

Mr. MAGILL. Very much so.

Mr. PARKER. As I understand the estimate it is computed on the 1921 rule, where the losses would be applied against ordinary income, is that right?

Mr. MAGILL. That is net losses.

Mr. PARKER. That is going to make a considerable difference in the estimate.

The CHAIRMAN. I think the 1921 act only allowed the 1-year losses.

Mr. O'DONNELL (Mr. Al F. O'Donnell, Assistant Director, Division of Research and Statistics). Over two.

The CHAIRMAN. Two-year losses, and you can apply them not only against your capital gains for 2 years, but if your losses were more than the capital gains you can deduct it against ordinary income.

Mr. PARKER. That is right, with a 12½-percent limitation.

Senator CONNALLY. Your idea is to limit the losses.

The CHAIRMAN. You can give us estimates on the 1-year carry-over losses as against the capital gains, and then give it to us the other way, 1-year loss against the capital gains and income, too. It would not make it a 2-year loss, you haven't got that in this bill at all.

Mr. PARKER. I was not talking about the carry-over. The thing that seemed to me indefinite in connection with these estimates—

Senator LA FOLLETTE (interrupting). It will clear it up, Mr. Parker, by giving us an example.

Mr. PARKER. As I understand the estimate, if a man had a \$100,000 loss and figured a tax on his ordinary income which, if it was over the effective rate of 12½ percent, would be perhaps \$50,000. Now we will take the \$100,000, take 12½ percent of that which makes \$12,500, and subtract that from his \$50,000 tax on ordinary income. That was the 1921 system.

Mr. MACILL. Perhaps you may understand it this way: Under the 1921 system suppose he had a \$100,000 salary, and suppose he also had a \$100,000 capital loss, you can see in that case he would not pay any taxes at all, if you gave him a full deduction of the capital losses. After 1924 the limitation that went in, as I recall it, was this: You figure the tax on his \$100,000 of ordinary income, and then you take 12½ percent of the loss which he has sustained on the sale of capital assets, that would be \$12,500, and that was the greatest amount by which his tax could be reduced for the loss. In other words, if his tax on his ordinary income was, say, \$25,000, then the tax which he would pay would be \$12,500, that is, \$25,000 less 12½ percent of his capital loss.

The CHAIRMAN. Give it to us both ways.

Mr. PARKER. If he has a capital net loss you could deny that against the ordinary income and let it be carried over, if you please, against his net gains the next year.

The CHAIRMAN. What we want is the whole picture, so figure us out the estimate on the three propositions, the last proposition as well as the one in the 1924 act and the one in the 1921 act.

Mr. PARKER. You need not take the 1921 act. That was entirely unfair to the Government. All you need is the 1924 act, because if you are going to give a flat rate on gains you certainly have got to make a corresponding reduction on losses. Everybody admitted at that time, that in the 1921 act it was just practically an oversight.

Mr. MACILL. Here is an alternative that may run along the line you are thinking. I will let you have it with the estimates. This is a product, I believe of the draftsmen. What they were trying to do was to figure out some means of giving the taxpayer in the lower brackets some kind of treatment on his capital gains which would be as favorable to him as the 15-percent rate is favorable to the big fellow, and what they worked out was this: They said, "Suppose you take the 1 year gains and losses and enter the 1 year gains as ordinary income and the losses should be disallowed except to the extent of the gains, then as to gains and losses over 1 year give the taxpayer the option of a tax of 15 percent, or if he wants to, put one-half of the net gains into his ordinary income." Now that latter option would be taken by the little fellow.

The CHAIRMAN. That would be fair to the little fellow?

Mr. MAGILL. That would give the little fellow the advantage of an option, and the upper fellow would get 15 percent. Then as the losses give him something like what he gets at present, let him take into account either one-half of the net loss, or \$2,000, whichever is the lowest. You recall you now have a \$2,000 limitation.

Senator KING. Well, all your losses are deducted now.

Mr. MAGILL. Under the present plan you can deduct the capital losses against the capital gains, if you have any. If your losses exceed the gains you may deduct them from ordinary income up to \$2,000, but not more. In other words, if an individual had, let us say, \$10,000 capital gains and \$25,000 capital losses, the losses would wipe out the gains and he could reduce his ordinary income by only \$2,000.

Senator KING. That is if the ordinary income were \$20,000 and the capital losses were \$20,000 they would be balanced?

Mr. MAGILL. No; under the present law he is taxed on \$18,000. That is, if he had a salary of \$20,000 and losses of \$20,000, after using these percentages then he can take into account in his ordinary income only \$2,000, in such a case.

The CHAIRMAN. I think what the committee would like to have is an estimate on every one of these suggestions, so we can get the picture from a revenue standpoint, and then we have got to exercise our own judgments as to whether or not they will increase the revenues.

Mr. MAGILL. You want me to give you now the estimate on this last proposition that I have outlined here?

The CHAIRMAN. Yes. That is on the 15-percent basis.

Mr. MAGILL. But also giving this break to the smaller taxpayer of entering one-half of his gains into his ordinary income instead of all of it, which otherwise would occur.

The CHAIRMAN. You talk about the little fellow. Where would you start under this system?

Mr. MAGILL. The break is what? About \$25,000?

Mr. O'DONNELL. It is about \$25,000, due to the higher surtax rate.

The CHAIRMAN. I would suggest that the experts confer on this matter. We would like to get the whole picture. (Remainder of the discussion off the record.)

(At the hour of 11:50 a. m., the committee recessed until 2 p. m., at which time public hearings on the revenue bill were to begin.)